

EXECUTIVE SUMMARY

THE ROLE of LAW and LEGAL INSTITUTIONS in ASIAN ECONOMIC DEVELOPMENT 1960-1995

Prepared for the

ASIAN DEVELOPMENT BANK

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The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995, tests competing theories about law and its relation to economic development against experience in Asia. The role played by law in Asia's remarkable economic growth during the second half of the twentieth century has been largely ignored, even disputed as irrelevant, and this study refutes that view. Law mattered. Its effect depended very much on the country's approach to the role of markets in the economy. This conclusion is the result of an interdisciplinary research effort by legal and economic experts from Asia and the West, commissioned by the Asian Development Bank. Oxford University Press is publishing the book setting out the comparative research results, and the Harvard Institute for International Development is publishing portions of the country studies as part of its development papers series.

† *Is law relevant to Asian economic development and are the uses of economic law converging, both within the region and with the West? These are the core issues for the study.*

The study tracks these questions to their conclusions by testing theories about law and its relation to economic development against the experience of six Asian economies—People's Republic of China, India, Japan, Malaysia, Republic of Korea, and Taipei, China—during the thirty-five-year period after 1960, when economic growth took off in Asia. All achieved a certain economic success, four of them to a startling degree.

The four economies—Japan, Republic of Korea, Malaysia, and Taipei, China—that experienced unprecedented economic growth rates are commonly considered responsible for the "East Asian miracle." The other two—People's Republic of China (PRC) and India—are now seen as having the potential to join the other four in making a significant contribution to another remarkable growth period.

The six Asian economies provide a sample large enough to allow for some generalization but small enough for analysis in sufficient detail to account for the complexity of law and legal institutions within economies. The time-frame, 1960 to 1995, covers a dynamic period in the economic development of the economies and is long enough to capture the usually slow change of institutional behavior.

The legal histories of the six economies have common characteristics and important differences. All six received entire legal systems from the West, two

from Great Britain and four primarily from France and Germany. Historically, all six economies share a history of a strong bureaucracy. Two—India and the PRC—have experienced particularly extensive state controls in more recent times.

LAW AND SOCIOECONOMIC CHANGE

- ‡ *To what extent were the Western-style laws imposed or adopted in the colonial period used then or later? The striking degree to which they were not enforced during 1960 to 1995 has important implications for Western theories about the role of law in development.*

Legal Transplants before 1960

The creation of colonial empires led to a proliferation of Western legal systems in Asia from the second half of the nineteenth century. Other Asian countries, which had not been colonized, responded to the threat posed by Western powers by modernizing their legal systems. In this process they borrowed heavily from the West. Political factors, which included the military and economic conquest by Western powers, greatly influenced not only the source of law but the scope of legal change.

Two of the six economies received common law and the other four took codified civil law. India and Malaysia received English law after British administration was established over their territories. By contrast, Japan independently adopted Western law primarily from French and German sources in an attempt to modernize its legal system and to fend off foreign pressure. From Japan, this new law was transferred to the island of Taiwan, which came under Japanese occupation in 1895, and to Korea, where Japan established a protectorate in 1905 and subsequently colonial rule in 1910. China, in a move similar to Japan's, made a major effort, first at the very beginning of this century during the ultimately failed restoration and then again during the 1920s, to transplant codifications from the West. Continental European and, in particular, German law again served as the primary source for these transplants.

The comprehensive reception of Western law influenced the formal legal system in all six economies prior to World War II, but for economic law, the distinction between common (English) law and civil (continental European) law has had little bearing on the development of these economies' legal systems. The content of substantive economic laws and legal processes was determined initially by the source of these transplants. Subsequently, the influence of the original donor country became less important as these economies began to borrow from multiple sources. As an example, US law was brought to Japan under American occupation following World War II. From

there it was transferred to the Republic of Korea, which used Japanese models when revising its own laws. The study therefore refers to specific country sources of law and legal reforms, but for the most part refrains from grouping economies into legal families.

Limited Use of Western Law

Superimposed on Asian concepts of authority, Western approaches to law have sometimes been ignored or slow to gain acceptance. The content of many laws on the books is still a legacy of this earlier legal borrowing and might suggest that legal systems had converged long before the onset of economic growth in the 1960s. However, in the more authoritarian phase of policy-driven growth, many of the borrowed laws appear to have been ignored in practice. They were in fact superseded, at least temporarily, by new rules and regulations that allocated substantial authority to the state.

Asian theories of law, legal evolution, and the interaction between legal and economic development suggest that law would not play an important role. Theories of law are closely related to the concept of authority, and Eastern concepts of authority differ substantially from those in the West by allocating significant power to the ruler. This helps to explain how formal law, in the Western sense, could be ignored in practice.

Western Theory Applied to Asia

Theories about law and economic relations that evolved mainly in the West seem inadequate to explain development in Asia. The major legal changes establishing formal legal systems modeled largely on Western law occurred long before Asia's economic takeoff, and much of the transplanted law may have been ignored during the early years of the takeoff. This immediately puts in question the causal relationship between legal and economic development posited by many Western theorists.

Western theory accepts that there is a significant correlation between effective legal systems and economic growth. Western theories about law and social change view legal change primarily as an important but evolutionary process that interacts with a similarly evolutionary process of social and economic change. This view is based on the European experience, although even there it is not always congruent with historical facts. Certainly the most influential theories on the role of law in economic development were developed in Europe and played an important role during the Enlightenment. One obvious reason for their influence is that the most dramatic change in legal and economic relations—the development of capitalism—took place in the West and influenced the world view of Western scholars.

In Asia, by contrast, the specific economic and legal developments challenge Western theory. Imperialism disrupted the evolutionary process of legal and socioeconomic development in the last century. This helps to explain the inadequacies of Western theories of law and development.

Legal Change and Legal Transplants, 1960-1995

The process of socioeconomic change after 1960, and particularly since 1980, revived and encouraged the assimilation of largely foreign legal systems that had remained for the most part dormant until that time.

Between 1960 and 1995, the legal systems of the six economies underwent major changes. Of these the most fundamental occurred in the PRC where, after the introduction of economic reforms in 1978, a new legal system was created virtually from scratch. The new system relied to some extent on legal reforms introduced during the first decades of communist rule. But the PRC also made substantial use of other concepts and systems including the common and civil law systems.

In the other five economies of the study, borrowings from foreign sources between 1960 and 1995 were primarily supplementary and occurred for different reasons. In some cases legal transfers were imported as part of technical assistance programs. In others, law reform was initiated after crises, such as environmental disasters or blatant misuses of monopoly power. The areas of law most affected included antimonopoly law (competition), environmental and consumer protection law, intellectual property rights, and securities and exchange regulations.

A striking feature of the history of these transplants is that many of them were left unenforced for years after they had been enacted. Reasons vary from country to country: domestic policies at times favored industry concentration and therefore by-passed existing antitrust rules or led to a change in the rules; governments favored financial systems centered around banks, which were often controlled by the state, reducing the attractiveness of capital markets; environmental protection legislation passed to comply with international treaties tended to be weakly enforced.

A turning point in most economies came, often around 1980, when domestic as well as foreign interests called for the enforcement or extensive revision of these laws to support changing perceptions of what economic policies should achieve. Even then the effectiveness of law enforcement often depended on policy support.

ECONOMIC POLICY PERIODS AND CHANGES IN LEGAL SYSTEMS, 1960 - 1995

- † *Can one discern a relationship between legal systems and macroeconomic development? Qualitative analysis reveals the crucial role of government economic policy.*

Experience and theory reveal that two dimensions of a legal system are critical to economic development. The two dimensions are used in the study not only to analyze law as written, but also law in action.

The *allocative* dimension is the legal rules that stipulate who decides the allocation of economic resources in society: the state or the market.

The *procedural* dimension refers to how law is promulgated and enforced and includes the functioning of the necessary legal and administrative institutions. Procedures may be rule-based or discretionary. Rule-based means that state action is bound by law and, to be valid, has to comply with preestablished legal procedures about making, administering, and enforcing the law. Moreover, in cases where these principles are violated, nonstate actors have recourse to legal review. Discretionary law, by contrast, allows state agents to set rules and enforce them without significant legal constraints.

One can describe a legal system, then, according to the four different combinations of the allocative and procedural dimensions: *market/rule-based*, *state/rule-based*, *market/discretionary*, and *state/discretionary*. This classification is useful for rough general analysis, as the following paragraphs show, even though the two dimensions used to derive the four types are not always clearly distinct from each other in any one legal system or situation, and no system or situation necessarily always falls neatly into any one of the four categories.

To locate a legal system in this 2 x 2 matrix, the study relied primarily on qualitative analysis. Quantitative data illustrate the findings. The small sample size, the difficulties in defining indicators for comparing legal institutions, and the shortage of current and historical data limit the usefulness of quantitative tools.

After 1960, each of the legal systems shifted within this matrix. The changes reflected important shifts in government economic policy.

Fundamental Shifts in Government Policies Toward the Economy, 1960-1995

The shifts in government economic policy followed broadly similar patterns of movement across the economies from periods of mainly state-led policies to periods that were more market-led. Changes in economic policy

affected both economic development and the legal systems, which then further affected economic development.

Analysis of the relation between law and the economy in the six survey economies shows broadly similar patterns of movement between 1960 and 1995, from periods of mainly state-led economic policy to periods when policy was more market-led.

Policy Periods and Legal Change in the Six Survey Economies

Overall, one economy after the other showed a remarkable congruence between law and the policy periods in the changes that occurred. The basic point that emerged was that in different periods, state- or market-oriented allocative law combined with rule-based or discretionary procedures to create a legal system that generally supported the prevailing economic strategy during that policy period. For example, as a country switches from an economic strategy of laissez-faire commodity-led export growth to import substitution based on greater state intervention, the legal system shifts to give the state more allocative power and more procedural discretion. As government strategy opens an economy to the rest of the world, the substance of laws in such areas as property rights and cross-border transactions changes to fit international standards. Overall, broad patterns in economic policy periods and economic growth during those periods related to the broad pattern identified for the legal system. Major legal changes adopted during a policy period were generally appropriate to that period. The legal systems were seen to adjust to support the new economic strategy. These are important findings, because they say that the general function of law is neither irrelevant nor unique to each economy.

The Complex Relation between Economic Policies, Legal Systems, and Economic Development

The evolution of legal systems in Asia offers important insights into the causal relations between legal development and economic development. This is not a simple unidirectional causality. The strength and direction of interaction is determined by a third variable, economic policy. The relationship between the three is multicausal.

The strongest evidence is for causal links that go from changes in economic policy both to economic development and to the legal system, which then further affects economic development. Thus, for rule-based law to play an effective role in economic development, economic policies must be in place that reduce direct state management of economic activities.

Predictions of the Effect of Legal Change on Development Below the Macroeconomic Level

The study assessed the very complex interactions between law, economic policy, and performance at a narrower level of abstraction than the macroeconomy through a review that focused on three areas of law: business governance, security interests for credit, and dispute settlement. These are areas of economic law important to those willing to undertake the risks inherent in developing capitalism

BUSINESS GOVERNANCE AND CAPITAL FORMATION

- † *The formation of capital needed for economic growth can be achieved either through the state or through the market, or a combination of both. How far has Asia used the corporate form of business governance inherited from the West and considered to be optimum in reducing the cost and risk of raising capital and applying it to commerce?*

The history of economic development in the West suggests that law has encouraged the growth of the investor-owned firm by reducing the investor's costs and risk. Investor-owners in the West generally use the corporate form to reduce the high cost of contracting for financial capital. The study examined the relevance of the corporate form to Asian economic development, both for its relationship to the law and because an important role for the corporate form in Asian economic development would suggest convergence of legal institutions between the two regions.

Basic corporate statutes allowing full limited liability for all shareholders, free tradability of shares, and independent legal personality were enacted in Asia during the nineteenth century, not long after the corporate form was codified in the West. Even before this, several Asian economies had already developed entities with partial limited liability.

Capital Formation in Asian Economies

In Asian economic development, the importance of the corporate form for the process of capital formation has depended largely on prevailing economic policies. Although the corporate form has served to limit investors' liability, its use for raising capital from a large pool of investors increased only after economic policies that gave the state substantial control over the financial sector were relaxed. This meant that the corporate form played less

of a role, despite its unique attributes, in capital formation for much of the 35 years.

As in all economies, both the state and the private sector in Asia contributed to capital formation, although the share of the state in Asia has been much larger than in most developed economies. But sources of capital formation in the six Asian economies changed during the 35 years. The importance of the state sector declined relative to the nonstate sector. Within the private sector, the relative importance of unincorporated units fell against incorporated units.

In all the economies except Japan, the state sector made an important contribution to capital formation at least during some period between 1960 and 1995. The PRC and India are clearly the front runners in terms of state-led capital formation. In both economies the relative share of the state sector in capital formation did not decline following the introduction of economic reforms that provided the basis for a more market-based development strategy.

Capital formation in the nonstate sector accelerated with the introduction of economic reforms and, as a result, total capital formation increased. The private corporate sector strongly led capital formation in Malaysia and Taipei, China by the mid-1990s, despite earlier fluctuations. In India, after the policy shift in 1980, the incorporated private sector outperformed the nonincorporated private sector for the first time since 1960. In Japan the incorporated sector has been more important for capital formation than either the nonincorporated sector or the state-owned enterprise sector. Where, as in Republic of Korea, industrial census statistics do not adequately distinguish public from private or incorporated from unincorporated, other sources suggest that, at least after 1980, the private corporate sector has taken up a larger share in capital formation.

Business Governance in Asian Economic Development

Even though the corporate form became increasingly important in capital formation, business governance techniques in Asia made the content of the law less relevant to business decisions during state-led economic policy periods. The general legal framework for a corporation is less important where factors other than the economic interests of shareholders, managers, and creditors determine the sources of financing and business strategies of a firm. Conversely, where these other factors cease to play an important role for the governance of firms, the role of corporate law increases.

So the existence of a corporate law does not necessarily imply that the governance of firms is determined primarily by the norms set forth in the law. Four main patterns of business governance can be distinguished for the six economies from 1960 to 1995. They are governance of state-owned firms,

governance of private firms under state guidance, governance of family-owned firms, and governance of firms that are owned by (nonfamily) investors. These governance structures have different implications for a firm's sources of finance, its business objectives, and the content of the norms that determine the governance of such firms. By the same token, they render the legal framework for corporate law more or less important in determining a firm's business conduct.

For the governance of firms in practice, corporate law appears to be not very important even for privately owned firms as long as state intervention influences major business decisions or the costs of contracting for financial resources. Administrative guidance or state controls over the flow of financial resources limit the relevance of corporate law. Corporate law defines the respective rights and responsibilities of private economic actors. It assumes that these relations are decisive in determining the governance of firms. This assumption does not hold if the governance of firms is determined by other factors, including state policies. For example, in the Republic of Korea, the state, by controlling the financial sector directed the flow of funds to both state and private firms. Even after the banks were privatized in the early 1980s, more than 50 percent of total domestic credits were still policy loans. The state continued to play a key role in banking decisions even though it was neither a shareholder nor a depositor.

Whatever the causes for the prevailing patterns of business governance in Asia, there are signs of change allowing for diversification in the sources of corporate finance. In particular the surge in capital market development in recent years has raised the significance of equity finance. Law played an important role in facilitating this change and in making it sustainable.

Implications for the Future of Business Governance in Asia

Policy changes played a key role in promoting the development of capital markets, and the liberalization of capital controls was positively correlated with stock market development. However, it is difficult to identify cause and effect between legal and economic change. After the initial takeoff of capital markets, legal change was primarily reactive. Most changes have addressed the need to make markets more transparent, to counter fraud, and to streamline market oversight. In addition, changes in company law have sought to strengthen shareholder rights.

The corporate form has been used in Asia mainly to limit liability of shareholders in companies which remained under the direct or indirect control of families, the state, or a combination of both. In the future, if public equity markets in Asia grow in importance, the corporate form may bring about a shift in control from private owners to those in the public markets. This could

have important implications for the governance of these firms and, if confirmed by actual development, would be not unlike what happened in many Western market economies where family ownership at least of large firms declined over time through a process of mergers, new sources of financing, and the need to professionalize enterprise management.

THE RELATION BETWEEN CREDIT AND LAWS GOVERNING SECURITY INTERESTS

- † *To what extent do legal and economic practice in Asia reflect the traditional Western view that good collateral promotes lending for productive purposes? Only to a degree during the survey period and only as markets replaced government management of the economy.*

The invention of credit has been hailed as a precondition for capitalism. Credit is an essential link between savings and investment. It helps allocate resources to productive use. A security interest is the interest a creditor has in collateral which, if the debtor defaults, can be sold and the proceeds used to pay the debtor's obligation. Self-help and courts offer two vehicles for enforcement. The use of security interests is a good indicator of the relevance of formal law to lenders and borrowers. In the traditional view, good collateral promotes lending for productive purposes, which in turn fuels economic growth.

Credit Regimes for Private Borrowers

All the economies except the PRC had laws governing secured credit in place by the mid-1960s, and few major changes occurred except in the PRC, where important laws were enacted providing for interests in collateral during the 1990s. However, big differences existed in law and practice, varying along important dimensions of substantive law, legal process, and use of law.

Factors Affecting the Use of Security Interests

The use of security interests in all the economies was significantly affected not only by the security regimes themselves, but also by several other factors, including substitutes for security, the government's economic strategy, and economic development itself. The following are examples of these influences at work:

- *Substitutes for security.* Availability of criminal sanctions for default can reduce a creditor's need to rely on security interests.
- *Economic strategy.* The government's economic strategy can directly affect the use of security interests by making collateral seem unnecessary, as in the Republic of Korea's program of policy loans through banks to finance key sectors, such as heavy and chemical industries. If the government directs a bank to lend to a particular borrower, sometimes called policy loans, the bank will rely on the government rather than collateral to offset potential losses if the borrower defaults.
- *Economic development.* The rising income of the middle class, as the economy develops, increases its demand for credit, prompting lenders to rely more on types of collateral available to middle class borrowers.

Overall, security interest regimes were of much greater importance to lenders when the government's development strategy was market-oriented and much less important when it was not. Indeed, when markets were managed by the state, regimes for security interests could increase economic inefficiency. However, as lenders moved into a more market-oriented environment, they needed ways to reduce risk. For example, with the advent of more market-oriented economic policy in one of the economies, banks with a high proportion of loans that were unsecured were more likely than other banks to run into serious bad debt problems. Law could either promote or impede the use of security, which in turn could promote or impede lending with a concomitant effect on economic activity. However, since markets were only allowed to work near the end of the survey period, we did not see a clear enough effect on lending to distinguish easily the important elements of the various security interest regimes.

Convergence of Laws Governing Security Interests

In one sense, convergence with the West did not happen. Many of the same laws derived from the West were on the books in each economy in 1960 and 1995, but they were largely dormant until market allocative/rule-based procedures were required. It is not that the laws governing security interests were ignored, just that secured lending was less important in periods of direct government control of the economy.

But there was convergence in use to the extent that lenders in both Asian and Western economies distinguish between types of borrowers. In the United States, big borrowers need relatively much less collateral than small and medium-sized borrowers. The same was true in Japan, Taipei, China, and

the Republic of Korea. It was not true where prudential rules required full security or were believed by loan officers to require it.

Asian lenders used security interests as one of several ways to reduce the risk of default and loan losses, and they shifted to greater reliance on security interests as alternatives became relatively less effective and as markets replaced government management of the economy.

THE SETTLING OF COMMERCIAL AND ADMINISTRATIVE DISPUTES

- † *Do increasingly complex economic development and expanding markets demand effective low-cost dispute settlement institutions and state accountability? Local institutions, formal and informal, had often been replaced by colonial powers or had been reorganized into quasi-formal dispute settlement institutions. The new formal courts that replaced these institutions were not used much for a long time. With rapid economic development, however, they became more active. In recent years, courts also gained importance settling disputes between state and nonstate parties.*

A host of dispute settlement systems was already in place in Asia when Western-style court systems were transplanted there. Asian systems included informal institutions relying primarily on voluntary compliance and formal institutions empowered to enforce primarily criminal and administrative law.

The key question for Asia is not if and how formal dispute settlement institutions evolved; it is whether the institutions that were transplanted from the West came to play an important role in settling commercial disputes as economies became more complex. The answer—a qualified yes—emerges from an examination of the role of institutions in settling disputes between nonstate parties and the ability of private parties to take legal recourse against state actions, matters of legal accountability and administrative litigation.

Dispute Settlement Institutions

Theories on the evolution of dispute settlement institutions suggest that they evolve in response to socioeconomic changes. The study focuses on entrepreneurial activities. In small markets, disputes can usually be settled informally. As markets expand, informal mechanisms become less reliable. Formal institutions with powers of enforcement become more important and can be useful in providing information about unreliable business contacts. In the West, the courts play this role in resolving commercial disputes. Although established by the state, their credibility as neutral arbiters has been enhanced by vesting them with independence.

Asia shows a preference for the mechanisms of mediation and conciliation available through traditional dispute settlement institutions. However, awards from these institutions could now be enforced through the court system, and there is evidence of that option being increasingly used.

Evolution of Civil and Commercial Litigation in Asia

Litigation rates indicate the demand for dispute settlement institutions may be determined not only by the willingness of nonstate parties to use the courts, but also by the availability of other mechanisms for dispute settlement. Accurate, comparable data about litigation rates are rare. In the study, civil litigation is a proxy for commercial litigation where the figures could not be broken down.

As economies became more specialized, their litigation rates rose. With one exception—Japan—the different levels of litigation supported the proposition that the rates should be related to economic specialization. That is, in a comparison of the development of civil and commercial litigation across the six economies of the survey, formal dispute settlement became more important with increasing division of labor. Though data are not strictly comparable across the economies, the propensity to litigate was a proxy for the proportionate share of formal and informal dispute settlement institutions. These trends also support conclusions reached by other means.

In the PRC and India in 1960 and 1995, civil and commercial litigation rates, though increasing, were much lower than in the other economies, which were more specialized. In the Republic of Korea, Malaysia, and Taipei, China, civil litigation rates increased substantially. Taipei, China's civil litigation rate was higher than in any of the other economies, but commercial litigation was low, probably because for much of the period defaulting debtors were handled through the criminal courts. Data for the 1960s in Malaysia are inadequate, but commercial litigation rates probably increased during the survey period. The outlier among the countries in the sample is Japan, where litigation rates remained surprisingly low despite the country's achievements in socioeconomic development. This is particularly striking, as the Republic of Korea and Taipei, China, with a very similar institutional framework, have witnessed much higher litigation rates.

State Accountability

In modern economies, the important role of the state in the market as regulator and player raises the question of whether private parties can challenge state actions affecting their business interests. The measures nonstate parties may choose depend on the procedures and institutions made avail-

able to them by the state. In other words the state has to volunteer the framework necessary to challenge it. Such state accountability, based on the principle that state acts should comply with the law, became common in the West only in the twentieth century. It had long been in place in the United States, but was still evolving in Europe in the late nineteenth century.

Max Weber considered state accountability a precondition for capitalism, and the history of administrative courts in Europe suggests that even in the absence of fully democratic regimes, as the economy develops so does a demand for greater state accountability. The West developed a system of effective recourse against state actions in the form of administrative litigation and judicial review.

Administrative Litigation in Asia

The type of received law—civil or common—affected the significance of administrative litigation in the six economies in 1960. In India and Malaysia, a basis in common law meant that extensive judicial review was already practiced at the time the countries became independent. In the other economies, the copying of administrative law and procedures from late nineteenth century continental European models meant that procedures to provide nonstate parties with effective legal recourse against state actions were much weaker.

The importance of the type of received law for administrative litigation faded over the next 35 years. In India, the judiciary, and in particular the Supreme Court, retained autonomy in spite of major attacks by the legislature, although the effectiveness of judicial supervision over administrative acts and regulations at lower levels was undermined by extensive administrative rule-making. Malaysia effectively curtailed the rather comprehensive rights to judicial review given in the 1956 Constitution and is the only economy of the six where judicial independence and judicial review were reduced rather than expanded after the mid-1980s. The other four economies strengthened the recourse of non-state parties.

The changes occurred for several reasons. Politics triumphed in Malaysia, but led to a standoff in India. In the four other economies, protection for nonstate parties strengthened over time as a result of legal change that fueled further demand by market participants for processes that would define the legal boundaries of state intervention. In the PRC, Republic of Korea, and Taipei, China, politics, probably influenced by economic development, were important in determining the greater commitment of the state over the past decade to judicial review of state acts.

CONVERGENCE AND DIVERGENCE IN LEGAL AND ECONOMIC DEVELOPMENT

- † *To what extent do Asian legal systems remain different from those of the West? The differences are more in terms of process and operation than substantive rule and form, but have narrowed and appear to be continuing to narrow.*

The role of law in economic development in Asia raises the question of whether the development of law and legal institutions in Asia differs from the West. The study found that law is certainly not, as some have argued, irrelevant to economic development in Asia. But it is also not true that, as a result of economic convergence, legal systems have largely converged across economies in Asia and the West, at least not yet. Nor is it true that legal development in each economy is idiosyncratic. If the last were true, this would influence economic development, because different legal arrangements might be more or less conducive to economic growth. Instead, the study reveals a middle ground between these two extreme views about law and economic development and suggests that some aspects of the legal system may converge with economic development, while others continue to diverge.

This analysis assumes that the economies of the six Asian countries are converging with each other and those of the West.

Convergence and Divergence in Economic Development

Changes in the involvement of the state in three variables—the means of production, financial resource allocation, and trade—suggest economic convergence both across Asian economies and between them and the West. These are important variables because in Asia, during the survey period, high growth rates were crucially dependent on policy. Variables measuring the extent to which the state allocated resources in the economy are useful indicators of the degree of legal and economic convergence.

Economic policies that promoted state control over the allocation of resources were often comprehensive, affecting not only the allocation of financial resources but their ownership and the state's controls over trade. Economic policy changes aimed at reducing the role of the state also tended to affect all sectors but at different paces. The controls most readily reversed were trade controls. Downsizing the state-owned enterprise or banking sectors posed more substantial problems. An interim policy measure in many economies was opening of markets to new entries, substantially reducing the relative share of state-controlled sectors. However, most governments real-

ized that they need further structural reforms in order to provide a sound basis for market-led economic development strategies.

Convergence and Divergence in Legal Development

In historical perspective, patterns of legal change in the survey economies seem to confirm that the relationships between economic policies, legal change, and economic development changed over the survey period. The transplantation of Western law to Asia would seem to have given Asian economies a head start toward economic development, but proved insufficient before 1960. The economic takeoff, when it came later, initially went hand in hand with policies that strengthened the role of the state in the economy. Law was used as an instrument of change, and legal change often preceded economic outcome. The policy changes of the 1980s that shifted allocative rights from the state to markets were implemented by repealing many laws establishing the right of the state to control the economy. Although law seemed to lead economic change between 1960 and 1980, later the sequence seemed to be that new policies prompted economic change that in turn gave rise to the demand for new law. The period that started for most economies around 1980 saw a closer interaction between legal and economic change, more akin to that which characterized much of the legal evolution in the West.

Nevertheless, evidence of differences in Asian legal development caution against concluding that legal developments in Asia and the West were fully converging. Diverging legal systems largely derive from differences in the institutional environment. These differences were certainly found, for example, in the extensive preemptive involvement of large business in rule-making and the common avoidance of legal conflicts in the implementation of rules. These give a glimpse of a legal system that operates differently from the West. The study supported the view that institutional change tends to be path dependent. Changes in legal processes and legal institutions are taking place but at a considerably slower pace than changes in substantive law.

CONCLUSION

Thirty five years after the onset of high growth in Asia, market-oriented law had come to play a greater role in Asian economies than in the past. Even in the past, however, law played a role in economic development as handmaiden to government economic strategy. Law was not irrelevant to the economy.

During the thirty five years, differences in legal systems between Asia and the West diminished, particularly in the substance of the law. The patterns of

legal and economic change in Asia suggest that substantial differences in legal process persist. However, this does not necessarily justify the assumption that legal systems in Asia will continue to diverge from those in the West. The variety in Asia's growth resembles the many paths of economic and institutional change taken historically in the West, where substantial differences in legal systems and the structure of economies remain to this day.