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Economic Success of Chinese Merchants in Southeast Asia: Identity, Ethnic Cooperation and Conflict

Integrating the Social Sciences with Evolutionary Biology

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To the memory of:

my professor,

Nobel Laureate James M. Buchanan

and my esteemed friend,

Nobel Laureate Ronald H. Coase

and my beloved parents,

Father: 戴淮清先生

Mother: 唐錦雲女士

Contents

The Author

Born in Hong Kong, lived in Singapore before moving to Canada, Janet Tai Landa is Professor of Economics, Emerita, York University, Toronto, Canada. Her degrees are all in economics: B.A. (Honors), University of Singapore; M.A., University of British Columbia; and Ph.D., Virginia Polytechnic Institute & State University.

Her primary research interests are in the law-and-economics of exchange institutions; some of her articles are published in her first book*, Trust, Ethnicity, and Identity: Beyond the New Institutional Economics of Ethnic Trading Networks, Contract Law, and Gift-Exchange* (University of Michigan Press, 1994). Her more recent research interests are in the bioeconomic (economics-and-biology) analysis of human and non-human societies. She was the Founding Editor-in-Chief of the *Journal of Bioeconomics* (1999–2009).

She has received a number of research grants/fellowships/visiting professorships from Canada's Social Sciences and Humanities Research Council; Hoover Institution, Stanford University, California; Vincent and Elinor Ostrom's "Workshop in Political Theory and Policy Analysis," Indiana University; Center for the Study of Law & Society, University of California, Berkeley; University of Maryland's "Institutional Reform and Informal Sector" (IRIS) Program; Germany's Peter Klöckner Foundation; Max Planck Institute of Economics, Jena, Germany; Center for the History and Philosophy of Science, California Academy of Sciences, San Francisco; Canada's York University, Faculty of Arts, Toronto; and International School of Financial Law, East China University of Political Science and Law, Shanghai, China.

She has been invited to give lectures at numerous universities and research institutes including Binghamton University, New York; École Polytechnique's C.R.E.A. (Center for Research in Applied Epistemology), Paris, France; Humboldt University, Berlin, Germany; Nanjing University, China; National Chung Hsing University, Taiwan; New York University; Nuffield College, University of Oxford, UK; Peking University, Beijing, China; Stanford Law School, California; University of California Berkeley School of Law; University of Chicago Law School; University of Hamburg, Germany; University of Hawaii, Honolulu; University of Toronto Faculty of Law; University of Turin, Italy; the World Bank, Washington, D.C.; Yantai University, China; Zhejiang University, Hangzhou, China; and the University of Zurich, Switzerland.

Foreword
by Ronald H. Coase*

This is an important book for all interested in the determinants of the structure of production and exchange, not simply because it explains why the Chinese merchants have been so successful in Malaysia and Singapore but because it deals with an important problem in all societies—how to make it possible for trust in other's good behavior to play an important role in facilitating business transactions. To rely on the law and the working of the legal system would be too expensive. Trust in the words of others has to play an important role in all economies.

No economist knows more about the Chinese merchants than Janet Landa. Coming from a Chinese family in Singapore, Janet Landa studied economics at the University of British Columbia before earning her doctorate from the Virginia Polytechnic Institute and State University in 1978 under the supervision of James M. Buchanan. Her doctorate thesis was a pioneering study of the Chinese merchants based on her fieldwork in Malaysia and Singapore. This theoretically rich and empirically solid work helped to launch a successful career for Janet Landa. She secured a job at the University of Toronto in 1978 and later moved to York University where she remains today.

The study of the Chinese merchants is of important and general significance for many reasons, as masterly demonstrated by this collected volume. Since Adam Smith, trade and specialization have been recognized as the foundation stone of the market economy. But economists usually assume that trade and specialization take place automatically as long as economic gains can be reaped. They have been mainly preoccupied themselves with

* Ronald H. Coase is the Clifton R. Mussser Professor Emeritus of Economics at the University of Chicago Law School, and the recipient of the 1991 Nobel Memorial Prize in Economic Sciences.

formalizing the powerful insight of what Adam Smith called the "invisible hand," while ignoring the structure of production. Only recently did economists begin to appreciate the role of contracts, property rights and other legal institutions in facilitating trade and specialization. Janet Landa has gone further to call our attention to the presence of social institutions, such as the ethnically homogeneous Chinese middleman group, mutual aid communities, social norms, trust, identity, and *guanxi*, to structure exchange relationships, without which trade and specialization would be severely impaired, if not impossible. These social institutions have come to be known as informal institutions in the literature—they are informal as compared with the formal legal institutions.

These informal institutions are not some inefficient residuals from the past that better be replaced by formal institutions. On the contrary, they often serve as the foundation on which formal institutions rest and evolve. This is not just because formal institutions are more costly—and they usually are—hence leaving some gap for the informal institutions to fill up. More important, formal institutions by definition are more standardized and they often have to be modified to adapt to the local context. In this process, informal institutions often play a key role in conditioning the working of the formal institutions.

I was impressed by the importance of informal institutions when I was working at the Cabinet Office in London during WWII. Although my main work was in the Central Statistical Office, I was asked by James Meade to examine the terms of long-term contracts. An office headed by Winston Churchill had no difficulty in obtaining copies of the contracts from the firms. I was given the job of examining them. I was amazed to find that on important points the contracts were silent, the quantities to be delivered, where they would be delivered and so on. It was apparent that the relations between the contracting firms were not largely based on the terms of a written contract, but on trust made possible because the firms would have repeated dealings with each other.

Janet Landa's study of merchants brings to focus a kind of actor indispensable for the working of the market economy but grossly underappreciated in modem economics. Consumers and producers are the only actors found in economics textbooks. Merchants or traders are rarely visible. But without merchants, we would still be trapped in a self-subsistence economy, consuming what we could produce and producing what we would consume. There would be little room for the division of labor and trade. Janet Landa's pioneering empirical and theoretical work on Chinese merchants foreshadows the recent growing interests in study of the organization of exchange among economists and economic historians. Moreover, since

Landa builds her work mainly on the Chinese merchants in Southeast Asia she helps to bring out a common misunderstanding of trade and an ensuing tragedy often befalling merchants. As nothing tangible is created in trade, traders are often viewed as exploitative, or worse, opportunistic and evil. Traders are specifically vulnerable when they are a minority in an ethnically divided society, a tragedy suffered by the Chinese merchants in Southeast Asia.

In conducting her research on merchants, Janet Landa also becomes a pioneer in engaging economic research with the rich scholarship in other social sciences. Rather than applying economic tools and concepts to understanding non-economic phenomena, a growing practice that has become known as economic imperialism in modem economics over the past half century, Landa has drawn insights from anthropology, sociology, political science, legal studies and evolutionary biology and made them an integral part of her theoretical framework. This has allowed her to develop a theory of wide explanatory power and a deeper understanding of the subject.

In this volume, Janet Landa brings together her lifetime work on the study of the Chinese merchants which has been informed by, and has also enriched, the new institutional economics. I came to know Janet Landa and appreciate her work when she was invited to the University of Chicago Law School in 1994. I immediately found her research interesting and her interdisciplinary approach fruitful. I have no doubt that readers will find much to learn from this volume.

December 31, 2012 Ronald H. Coase

Preface

Ethnic and religious conflicts are two of the most important phenomena of the modern world. I have always been interested in ethnic conflicts, as someone who is ethnic Chinese and familiar with the Chinese middleman diaspora and events such as the May 13, 1969 racial riots that saw Malays kill hundreds of Chinese in Malaysia. In 1978, I completed my Ph.D. dissertation on economic success of Chinese merchants in Singapore and Malaysia — written under the direction of James M. Buchanan. That thesis dealt with — in addition to explaining economic success of Chinese merchants — the topics of trust, ethnic identity, ethnic cooperation, competition, and conflict, and these topics have been central in all my subsequent work. This book collects together the most important chapters in my 1978 unpublished dissertation, and what I have written on these topics since my dissertation.

This volume consist of 14 articles—9 published and 5 unpublished articles—written over a span of more than three decades on Chinese merchants in Southeast Asia, with special reference to Malaysia and Singapore. The main aim in this book is to provide theoretical insights as to why Chinese dominate middleman roles in Singapore and in Malaysia. Chinese dominance in middleman roles have generated envy and hatred of the Chinese by the indigenous Malay population. The May 13, 1969 racial riots and killings of Chinese by Malays was a watershed event in inter-ethnic relations in Malaysian history.

In order to understand the basis of economic dominance or success of Chinese merchants in Southeast Asia, I embarked on a 6-month fieldwork in Malaysia and Singapore in 1969, one month after the May 13 riots. The material I collected on Hokkien smallholders' rubber merchants allowed me to develop an empirically-based economic theory of the nature of the Hokkien-Chinese trade network, organized as a tightly knit "ethnically homogeneous middleman group" (EHMG), as well as the economic basis of Chinese middleman success. In developing my theory of the EHMG and Chinese middleman success, I incorporated some core concepts in the social sciences and from evolutionary biology into an over-arching New Institutional Economics theoretical framework. Flowing from my theory of Chinese middleman success are policy recommendations which are viable alternatives to the Malaysian governement's New Economic Policy/New Economic Model for promoting Malay entrepreneurship.

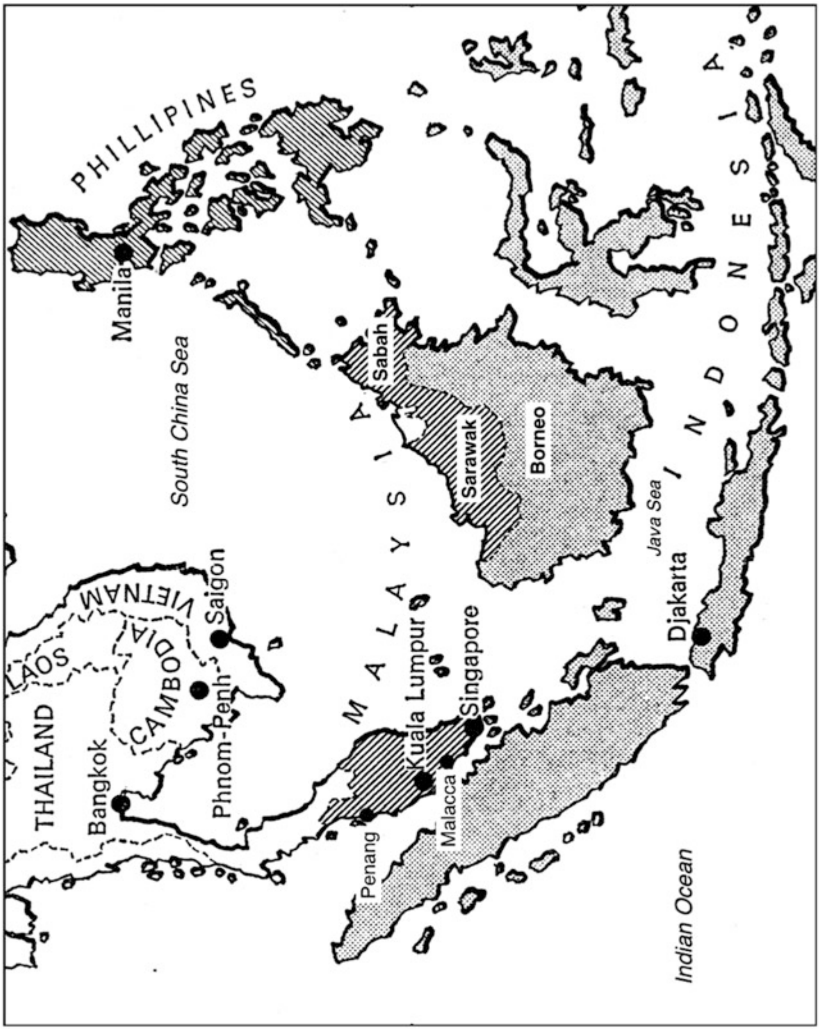
Chapter 1, Introduction, ties the various essays into a coherent whole. This book will be relevant to readers who are interested in the topics of trust, institutions (formal and informal), ethnic identity, ethnic cooperation and conflict, "private ordering" type organizations, and trade diasporas.

I would like to thank York University for providing me with a Faculty of Arts Fellowship, July 2003-July 2004, a one-year research funding, equivalent to one year of my salary, to work on this book, free from teaching commitments. This allowed me to publish additional articles related to the topic of my book. I thank the publishers of the published articles included in this book for permission to reprint in full or in part. Permissions to reprint the published papers are acknowledged at the beginning of each chapter of this book. I also wish to thank computer scientist Anthony Wallis who generously found the time to help me with computer-related matters involved in preparing the articles for typesetting. I cannot thank economist Charles Rowley enough, who, having read most of the articles included in this book, as well as the first draft of my Introduction, provided me with invaluable advice. Sadly, Charles Rowley passed away on August 2, 2013. I also wish to thank the Springer team—Toby Chai and Jenna Zhou; and the Springer production team, Kiruthika Govindaraju and Sunil Kumar—for their patience with the typesetting and proof-corrections of the chapters in this book.

Finally, I dedicate this book to the memory of my beloved parents, Mr. Tai Huai Ching (戴淮清先生) and Madam Tang Chin Yuin (唐錦雲女士); to the memory of Nobel Laureate Ronald H. Coase (Dec. 29, 1910-Sept. 2, 2013), from whom I have learned so much law-and-economics, and who spent time in 2012 reading my book manuscript and wrote a Foreword for my book on December 31, 2012; and to the memory of my professor, Nobel Laureate James M. Buchanan (Oct. 3, 1919-Jan. 9, 2013), who had taught me so much about economics, hard work, and good writing style.

Toronto, Ontario, Canada Janet Tai Landa
September 11, 2014

PART I
Introduction



Map 1 Southeast Asia (Source: Adapted from Myint (1972, p. 21), *Southeast Asia's Economy: Development Policies in the 1970s*)

Chapter 1
Introduction

1 Ethnic conflict in Malaysia's plural society: May 13, 1969 race riots

May 13, 1969 was a watershed event in inter-racial relations in Malaysia,[1] (see Map 1), a multi-ethnic nation with an indigenous ethnic Malay majority and three immigrant ethnic minority groups: Europeans, Chinese and Indians.[2] On that day violent anti-Chinese race riots erupted in Kuala Lumpur, Malaysia's capital located in the state of Selangor. The Malaysian government imposed a twenty-four hour curfew in Kuala Lumpur. Within four days the riots spread to other Malaysian states. The government declared a national emergency throughout Malaysia. Peace was restored only two months later.

According to *Time* magazine (May 23, 1969), in an article entitled "World: Race War in Malaysia":

> Malaysia's proud experiment in constructing a multiracial society exploded in the streets of Kuala Lumpur last week. Malay mobs, wearing white headbands signifying an alliance with death, and brandishing swords and daggers, surged into Chinese areas in the capital, burning, looting and killing. In retaliation, Chinese, sometimes aided by Indians, armed themselves with pistols and shotguns and struck at Malay kampongs (villages). Huge pillars of smoke rose skyward as houses, shops and autos burned.

Time magazine further reported that the Malaysian government, downplaying the racial violence and killings, reported a death toll of only 104, whereas other Western sources put the death toll closer to 600 victims, mostly Chinese. If six hundred, mostly Chinese, were killed, then the

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May 13 killings can be described as “deadly ethnic riot” (Horowitz 2001). In a subsequent article, entitled “Malaysia: Preparing for a Pogrom,” *Time* magazine (July 18, 1969) reported that Chinese secret societies, in self-defence, “are flourishing, and. . .Malaysia’s minorities are preparing for a pogrom.”[3] Furthermore, Chinese merchants retaliated against Malays by raising “prices on many goods to Malay buyers and cut off *paja* (credit), by which many a Malay farmer buys seed for his next crop.” Chinese merchants also retaliated by refusing to send trucks to the countryside to pick up fish and durians resulting in loss of income to Malays.

What caused the May 13 racial riots? The proximate cause was political. In the May 10, 1969 general elections in Malaysia, Prime Minister Tunku Abdul Rahman’s Alliance Party lost many seats to the opposition parties, but managed to win the election, albeit losing its two-thirds parliamentary majority. The Alliance Party was a coalition government formed between three ethnic-based parties: the United Malays National Organization (UMNO), the Malaysian Chinese Association (MCA), and the Malaysian Indian Congress (MIC); the dominant group within the Alliance was UMNO. After the elections, one of the opposition parties, a Chinese party—the Democratic Action Party (DAP)—held a jubilant parade through predominately Malay parts of Kuala Lumpur. On May 13, UMNO countered by organizing its victory parade in Kuala Lumpur as well. It was this event that triggered the race riots.

The ultimate cause, on the other hand, was economic: the long-standing hostility—envy and resentment—of the indigenous Malay majority towards the ethnic Chinese minority who dominated the trade and commercial sectors of the Malaysian economy. The indigenous Malays perceived the Chinese minority group as “exploiters,” who excluded them from the profitable trade and commercial sectors. The ethnic Malays’ perception of the Chinese as “exploiters” was consistent with the then prevailing Marxist monopolist-monopsony thesis of Chinese middleman success, as espoused, for example, by economist Hla Myint (1954).

At the time of the May 13 ethnic riots, the income disparity between Malays and Chinese was significant, with Malay households having a lower average income than Chinese and Indian households. Available statistics showing mean monthly household income by ethnic groups in Malaysia, 1970–2002, showed that in 1970 Malay households had a monthly income of RM276 [Malaysian ringgit (RM)] compared to Chinese monthly household income of RM632, and RM478 for Indian households (Jomo 2004, Table 3, p. 6).

To forestall another deadly ethnic riot from recurring in Malaysia, the Malaysian government, led by prime minister Tun Abdul Razak Hussein—who succeeded Tunku Abdul Rahman and led Malaysia from 1970 to

1976—introduced the New Economic Policy (NEP) in 1971, a policy to stretch over twenty years (1971–1990). The NEP was an affirmative action program to redistribute wealth in favor of the Malays (the "bumiputra," sons of the soil) by increasing Malay equity ownership and by providing special treatment for Malays in areas of employment and higher education (Jomo 2004). Although the NEP officially ended in 1990, much of the affirmative action policies of the NEP remained in effect, in five year intervals until March 30, 2010.

Did the NEP achieve its goals of reducing income inequality between Malays and other ethnic groups and promoting inter-racial harmony? According to Tan Teong Jin *et al.* (2005, p. 61), over the twenty years, while the Malay majority benefited from the NEP, many Chinese were dissatisfied with the NEP, especially in the early years, and this led to their emigration. According to K. S. Jomo (2004, p. iv):

> While there is little doubt that specific socioeconomic targets of the NEP have been largely achieved, later rather than sooner, it is not clear that such achievement has led to national unity, understood in terms of improved interethnic relations. Associating improved interethnic relations almost exclusively with reduced interethnic disparities among the respective business communities and middle classes has in fact generated greater ethnic resentment and suspicion on both sides. Ethnic affirmative action policies as implemented and enforced in Malaysia have associated the interests of entire ethnic groups with their respective elites, thus generalizing resentments associated with interethnic, intra-class competition. Thus, it is unlikely that the ethnic affirmative action policies will achieve the end of improved interethnic relations. An alternative approach needs to be found to create more lasting conditions for improved interethnic relations

On March 30, 2010, Malaysian Prime Minister Nijib Razak replaced the NEP with the New Economic Model (NEM). An important goal of the NEM is aimed at promoting "inclusiveness" for all the ethnic groups in Malaysia by replacing the ethnic-based affirmative action program with "market friendly affirmative action programme":

> Ethnically divided societies are more prone to violent conflicts. The multi-racial composition of the Malaysian population is still its outstanding feature and this ethnic diversity will always be with us. But the excessive focus on ethnicity-based distribution of resources has contributed to growing separateness and dissension. A key challenge of inclusive growth is the design of effective measures that strike a balance between the special position of bumiputra and legitimate interests of different groups. Hence, the market-

> friendly affirmative action programmes in line with the principle of inclusiveness will…focus on building capacity and capability of low-income households and small businesses, instead of imposing conditions to meet specific quotas or targets (*National Economic Advisory Council* 2009, p. 10).

The NEM is a belated recognition that affirmative action policies that discriminate against a successful ethnic minority group, like the Chinese in Malaysia, do not promote racial harmony in ethnically divided societies such as Malaysia.

2 Chinese merchants in the "dual economies" and "plural societies" of Southeast Asia

The ethnically-homogeneous Chinese middleman group (EHMG) is ubiquitous in the "dual economies"[4] of Southeast Asia; historically, Chinese merchants connect indigenous producers in the peasant sector with the European exporters in the export sector. The very ubiquity of Chinese middlemen in Southeast Asia prompted J. S. Furnivall (1956) to coin the term "plural society" to describe the pattern of division of labor along ethnic lines.[5] In a much quoted paragraph, Furnivall (1956, pp. 304–305) introduced his concept of "plural society":

> In Burma, as in Java, probably the first thing that strikes the visitor is the medley of peoples—Europeans, Chinese, Indian and native. It is in the strictest sense a medley for they mix but do not combine. Each group holds by its own relations, its own culture and language, his own ideas and ways. As individuals they meet, but only in the market-place in buying and selling. There is a plural society with different sections of the community living side by side, but separate within the same political unit. Even in the economic sphere there is division of labor along racial lines. Natives, Chinese, Indians and Europeans all have different functions, and within each major group subsections have particular occupations.... The plural society has a great variety of forms, but in some form or other, it is the distinctive character of the tropical economy.

Furnivall's concept of plural society describes an "ethnically divided society" with the additional phenomenon of ethnic specialization or division of labor, with foreign ethnic groups specializing in the middleman function of linking the indigenous agricultural sector with the European export sector. Examples of plural societies with foreign middleman minority groups: Chinese merchants in Southeast Asia, East Indians in East Africa, the Syrians in West Africa, and the Lebanese in North Africa. Often these foreign middleman minority groups were the targets of racial violence and expulsion: witness, for example, the May 13, 1969 ethnic riots and killings in Malaysia; the expulsion of Chinese merchants from Indonesia by President Sukarno in the 1960s (Myint 1972, p. 34); the expulsion of East Indians from Uganda on 4 August 1972 by President Idi Amin; and the anti-Lebanese rice riots of July and August 1919 in Sierra Leone, West Africa (Kaniki 1973). And, of course, the pogroms against European Jews.

3 The New Institutional Economics (NIE) of Chinese middlemen success: Ethnic cooperation in the provision of club goods

A major aim of this book is to provide an economic theory to explain Chinese middlemen success in Southeast Asia, with specific reference to Malaysia and Singapore. This is important for two reasons. First, because an economic theory of Chinese middlemen success is analogous to the question raised by monetary theorists as to why a particular commodity emerges to become "money." Leland Yeager's (1968, reprinted in Clower ed., 1969, pp. 58–59) answer is particularly insightful:

> Several assets may have low trading costs, but the asset with the *lowest* costs of all is unique in that respect. Having the lowest transactions costs and being medium of exchange are properties so related that even a slight disturbance to existing institutions or practices would conceivably be self-reinforcing.

Could economists not explain Chinese dominance in middleman roles in the same manner analytically, using the transaction costs paradigm—pioneered by Ronald Coase (1937)—which is part of New Institutional Economics (NIE): Several different ethnic groups may have low trading costs, but the Chinese ethnic trading group may have the lowest transaction costs and hence may be uniquely suited to play the role of middlemen. But to explain Chinese middleman success, we need to know the factual details of the basis of efficiency of the Chinese middleman group.

Second, theoretical understanding of the basis of Chinese middlemen success in Malaysia and Singapore has important public policy implications for promoting inter-racial harmony by encouraging Malay entrepreneurship, which may call for re-thinking of Malaysia's NEP and the New Economic Model policies.

A major aim of the essays in this book is to provide theoretical insights into the basis of Chinese middlemen success based on empirical material gathered from my ethnographic fieldwork in Malaysia and Singapore in 1969. In searching for plausible theories of Chinese middlemen success, as a Ph.D. graduate student looking for a doctoral thesis topic, I came across the insightful work on traditional/peasant markets by anthropologists such as Cyril Belshaw (1965), and particularly the work of Alice Dewey. Dewey (1962, p. 43) provided her explanation, based on her ethnographic research, on why Chinese succeeded as merchants in Java:

> The group which has the strongest assurance that contracts will be fulfilled has a great competitive advantage in many types of trade over the group which must constantly adjust the activities to uncertainty and distrust. The Javanese belong to the latter type of group, the Chinese to the former type, This, I believe, is one of the most important factors explaining why the Chinese are more successful and the Javanese unsuccessful in large-scale trade.

I was convinced by Dewey's explanation that Chinese middlemen success in Java had something to do with their ability to cooperate in enforcing contracts, which helped them to out-compete indigenous population and appropriate middleman roles. Since neither Dewey nor anyone else had provided actual details of how Chinese middleman groups in Java or elsewhere in Southeast Asia cooperated among themselves to enforce contracts, I decided that it was necessary for me to find out for myself by doing fieldwork in Singapore and Malaysia.

The six months' intensive fieldwork, June-December 1969 in Singapore and Malaysia, provided me with invaluable empirical data[6] on the details of how Chinese merchants, involved in the marketing of smallholders' rubber, cooperated among themselves not only in enforcing contracts, but also in extending credit, sharing credit and price information with each other, and using the compromise method for debt-settlement. In short, Chinese middleman-entrepreneurs provided for themselves many of the essential club goods which facilitated them in their middleman-entrepreneurial roles. The materials collected from my fieldwork in 1969 enabled me to develop an empirically-based law-and-economics/NIE theory of Chinese middlemen success, drawing on two key concepts from New Institutional Economics:

(1) "Institutions as rules," laws and informal standards of conduct (Buchanan 1975, pp. 4–5; North 1990, p. 3) which, together with social sanctions, constrain individual behavior[7]; and

(2) "Transactions costs" (Coase 1937), the costs of exchange. NIE is comprised of several sub-disciplines within economics: law-and-economics,

public choice theory, Austrian theory of entrepreneurship, and the new economic history associated with the work of Douglass North (1990). See chapter 10 for details of NIE; see also Eggertsson (1990).

My theory of Chinese middlemen success in enforcing contracts is developed in chapter 5, and a general theory of Chinese middleman success is developed in chapter 14. An important policy implication, alternative to the affirmative-action-oriented NEP policies, flowing from my theory of Chinese middleman success, is discussed in chapter 14.

4 Fieldwork in Malaysia and Singapore, June-December, 1969

In June 1969, about a month after the May 13 massacre, and when peace was not yet restored, I arrived in Singapore to begin six months of intensive fieldwork in Malaysia and Singapore in order to find out for myself the basis of Chinese merchant success. At that time, I was enrolled as a graduate student in the Ph.D. program at the Department of Economics, University of British Columbia (UBC), Vancouver, Canada. I had completed, for my Ph.D. dissertation committee, my doctoral thesis proposal on the topic of Chinese middlemen success. This topic was motivated by my desire to understand the basis for Chinese middlemen success and why the indigenous population resented their dominance of middleman roles in the economies of Southeast Asia. Before I left for my fieldwork in Malaysia and Singapore, I had also completed the design of the questionnaire surveys of Malay rubber smallholders and Chinese rubber dealers. Despite the occurrence of the May 13 massacre of Chinese by Malays in Malaysia, I did not postpone my planned departure from Vancouver to embark on fieldwork in Malaysia and Singapore in June 1969.

Was it good luck or bad luck for me that the May 13, 1969 ethnic riots had just occurred? Unbelievable good luck because it threw up in sharp relief the ethnic conflict inherent in a plural society where a Chinese minority group dominated merchant roles, and hence highlighted the importance and timely relevance of my chosen dissertation topic. On the other hand, it was incredibly bad luck that I was travelling to Malaysia to carry out my fieldwork only one month after the outbreak of racial violence and before social order had been restored. I was therefore embarking on fieldwork in Malaysia at the risk of personal safety, I being an ethnic Chinese. In addition, it is well-known to anthropologists that fieldwork in an unfamiliar tropical location always carries with it inherent risks such as succumbing to tropical diseases (Peacock 1986). Clearly, my timing to do fieldwork in Malaysia in June 1969 exposed me to a higher degree of risk of harm.

My choice of Singapore and Malaysia as the sites for my fieldwork was determined by two factors:(a) My parents lived in Singapore, a safe haven from the May 13 racial riots in Malaysia, hence Singapore served as my home base for conducting my fieldwork in Malaysia and Singapore; and (b) the Chinese in Malaysia, constituting the largest of the foreign ethnic minority groups in Southeast Asia, dominated merchant roles, hence I would be able to gather materials for a case study of the classic Furnivallian plural society in Malaysia.

Armed with questionnaire surveys of Malay smallholders and Chinese smallholders' rubber dealers in the Pontian District in the state of Johore, a Malaysian state across the Causeway from Singapore, I began my fieldwork, with the help of a research assistant, Mr. Goh Choo Keng, a graduate of Nanyang University, who was fluent in Mandarin, Hokkien-Chinese dialect, and Malay. In addition, I conducted interviews, tape-recorded or written notes, with Chinese smallholders' rubber merchants and community leaders in Singapore and Kuala Lumpur, assisted by my research assistant, Miss Gan See Khem, a B.A. graduate of UBC, whose father was at that time a prominent rubber merchant in Malaysia.

In the process of collecting data for my doctoral dissertation, I became a self-taught anthropologist engaged in the distinct method of anthropology, i.e. *ethnographic fieldwork*: (a) travelling to a foreign location (e.g. Pontian district, Johore, Malaysia); (b) doing interviews; and (c) conducting sample surveys of Malay smallholders and Chinese dealers with the help of questionnaires, a methodology associated more with sociology rather than anthropology with its observer-oriented ethnography. I returned from the field to Vancouver at the end of December 1969 with a rich collection of empirical data to analyze and interpret, and to develop an empirically-based theory of the EHMG and of Chinese merchant success.

Looking back on my theory of the EHMG, and my theory of Chinese middlemen success from the vantage of the present, I would not have been able to develop my NIE theory of the EHMG and Chinese middlemen success had I not done fieldwork and found out for myself the *importance of division of labor among the independent Chinese merchants/firms which made up the trade network*. This allowed me to appreciate the critical importance of Adam Smith's concept of division of labor or specialization (his famous example of the pin factory), and hence the importance of Adam Smith's "laws and institutions" for *coordinating* the recurrent activities of the network of interdependent traders. Public choice economists Geoffrey Brennan and James Buchanan (1985, p. 14) are among the few economists who recognized the importance of Adam Smith's notion of division of labor and hence the importance of rules for achieving cooperation.

Game theorists, ignoring Adam Smith's concept of division of labor, have tried to explain the "puzzle" of why self-interested humans would want to cooperate with each other by modeling *repeated Prisoner's Dilemma games played between two parties*. But as Alexander Field (2008, p. 204) pointed out, game theorists simply *assumed repeated interactions* but have not explained how *repeated interactions* came about in the first place. Furthermore, concepts of trust and reciprocity,[8] as well as punishment as in the Fehr and Gachter (2000) experimental game, have been introduced to produce cooperation in public goods experiments. But the bases of reciprocity and trust in these experimental games have not been explained. Still, none of the existing body of Prisoner's Dilemma games or public goods experimental games surveyed in Poulsen (2009) have introduced a "marketing game" with at least three traders linked together by division of labor; such a marketing game is predicted to produce high levels of trust and mutual cooperation.

I did not complete my Ph.D. degree at U.B.C. Economics as taught in the economics departments in the late 1960s was dominated by Neoclassical economic theory with its abstract mathematical models of man and the economic system that has nothing to do with real economies; this is what Nobel Laureate Ronald Coase (1991) famously dubbed "blackboard economics." Even today, according to Coase (2012, p. 2):

> Economics as currently presented in textbooks and taught in the classroom does not have much to do with business management, and still less with entrepreneurship. The degree to which economics is isolated from the ordinary business of life is extraordinary and unfortunate.[9]

Thus it was unheard of for economists to engage in fieldwork in the 1960s. My Ph.D. committee was unsympathetic to my ethnographically-based Ph.D. dissertation topic. It was a severe blow for me not to be allowed to complete my Ph.D. thesis. Some years later, by the strangest concatenation of events, helped by a number of Good Samaritans spearheaded by Mancur Olson[10] (1932–1998), I arrived in Blacksburg, Virginia in 1975 to start life as a Ph.D. student all over again.

5 The "Hobbesian anarchy" research program at Virginia Tech and my research program on Chinese merchants and their ethnically homogeneous middleman groups

In 1975, I enrolled as a Ph.D. graduate student in the economics department at Virginia Polytechnic Institute and State University ("Virginia Tech") in the fall semester, with Professor James M. Buchanan serving as chair of my Ph.D. dissertation committee.[11] The academic environment when I arrived at Virginia Tech in 1975 was most conducive for the completion of my Ph.D. dissertation. This was because in the early 1970s, James M. Buchanan, Director of the Center for Study of Public Choice, participated with economists affiliated with his Center, in the "Hobbesian Anarchy" research program initiated by Winston C. Bush (1940–1973) who organized a series of weekly workshops on the topic of how social order emerged out of anarchy.[12] By the time I arrived, several books on anarchy had been published by Gordon Tullock (1972 ed. 1974) and by James Buchanan (1975). My doctoral dissertation topic, with its empirical-based theory of how a private-order "club-like" economic organization of the "ethnically homogeneous (Chinese) middleman group" provided members with club goods (e.g. contract enforcement, credit, etc.), fit nicely into Buchanan's anarchy and social order research program. Three years later, I completed my course work and my Ph.D. dissertation, entitled "The economics of the ethnically homogeneous Chinese middleman group: A property rights-public choice approach" (Landa, June 1978). Three of my unpublished chapters from my doctoral dissertation are included in this volume of essays (chapters 2, 3 and 5).

6 Overview of the volume of essays

This book consists of 14 chapters—nine published papers and five unpublished papers (including chapter 1. Introduction)—selected from my research output, beginning in 1969 and spanning a period of three decades, on Chinese merchants in Southeast Asia. Part I consists of one chapter, Introduction, which ties the various chapters together. Except for chapter 1, the Introductory chapter, the rest of the chapters were completed between 1978 and 2008.

Part II contains two empirical chapters which provide the historical and empirical (fieldwork) material for the economic theorizing in Part III. Chapter 2, entitled "Chinese mutual aid ("Pang" 帮) and socio-economic organizations: General background," is an unpublished chapter from my doctoral dissertation (Landa 1978, chap. 2). The chapter provides a historical account of how Chinese immigrants from Fukien and Kwangtung provinces of China adapted their traditional Confucian values of mutual aid, embedded in Chinese kinship and lineage organizations, to the new conditions in which they found themselves in the host countries by organizing the Chinese community—with its five distinct dialect/ethnic groups—Hokkien, Teochew, Cantonese, Hakka, and Hailam—into five mutual aid communities/"Pangs" (五帮). It is within each Chinese dialect group/"pang" that trust, mutual aid and cooperation manifested themselves in numerous mutual aid associations and organizations, and in the economic sphere in the "particularistic"—in the sense of sociologist Talcott Parsons (1951)—kinship and ethnic ties that occur within Chinese family firms and across markets (e.g. Teochews dominated the pepper and gambier trade; Hokkiens dominated the marketing of smallholders' rubber). *Particularistic relations* in economic relationships or social connections—"guanxi" (关系)—is a key feature of Chinese economic organization in Singapore and Malaysia, just as it is a key feature of Chinese economic organization in China, Taiwan and Hong Kong (Willmott 1972, Introduction, p. 5).

Francis Fukuyama (1995) claims that Chinese societies—China, Taiwan, Hong Kong, Singapore—are "low trust" societies because trust is confined within the family and kinship groups. Given the evidence presented in Chapter 2 and Chapter 3 (also outlined below) I would argue that Chinese societies in Southeast Asia are "high-trust" societies because trust is extended to the boundaries of the Chinese dialect groups. "Bounded high-trust" is a concept I would coin to describe Chinese societies in Southeast Asia. See also Ralph Weber's (2009, pp. 118–121) and William Tai's (2013, p. 64) criticisms of Fukuyama's notion that Chinese societies are low trust societies.

Chapter 3, entitled "Marketing of Pontian smallholders' rubber: Mutual aid among Hokkien dealers," is an unpublished chapter from my Ph.D. thesis (Landa 1978, chapter 3). It is an empirical chapter based on data I gathered from my fieldwork in Malaysia and Singapore in 1969. Questionnaire surveys of a sample of rubber dealers and Malay rubber smallholders in the Pontian district of Johore, Malaysia in 1969 were used to collect information, supplemented by in-depth interviews of various rubber merchants and prominent members of the Chinese community in Singapore and Malaysia.

The chapter describes the marketing of Pontian smallholders' rubber through the various levels of middlemen, characterized by specialization of marketing functions, and the mutual aid arrangements they made among themselves for protection of contracts, extension of credit, exchanging information about rubber prices and creditworthiness of potential trading partners, and for debt settlement. The middleman group involved was a tightly-knit homogeneous group of Hokkien rubber dealers, dominated by six clans from Chuanchow and Yunchun in Fukien province in China. My interviews with rubber dealers in Singapore and Kuala Lumpur revealed the importance of *identity*—individual and group identity—and *trust* ("xìnrèn" 信任)[13] manifested in the conscious particularization of exchange relations by rubber merchants, resulting in the formation of the phenomenon of the tightly-knit "ethnically homogeneous (Chinese) middleman group" (EHMG)/ethnic trade network. Business transactions among members of the EHMG were sealed with handshakes and oral promises, and rubber merchants complied with the informal social norms—*Confucian ethics of mutual aid and reciprocity*—of the merchant group. Informal sanctions were imposed on traders who breached the social norms of the Chinese business community: withdrawal of credit, shaming the offending party, and even ostracism from the middleman group. The materials gathered from my fieldwork in 1969 formed the basis of my theorizing of the economics of the EHMG (see chapter 5) and my NIE theory of Chinese merchant success (see chapter 14).

Are trust and Confucian values still important for Chinese entrepreneurs in more recent decades?[14] Historian Wang Gungwu (1991, p. 186), who has written extensively on overseas Chinese, in his article on "The culture of Chinese merchants" said that Chinese merchants accepted Confucian virtues of "thrift, honesty, trust, and industriousness," while being profit-seeking and risk-taking entrepreneurs.[15] As profit-seeking entrepreneurs, philanthropy was "most systematically developed among successful merchants. . . [and] was part of a social strategy that made the rich merchants the most philanthropic group of people in China and made their brand of philanthropy unique to their class" (Wang Gungwu 1991, p. 187). Similarly, Chinese in, e.g. Singapore, also practiced philanthropy; see the biographies of successful Chinese entrepreneurs in Singapore in Song (1967); see also chapter 11 in this book for a case study of Tan Kah Kee and his family firm. Wang (1991, p. 192) further stated:

> From all accounts down to the twentieth century, all successful overseas Chinese merchants, whether originally from a merchant family or not, started by working for a relative who had a business. If they were close and direct kin, they were more worthy of trust and more likely to improve their position rapidly. If the relationship were less close then hard work, honesty, thrift, and some early sign of initiative and talent would be essential if they were not to remain shop assistants and loyal retainers all their lives. The qualities of entrepreneurship became essential and were believed to be accompanied

> by luck and good fortune. When, as was often the case, spectacular success followed for some of them, the collective efforts of family members in management, as well as production, transportation and distribution would still be crucial. Without such support no successful merchant would feel secure.

In a news item entitled "Friendship, trust, and the Chinese way of doing business," *The Straits Times* weekly edition (24, August 1991, p. 13), reported that the first and biggest gathering of Overseas Chinese businessmen—800 overseas delegates from 30 countries—had attended a three day "World Chinese Entrepreneurs Convention" in Singapore. The purpose of the convention was to establish business deals and social ties. The article stated that:

> . . .doing business the Chinese way, especially if it were to culminate in a successful deal, has always been more effective if it is done in an informal atmosphere with someone you trust as a friend. Even for other delegates with no strong historical bonds, it was enough that one shared the same surname or spoke the same dialect with an otherwise near stranger.

The conference delegates spoke of the need to promote Confucian values as a means to achieve thrift, hard-work and group cohesion.

Finally, in a Chinese article written by 任成琦 [Ren Cheng-Qi] in the *People's Daily*, entitled, 放眼华商话"儒商" translated as "Watch Chinese merchants, the 'Confucian merchants,'" Ren (June 19, 2007, p, 6) used the term "Confucian merchant" (儒商) to describe a Chinese merchant who regards integrity, business ethics, and commercial morality as the primary standards of doing business. Examples of outstanding "Confucian merchants" cited by Ren included among others, 陳嘉庚 (Tan Kah Kee, 1874–1961) and 李嘉誠 (Li Ka Shing, 1928-present), both noted for their philanthropy.

I consider the term "Confucian merchants" to be very appropriate to describe successful Chinese merchants in China, Southeast Asia and elsewhere who are imbued with Confucian virtues, which are consistent with "bourgoise virtues" (McCloskey 2006)—honesty, integrity, and trustworthiness—essential ethics for merchants operating in a market economy.[16]

Part III, entitled "The ethnically homogeneous middleman group and the Chinese family firm: Theoretical approaches" consists of 8 theoretical chapters, chapter 4 to chapter 11. In Chapter 4, I develop a unified theory of western and Chinese contractual practices, resting on Coasean foundations. First, I develop a theory of contract law (Landa 1976) by extending Coase's (1937) theory of the firm to inter-firm transactions coordinated by the institution of contract law; contract law economizes on the transaction costs of private protection of contracts. I then extend my theory of contract law to develop my theory of the EHMG (Landa 1981) in which middlemen operate under conditions of contract uncertainty, where the legal infrastructure for contract enforcement is underdeveloped. My theory of the EHMG, briefly outlined in chapter 4, is discussed in full in chapter 5. Without developing a unified Coasean theory of western and Chinese contractual practices, it is hard for a reader to appreciate that my theory of the EHMG, incorporating various core concepts drawn from sociology and anthropology, rests on NIE/Coasean transaction cost foundations.

Chapter 5, entitled "A theory of the ethnically homogeneous middleman group: An institutional alternative to contract law," is the most important theoretical chapter in this volume of essays. It is a chapter from my unpublished Ph.D. dissertation (Landa 1978, chapter 5); slightly revised, it was subsequently published in *The Journal of Legal Studies* (Landa 1981).

Using rational choice theory, I argue that, under conditions of contract-uncertainty in economies with less-developed legal frameworks for enforcing contracts, a rational Chinese merchant will not trade with anonymous trading partners/strangers. Instead, the trader will choose to trade only with trading partners—with varying degree of social distance—whose identity he can trust because of shared rules/informal social norms (i.e. Confucian code of ethics), hence particularizing exchange relations along kinship and ethnic lines; social sanctions are imposed on members who breach the shared social norms. The aggregate outcome of all Chinese merchants' rational choices of their trading partners along kinship and ethnic lines is the spontaneous emergence of the macro-phenomenon of the EHMG/ethnic trading network, with Confucian social norms embedded in the ethnic trading network. The EHMG is a low-cost club-like economic organization alternative to contract law and the vertically-integrated firm for economizing on the transaction costs of enforcing contracts.

My 1981 theory of the EHMG contributes to the economics/social science literature by:

(1) Introducing *identity* into economics, hence establishing the new sub-discipline of the "Economics of Identity."[17] George Akerlof and Rachel Kranton (2000, p. 715) made the claim that their 2000 paper "introduces identity—a person's sense of self—into economic analysis." This seems to me an exaggerated claim.[18] According to Gordon Tullock–Karl Eller Professor of Economics and Political Science, University of Arizona–in his blurb on the dusk jacket of my book (Landa 1994): "Janet Landa has pioneered a new area which may be called 'The Economics of Identity,' which distinctly extends the scope of economic analysis, and is especially vital for development economics."

(2) Introducing a self-organizing private order phenomenon of the ethnically homogenous (Chinese) middleman group/ethnic trade network, a *new form of*

economic organization not found in the three forms of economic organization discussed in Oliver Williamson's (1975, 1985) New Institutional Economics of "markets-hierarchies-relational contracting" paradigm; Williamson's relational contracting refers to recurring long-term transactions between independent trading partners (*a la* Mcneil 1974) without personalistic ties between trading partners. Ethnic trading networks are a dominant form of merchants' economic organization in under-developed economies where contract law is not well-developed. Ethnic trading networks can be considered a form of economic organization, lying between Williamson's markets (price mechanism) and hierarchy (the vertically integrated firm) for coordinating inter-firm transactions. For further discussions, see Landa (1988).

Economist Avner Greif (1989, 1993) developed a theory of a private order (Jewish) "Maghribi trading coalition" very similar to my theory of the (Chinese) "ethnically homogeneous middleman group." Greif argued that Jewish traders, operating in the Muslim Mediterranean during the eleventh-century where contract law was ineffective, formed a "Maghribi trading coalition" in which merchants within the coalition are expected to hire only agents who abide by coalition rules, and, through reputational effects and sanctions imposed on those who break coalition rules, deterred opportunism, and hence facilitated Jewish-Maghribi merchant-agent long distance trade. In developing his theory of the "Maghribi trading coalition," Greif (1989, 1993) did not cite my published paper on the EHMG (Landa 1981), but instead cited my unpublished Ph. D. dissertation (Landa 1978), and a Hoover Institution Working paper on the EHMG (Landa 1988). Greif's subsequent meteoric rise to fame followed shortly his publication of his paper (Greif 1993) in The *American Economic Review*, the leading mainstream economics journal. Mainstream economists thereafter credited Greif, and not me, as the pioneer who developed a theory of trading coalitions in which informal norms and reputation of traders provided the alternatives to contract law for the enforcement of contracts. But Charles Rowley (2009) set the priority record straight in an editorial commentary, published in *Public Choice*: "The curious citing practices of Avner Greif: Janet Landa comes to grief," [pdf: http:hdl.handle.net/10.1007/s11127-009-9442-y].[19]

(3) Introducing *social norms* into the "law-and-norms" literature (see McAddams 1997, p. 343; Landa 2005).[20]

(4) Integrating various core sociological concepts of "particularism," "social norms," "trust", "social distance," and "social structure" into my NIE theory of the EHMG/ethnic trade networks. My theory of ethnic trade networks preceded sociologist Mark Granovetter's (1985) "embeddedness" theory of social networks. Granovetter argued that economic actors are not atomized individuals—as assumed in economics—but are engaged in personalized interactions with each other, and that personal relations

embedded in social networks promote trust which serve to mitigate against "malfeasance" [read: opportunism], hence function as an alternative to Coase-Williamson's markets-hierarchies (vertically-integrated firm) paradigm (see Landa Ch. 4, this volume). For his "embeddedness" paper, Granovetter is credited as the founder of "New Economic Sociology" with its emphasis on network theory, organization theory, and cultural sociology (see Swedberg 1997, pp. 162–164). I believe that Granovetter (1985) read my theory of the EHMG (Landa 1979) prior to publishing his 1985 embeddness paper. This is because in 1980, I gave sociologist Harrison White—Granovetter's professor–a copy of my early unpublished version of my 1981 paper (Landa 1979) when Harrison White gave a lecture at the Department of Sociology, University of Toronto. The same year, I received a letter from Harrison White asking me to mail a copy of my 1979 paper to Mark Granovetter, which I did.[21]

In Chapter 6, "The economics of symbols, clan names, and religion," Carr and Landa (1983), extend Landa's (1981) theory of the EHMG by generalizing the theory to other homogeneous middleman groups (HMG) including religious trading groups such as Jewish merchants in medieval Europe. First, we use James Buchanan's (1965) theory of clubs to develop a mathematical club-theoretic model of the HMGs, analyzing the economic benefits (lowered breach costs because of trust among club members) and costs (contract enforcement and information costs) of belonging to a homogenous trading club and the optimum size of the club. We formalize the concept of trust by defining trust in terms of a trader's probability of breach of contract. Second, we incorporate anthropologist Fredrik Barth's (1969) concepts of "culture" and "ethnic boundary" in which embedded within the boundary of an ethnic/cultural group are: (a) the rules of the game shared by members of the group; and (b) symbols of identity such as language, religion, rituals, dress style, dietary restrictions of the ethnic/cultural group. We use Michael Spence's (1974) signaling theory in a novel way by developing a signaling theory of symbols of identity by arguing that symbols of identity, for example, Jewish dietary law performed two important economic functions: (a) lower the information costs of identifying fellow Jewish merchants; and (b) screening out outsiders by erecting barriers to entry for those outsiders who may wish to free-ride on the benefits of club membership by passing/faking as insiders. Laurence Iannaccone (1992) developed a club-theoretic model of religion–very similiar to the Carr-Landa (1983) theory–explaining that rational church members may benefit from bizarre behavioral restrictions such as observing dietary restrictions, painful initiations, etc. because such behavioral restrictions can overcome free-rider problems associated with collective action.

In Chapter 7, entitled "Personal versus impersonal trade: The size of trading groups and the law of contracts," law-and-economics scholar Robert

Cooter and Janet Landa (1984) extend Carr and Landa's (1983) theory of the optimal size of the HMG "club" by analyzing the relationship between the size of trading club and the development of contract law. To be effective in enforcing contracts, the trading group must be able to erect barriers to entry in the form of membership criteria such as ethnic/religious identity, dietary restrictions and religious rituals. We also prove, mathematically, that with the creation and improvement in contract law, the size of trading club falls as more members trade with outsiders/strangers. In other words, cooperation among *anonymous* traders is facilitated by the emergence and development of formal contract law enforced by the state. Thus, the creation and improvement of contract law in less-developed economies is a viable policy alternative to the harsh measures (example, expulsion of middlemen) by some countries to deal with the dominance of merchant roles by foreign ethnic minority groups.

In Chapter 8, entitled "Cognitive and classificatory foundations of trust and informal institutions," I develop a new and extended version of my theory of the EHMG by combining ideas in my 1981 paper with new ideas in: (a) Denzau and North's (1994) mental models/cognitive science approach to institutions; (b) anthropologist Mary Douglas's (1986) cognitive and classificatory approach to institutions; and (c) biologist Michael Ghiselin and Janet Landa's (2005) work on the bioeconomics (the economics and biology) of classification. The main idea in my new and expanded theory of social norms embedded in the EHMG is this: "Classification matters" because of cognitive limitations of the human brain/mind and because acquisition and processing of information are costly activities. "*Homo classificicus*," a term I coin for a new species of *Homo economicus*, operating under conditions of contract uncertainty, must therefore economize on cognitive and information costs by using "institutions-as-classification": the mental task of social construction of a system of classification of all traders into a small number of "cultural categories of similar kinds of people" i.e. people who share the same identities and shared ethics/rules. My contribution in this chapter to the NIE literature on institutions is to expand the taxonomy of institutions-as-rules of the game to include institutions-as-classification.

In chapter 9, entitled "The role of culture and institutions in promoting middleman-entrepreneurship in less-developed economies," I begin by discussing the concept of "culture"—a core concept in anthropology—and related anthropological concepts of the "ethnic group." I also discuss anthropologist Fredrik Barth's (ed. 1969) concept of "ethnic boundaries," with rules of the game embedded in the ethnic group, and where members share the same symbols of identity. Following Barth, who calls an ethnic group a "cultural-bearing unit," I discuss the role of the EHMG/ethnic trade network as a "cultural-bearing unit"—with rules of the game embedded in the

EHMG—which by promoting mutual trust, cooperation and coordination of interdependent activities among merchants, generated collective benefits to all the merchants in the EHMG. The collective benefits generate what sociologists call "social capital" (Coleman 1987)[22] and gave members of the EHMG a comparative advantage vis-à-vis other ethnic groups to appropriate middleman-entrepreneurial roles for themselves. In my theory of the EHMG as a cultural-bearing unit, I thus integrate the concepts of culture, institutions-as-rules (formal laws and informal social norms of reciprocity), trust, identity, and social capital across several of the social sciences within a unified NIE framework. Following this I developed my theory of the EHMG as a "cultural transmitting unit": I incorporate Robert Boyd and Peter Richerson's (1985) "dual inheritance theory" of genes and culture to show how the EHMG can *persist over time* by present members of the middlemen group, transmitting their cultural values/social norms of reciprocity to the next generation of middlemen.

Chapter 10, entitled "The co-evolution of markets, entrepreneurship, laws, and institutions in China's economy in transition: A new institutional economics perspective," I discuss the role of China's "Household Responsibility System" (HRS), contract law, and the rule of law in contributing to the growth of markets and the emergence of Chinese middlemen/merchants connecting rural and urban markets. As expected in newly emergent markets with underdeveloped legal infrastructure, the middlemen networks were not impersonal networks but particularistic or "guanxi" (关系) trade networks, based on social ties among the middlemen. Using several published legal cases, I discuss the role of contract law and the rule of law in resolving HRS disputes. In addition, the chapter discussed the darker side of particularistic relations: the emergence of local cadres as entrepreneurs via their "rent-seeking" activities with merchants embedded in trade networks. To show the power of New Institutional Economics (NIE) to shed light on the complexity of China's transition from a socialist economy to a more market-oriented economy, I provide readers with a brief discussion of the various sub-disciplines which make up NIE: law-and-economics, public choice theory (the economics of politics), Austrian theory of entrepreneurship, and the new economic history associated with the work of Douglass North (1990).

In chapter 11, entitled "The socioeconomic functions of kinship and ethnic networks in the growth of the Tan Kah Kee family firm in Singapore: A transaction cost approach," is an unpublished paper co-authored with sociologist Janet Salaff (Landa and Salaff 1980, 1986 slightly revised). We focus on one particular Chinese firm, the Tan Kah Kee family firm, as a case study to explain why the typical Chinese firm is organized as a family firm, and the reasons for the collapse of the Tan Kah Kee family firm when it grew into a very large vertically-integrated conglomerate. Our materials for the case study were obtained from published sources, as well as from Janet Salaff's interviews, conducted in Singapore in August 1981, with some of Tan Kah Kee's kinsmen as well as prominent persons in Singapore. Using my transaction costs theory of the EHMG (Landa 1979, 1981) with its model of widening concentric circles of personal relationships, we argue that the nature of the Chinese family firm with cooperating partners—co-owners, managers, branch managers—linked by kinship and ethnic ties, is an efficient economic organization which emerged to establish trust between co-operating partners, thereby economizing on the *transaction costs of monitoring* cooperating partners' anti-social behavior such as "shirking" (Alchian and Demsetz 1972) fraud, and theft. Our transaction costs/NIE approach in explaining the nature of the Tan Kah Kee Chinese family firm differs from the traditional sociologist's view that an owner of a firm which employ family members and extended kinsmen ("nepotism") within the firm impede entrepreneurship and growth of firms, which are doomed to remain inefficient and small in size. We also provided reasons for the eventual collapse of the Tan Kah Kee family firm in 1933, due to reasons that are not related to the traditional Chinese family mode of organization of the firm, i.e. the use of family and extended kinsmen in positions of power within the firm. For a comprehensive historical account of the Tan Kah Kee enterprise, see Yong (1987); for a recent historical account of the Tan Kah Kee enterprise, see Tai (2013, chapter 5).

Chapters 4 to 11 complete Part III of this book. Part IV entitled "Chinese merchant success: Ethnic cooperation and conflict," consists of 3 papers, chapters 12–14.

In Chapter 12, entitled "The bioeconomics of homogeneous middleman groups as adaptive units: Theory and empirical evidence viewed from a group selection framework," I integrate multi-selection/group selection theory in evolutionary biology (Wilson and Wilson 2007) into my theory of the EHMG, with the EHMG viewed as an "adaptive unit." In addition, I incorporate the following three concepts: (a) biologist David Sloan Wilson's (2002, p. 25) concept of "regulatory mechanisms" (read: institutions) that prevent free-riding by members of the group; (b) biologist Richard Alexander's (1987) concept of the origin of "moral systems" [read: informal institutions] which unite members of a group in competition with outsiders; and (c) economist/bioeconomist Jack Hirshleifer's (1982) concept of "group competition" in which society is divided into "us" and "them,"—with "us" (in-group) competing against "them" (outsiders") for society's scarce resources, and in the process generating ethnic conflict. Having provided the bioeconomics framework, I present a number of case studies of successful merchant groups, drawing on my own fieldwork on Hokkien-Chinese rubber dealers in Malaysia and Singapore in 1969, and the work of other scholars—including Curtin (1984)—on successful merchant groups elsewhere. I argued that the phenomenon of the Chinese EHMG, an "adaptive unit," adapted to the under-developed environment of the host country, is *not unique* because other successful merchant groups also formed homogeneous middleman groups in response to similar environments of their host countries. My comparative analysis of successful middleman groups as adaptive units throws up in sharp relief the following conclusion: whatever the diversity of cultures the middleman groups originated from—different religion, food, clothing, language—the middleman minority groups all *converged* to the same phenomenon of "homogeneous middleman groups" (HMGs). These HMGs are adaptations to similar under-developed settings in that the HMGs provide club goods for their members, such as contract enforcement, mobilization of information, etc. This convergence is what biologist David Sloan Wilson (2009, p. 186) calls "convergent cultural evolution."

In Chapter 13, entitled "Sows, cows, and Coase: The conflict of cultures," I develop a theory that can explain the *proximate* cause of the May 13 deadly ethnic riots in Malaysia in the sense that it provides a general theoretical framework for analyzing ethnic conflicts in which "starting a riot is as easy as killing a cow, or smearing pig's blood on a mosque" (*The Globe and Mail*, January 24, 1989, p. A8). The theoretical analysis draws on law-and economics scholar Coase's (1960) seminal article in which Coase argued that if transaction costs are zero or low when the number of people involved in a dispute is small (e.g. only 2), then disputes—for example, cattle trespassing disputes—between two neighbors can be resolved by *bargaining* between the parties to a dispute; this is the famous "Coase theorem."[23]

I show, drawing on three anthropological case studies of trespassing disputes in Malaysia, that *no bargaining occurred between two parties to a dispute*. In one case in a village in Malaysia, the trespassing pig belonging to a Thai pig farmer was killed by the Malay crop farmer. To explain this case, I argue that since pig is *taboo* to Muslims, and Malays have the inalienable right to practice their religion, unilateral pig-killing can be interpreted as a form of Pigovian-tax which the Malay-Muslim farmer imposed on the Thai pig farmer for crop damages plus the subjective costs of "pig pollution." I show, with other real-life examples, that in a multiracial society, with significant cultural differences between groups, that cultural/ethnic identity is non-negotiable and that a *clash of cultures within a plural society can trigger an ethnic conflict*.[24]

In Chapter 14, my final chapter, entitled "The law and bioeconomics of ethnic cooperation and conflict in plural societies of Southeast Asia...", I provide a theory of Chinese middlemen success. I draw upon William Glade's (1967) and Harvey Leibenstein's (1968) theory of entrepreneurship, as well as my theory of the EHMG (Landa 1978, 1981). My thesis of Chinese middlemen success:

> Chinese dominate middleman roles without special barriers to entry other than that arising from the organizational efficiency of the EHMG "club" organization in the provision of infrastructure/public goods externalities, externalities that are external to firms in the Chinese middleman economy, but are internalized by Chinese middlemen via the networks of mutual aid and collective action. The result is the creation of an efficient (i.e. least cost) Chinese middleman economy. The organizational efficiency gives the Chinese a significant differential advantage in maintaining the monopoly of middleman roles (Landa 1978, chapter 8, p. 227; Landa 1999, p. 274.)

An important policy implication flowing directly from my NIE theory of Chinese merchant success: the important role of government in providing for the basic infrastructure of an economy such as protection of property rights and enforcement of contracts. Government protection of property rights and enforcement of contracts will narrow the comparative advantage of Chinese entrepreneurs over the Malay population, thus facilitating the emergence of indigenous entrepreneurship. This policy recommendation is a viable alternative for improving inter-ethnic relations compared to the wealth-redistribution, affirmative-action-oriented policies in favor of Malays, associated with Malaysia's New Economic Policy, and the NEM policy which came into effect in 2010.

Before I conclude my comments in this section, I wish to point out two important points. First, this book focuses on the specific topic of explaining the nature of the Chinese EHMG/ethnic trading networks, and the economic success of Chinese merchants in Southeast Asia with special reference to Malaysia and Singapore. The book does not cover the wider topic of Chinese capitalism and Chinese entrepreneurship in Southeast Asia. For this, see, for example, Allen and Donnithorne (1957), Jomo and Folk (Eds. 2003), Edmund Terence Gomez and Hsin-Huang Michael Hsiao (Eds. 2004), and a recent in-depth historical study by William Tai (2013) of Chinese capitalism in colonial Malaya, 1900–1941, covering such industries as tin-mining, rubber planting, shipping, pawnbroking and banking. Finally, for a volume of essays on East Asian entrepreneurship, see Fu-Lai Tony Yu and Ho-Don Yan (Eds. 2015).

Secondly, even within the limited topic of Chinese middleman-entrepreneurship in Malaysia and Singapore covered in this book, I like to point out that some factors that facilitated Chinese middleman success, have either been left out or little discussed in this book. A more complete theory of Chinese merchant success therefore needs to take account of the following factors which gave the Chinese merchants in Malaysia and Singapore a comparative advantage over indigenous Malays and immigrant Indians in appropriating merchant-entrepreneurial roles:

1. *History matters*:

(a) Early Hokkien foreign maritime trade in the South China Sea: Chinese—especially Hokkiens from Fukien province in China—during the two decades from the 1620s to the fall of the Ming dynasty in 1644, had reached the peak of their success in foreign maritime activity in pre-modern Southeast Asia (Wang Gangwu 2000, p. 29). More specifically, Hokkiens had traded historically with the states of South China Sea (see Map 1 for location of South China Sea), which were more or less equivalent to modern Southeast Asia (Wang Gangwu 1991, p. 45).

(b) Early Chinese settlements: Many of the overseas Chinese sojourners, especially Hokkiens, had established settlements in various parts of Southeast Asia by 1644 (Wang Gangwu 2000, p. 34). In Malaya, Chinese communities were established in: Malacca after the founding of Malacca by Parameswara in 1398 (Purcell 1967, p. 16–17); Penang after the founding of Penang by Captain Francis Light in 1786 (Purcell, p. 39); Singapore after the founding of Singapore by Sir Stamford Raffles in 1819 (Purcell, pp. 70–71).

(c) "Cultural legacies" and market mentality that Chinese merchants brought with them from China to Malaysia and Singapore:

> . . .pre-modern Chinese village society, with its long and deep traditions of involvement with markets, financial holding, and complex organizations, produced social patterns and cultural legacies that equip its descendants with what, on average, amounts to an unusually rich and flexible portfolio of organizational skills with which to pursue economic advantage (Rawski and Rawski 2008, p. 22).

2. *Cooperation between British Managing-Agency Houses and Chinese merchants during colonial British* Malaya:

(a) When rubber industry became established in British Malaya in the early 20th century, British managing agency houses such as Singapore-based Guthrie and Company Ltd. cooperated with the Chinese business community. James Guthrie, for example, "gave financial help to enable many of Chinese immigrants to set up in business, doubtless in the hope of enlarging his markets and improving his access to supplies of produce. This was an early instance of the mutual dependence of Western and Chinese enterprise in the development of local resource" (Allen and Donnithorne 1957, p. 54). In the rubber industry, this means that the Western Managing Agency House enabled Hokkien-Chinese merchants to be their "middlemen" in order to access supplies of smallholders' rubber from Malay smallholders and from Chinese village dealers. This created the classic Furnivallian "plural society": European agency houses were the exporters at the apex of the pyramid, Chinese middlemen in the middle, and the indigenous rubber smallholders at the bottom of the pyramid (see chapter 3, this volume).

(b) The "Comprador" system in colonial British Malaya: Western banks conducted their business with the Chinese in Singapore and Malaya through Chinese middleman called "compradors." The Chinese compradors, extended credit to Chinese customers and acted as their guarantors. See Landa (chapter 2 in this volume). This was another instance of profitable mutual dependence of Western and Chinese enterprise. For discussions of the "comprador" system, see Allen and Donnithorne (1957, pp. 205–208); and Tai (2013, chapter 8).

3. *The role of the British colonial government*:

Rubber was first planted on a commercial basis in Malaya in the mid-1890s on estates previously opened for sago and other crops that were increasingly unprofitable. H.N. Ridley, Director of the Singapore Botanic Gardens and Supervisor of the Straits Forest Department, spearheaded the commercial production of rubber. He turned to the leading Hokkien merchants—particularly merchants from Chuan-chow district—to grow rubber, which they did. [See chapter 11 of this book for details]

4. *Changing environments*:

So as not to take an essentialist[25] view of Hokkien-Chinese merchant networks as being an unchanging "ethnically homogeneous" trading networks, it would be necessary to study how Chinese smallholders' rubber merchants have adapted to changing environments:

(a) Rubber boom, 1950–1951, a result of the Korean War: Some Hokkien town dealers during the rubber boom were able to quickly accumulate merchant capital so that they were able to vertically integrate forward into packer-exporter role, bypassing the European Agency Houses (see chapter 3, this volume). By the time I conducted my fieldwork on Chinese merchants in 1969, the whole smallholders' rubber marketing network—village dealers, town dealers, and packer-exporters—had evolved from a classic Furnivallian "plural society" to one dominated by an ethnically homogeneous (Hokkien) middleman group/ethnic trade network.

(b) "Speak Mandarin Campaign": Prime Minister Lee Kuan Yew of Singapore launched the "Speak Mandarin Campaign" on September 7, 1979, thus introducing Mandarin as one of four Singapore official languages—English, Mandarin, Malay, and Tamil. I predict that current smallholders' marketing network within Malaysia and Singapore would be less homogeneous, compared to the Hokkien-dominated smallholders' rubber network in 1969 because of the breakdown in dialect/language barriers between the five different Chinese dialect groups.

(c) China's globalization, and the emergence of specialized markets and Wenzhou merchants: Specialized markets emerged in the 1980s, after China embarked on major reforms in 1976, designed to transform China from a socialist economy to a more market-oriented economy and to promote foreign trade. These specialized markets are marketplaces located in industrial clusters, specializing in the production and marketing of such commodities as garments, leather, shoes, etc. (Ding 2012). What is unique about these specialized markets is that for the first time, the small producers—the industrial clusters—are able to develop their own marketing networks, so that merchants also take an active part in the production process (Ding 2012, p. 8); the merchants link producers with buyers from distant markets; the "Wenzhou Model" is named after their mode of operation.[26] These specialized markets are dominated by profit-seeking merchants from *Wenzhou,* Zhejiang province. The Wenzhou merchants are so successful that they are found in various places in China[27] (Ding 2012). Furthermore, Wenzhou merchants have migrated to Europe: to Italy—especially Tuscany (Kuhn 2008) and Veneto (Wu and Zanin 2007)—France, and the Netherlands (Li 1999, chapter 9). They are also to be found in South Africa (Ding 2012). These long-distance overseas Chinese Wenzhou traders form a Chinese "trade diaspora"[28] (Cohen 1971)—networks of trade communities dispersed in long distance trade—which play a vital role in promoting China's foreign trade with countries outside of Southeast Asia. The fact that these overseas Chinese merchants are *Wenzhou* merchants indicate that they are organized as close-knit "ethnically homogeneous middleman groups." In short, they are "adaptive units," responding to the new environments they found themselves in Europe and elsewhere outside Southeast Asia. "The first World Wenzhounese Conference" was held in Wenzhou in 2003 to enhance the social networks of Wenzhounese world-wide, while local government have paid increasing attention to the roles of Wenzhounese entrepreneurs in international cooperation (Wu and Zanin 2007, p. 5). See also Chang and Rucker-Chang's (Eds. 2011) study of international migration of Wenzhou people. An empirical study of Hokkien entrepreneurs, including smallholders' rubber merchants in Malaysia and Singapore in the age of increasing China's globalization in the 21st century, may reveal similar developments of close-knit ethnically homogenous Hokkien diasporas in different parts of the world outside the traditional countries of Southeast Asia.

7 "Consilience" and doing the "good economics" of success of Chinese merchants and their ethnic trade networks

Kenneth Arrow (1990, in Swedberg 1990, pp. 136–37), speaking of an area that economics has done badly in, namely explaining the differential success of various ethnic groups that dominate middleman roles:

> ...there are for example accounts of how special groups have played a distinct role, in say, trade. You have Chinese middlemen in Asia, Jews at certain times; Quakers during one period, and so on. And it is clear their social characteristics that matter. In the case of the Quakers, as I understand it, the general idea was that a Quaker would keep his word, and he was therefore a very useful intermediary. He would deal with other Quakers and trade over long distances, where trust was important.

For Arrow, the concept of trust which connects the disciplines of economics with sociology, is one explanation for middleman success. But that is not enough: it is necessary to include a "social system"—a shared set of symbols, a shared set of social norms, and a set of institutions for the enforcement of contract (Arrow, in Swedberg 1990, pp. 138–39). This means that Arrow would include not only the disciplines of economics and sociology, but also the sub-discipline of law-and-economics in a theory that can explain why certain ethnic groups dominate merchant roles.

More recently Evelyn Rawski and Thomas Rawski (2008, p. 22) have raised a similar question:

> Overseas Chinese—prosperous, enterprising, and linked to China by patriotism as well as family ties—contributed immensely to the flows of technology, market knowledge and managerial know-how that enabled the rapid expansion of China's exports. *But what explains the remarkable business acumen of the overseas Chinese? How did so many poor, uneducated migrants from South China villages attain entrepreneurial success in often hostile Asian environments?* (emphasis mine).

As my outline of the various chapters in this "Introduction" chapter have shown, I have developed a New Institutional Economics theory of Chinese middlemen success in Southeast Asia, with special reference to Malaysia and Singapore. In developing my theory, I have integrated various core concepts—trust, ethnicity, identity, culture, and institutions (laws and social norms)—which cross several of the social sciences and beyond to evolutionary biology—into an overarching New Institutional Economics/transaction costs framework.[29] What I have done is "consilience" of the economics of the EHMG/Chinese merchant success with several of the other social sciences, and beyond with evolutionary biology.

The concept of "consilience," according to biologist Edward O. Wilson (1998, p. 8) citing William Whewell's (1840) concept of consilience, is literally a jumping together of knowledge by the linking of facts and fact-based theory across disciplines to create a common groundwork of explanation. Wilson strongly advocates unification of the sciences in order to understand the complexities of the human condition; and for him "consilience is key to unification" (p. 8):

> Most of the issues that vex humanity daily—ethnic conflict, arms escalation, overpopulation, abortion, environment, endemic poverty, cannot be solved without integrating knowledge from the natural science with that of the social sciences and humanities. Only fluency across the boundaries will provide a clear view of the world as it really is.... (p. 13)

And: "We are approaching a new age of synthesis, when the testing of consilience is the greatest of all intellectual challenges" (pp. 11–12). Wilson illustrated how such consilience should cut across four domains of knowledge, each domain being placed in one of the four quadrants: (1) the social sciences, (2) biology, (3) ethics; and (4) environmental policy. A series of concentric circles, drawn around the point of intersection, the ring closest to the intersection is "where most real-world problems exist, and is the one in which fundamental analysis is most needed" (p. 10).

If "government policy" is substituted for "environment policy," it is clear that consilience is central to my research program on Chinese EHMG and Chinese middleman success. But this is hard work as there were no guidelines for me to follow, and hence my research program on Chinese merchants in Southeast Asia took over three decades to materialize.

This consilience approach—linking at least two disciplines—had been advocated and practiced by Ronald Coase (1910–2013), James M. Buchanan (1919–2013), and Jack Hirshleifer (1925–2005). Coase (1978) advocated the integration of economics with the "contiguous disciplines," even though Coase himself integrated law with economics, hence the founder of law-and-economics sub-discipline within economics; for his pioneering contributions to law-and-economics, Coase was awarded the Nobel Prize in Economics in 1991. James M. Buchanan contributed to the integration of economics with politics, and for his seminal contributions to public choice theory, he was awarded the Nobel Prize in Economics in 1986. Speaking of the future of economics, Buchanan (1990, 4n) said:

> I foresee the future developments as blurring the distinction between the social sciences generally, and not only between Economics and Sociology.

Economist Jack Hirshleifer (1985, p. 53) made a plea for economists to do "good economics" by expanding economics to include the entire social sciences:

> ...it is ultimately impossible to carve off a distinct territory bordering upon but separated from other social sciences. Economics interpenetrates them all, and is reciprocally penetrated by them. There is only one social science.... Ultimately, good economics will also have to be good anthropology and sociology and political science and psychology.

Hirshleifer, as a founder of bioeconomics—the integration of economics with biology—would have included biology in the above statement.

Finally, Ronald Coase (Dec. 2012, p. 2), in his article on "Saving economics from the economists":

> It is time to reengage the severely impoverished field of economics with the economy. Market economies springing up in China, India, Africa, and elsewhere herald a new era of entrepreneurship, and with it unprecedented opportunities for economists to study how the market economy gains its resilience in societies with cultural, institutional, and organizational diversities. But knowledge will come only if economics can be reoriented to the study of man as he is and the economic system as it actually exists.

I hope that in this volume of essays I have contributed to doing the "good economics" of ethnic trading networks/EHMG and of Chinese merchant-entrepreneurial success in Southeast Asia (with special reference to Malaysia and Singapore) by integrating concepts in several of the social sciences with concepts in evolutionary biology.

Acknowledgements I wish to thank political scientist Bernard Grofman, sociologist Michael Hechter, economist Beth Yarbrough and, especially, economist Nicolaus Tideman, for their comments on various versions of this chapter.

Endnotes

1. When I mention "Malaysia" in chapter 1, I take it to mean "West Malaysia" also known as "Peninsula Malaysia." East Malaysia comprise of the states of Sabah and Sarawak. See Map 1. Peninsula Malaysia acheived independence from Great Britain in 1957 and became the Federation of Malaysia, which in 1963 included Singapore and the states of North Borneo (now Sabah), and Sarawak. Singapore attained full self-government in 1959 with Lee Kuan Yew as Prime Minister. On Sept 16, 1963, Singapore joined Malaysia. Singapore seceded from Malaysia on August 9, 1965 to become the Republic of Singapore, an independent nation-state.
2. In 1970, out of a total population of 10,439,000, Malays/*bumiputera* constitute 56%, Chinese 34% and Indians 9%. See Table 1.4. *Population size, distribution, and growth rates by ethnic group, Malaysia, 1970–2000. United Nations Development Programme* (January 2005), p. 10.
3. According to the Merriam-Webster dictionary, "pogrom" is "an organized massacre of helpless people; specifically, such as a massacre of Jews." Horowitz (2001) defines pogrom in a similar way: pogrom is a subcategory of "deadly ethnic riots," involving the massacre of helpless peoples. For a comprehensive study of ethnic conflicts in various parts of the world, see Horowitz (1985). See also Forbes (1997), Ignatieff (1993), and Chua (2003).
4. There are many different definitions and concepts of a "dual economy." But common to all is the recognition of the co-existence of two sectors, an

advanced export sector and a traditional agricultural sector. See J. H. Boeke (1953).

5. Furnival rejected Boeke's concept of the "dual economy" in favor of his concept of the "plural society."
6. When I refer to my "empirical data" I do not mean the kind of work that econometricians do—collecting data to do a significance test but the kind of work associated with anthropologists and sociologists, such as collecting and interpreting data gathered from interviews, questionnaire surveys, etc. Even then, economists like McCloskey and Ziliak (2012) ask economists to forget about statistical testing and concentrate on empirical work that actually changes minds.
7. Recently Thaler and Sunstein (2008, 2009) came up with a "nudge" theory of individual decision-making that does not depend on formal or informal institutions and sanctions to direct behavior, but on the gentle method of "nudging" the person to a different course of action without restricting the individual's freedom of choice.
8. See Poulsen's (2009) survey of the experimental evidence on cooperation.
9. Thanks to Ning Wang for emailing me Ronald Coase's (2012) article in the December 2012 issue of *Harvard Business Review*.
10. I met Mancur Olson, a distinguished public choice economist, when he gave a public lecture in Vancouver in 1974. I gave Olson a copy of my unpublished legally-binding contract paper—subsequently published in Landa (1976). After reading my paper, Olson wrote me and advised me to present my paper at the Public Choice Society Annual Meetings in Chicago, April 1975. It was there that my fate was sealed: I met other public choice scholars; one thing led to another in the most amazing sequence of events. By the fall of 1975, I was in Blacksburg, Virginia, awarded with a three-year Scaife Foundation Ph.D. Fellowship, to begin my Ph.D. program.
11. Other members of my Ph.D. dissertation committee were Gordon Tullock, Robert Tollison, Gene Mumy, and Barry Keating.
12. See also James Buchanan's (2001, pp. 57–58) discussions about this early 1970s "Social order and anarchy" research program.
13. My empirical findings of the importance of trust embedded in kinship/ethnic relations among Hokkien rubber dealers in Singapore and Malaysia in 1969 are consistent with other scholars' empirical findings of Chinese merchants operating in Southeast Asia in the 1950s, 1960s, and 1970s: Chinese traders in South Vietnam during the decade before 1975 (Barton 1983), Chinese traders in the Philippine Iloilo city in 1972 (Omohundro 1983), and Chinese crop dealers in Malaysia in 1956 and in Thailand between 1969 and 1974 (Gosling 1983); see these studies in Lim and Gosling [Eds.] (1983).
14. Confucian core values are still important in contemporary Chinese society, see Gold et al. (2002), Bell (2008), Hsiung (2013).
15. Wang Gangu (1991, pp. 182–184) pointed out that the role of Confucianism to merchants in China is different from its role for overseas Chinese merchants.

In China, Confucianism placed merchants at the bottom of a hierarchy of four classes, with the literati at the top. Because of this, Chinese were not successful as entrepreneurs in China, but Chinese overseas were successful as entrepreneurs because they were no longer constrained by the lowly status of merchants in China, and no longer under the control of the powerful mandarin class.

16. McCloskey (2006) discussed the seven "bourgeois virtues": Hope, faith, love, justice, prudence, temperance, courage. The faith category include: identity, integrity, loyalty, and honesty.
17. Gordon Tullock, Karl Eller Professor of Economics and Political Science, University of Arizona, provided a blurb for the dust jacket of my 1994 book, *Trust, ethnicity, and identity: Beyond the new institutional economics of ethnic trading networks, contract law, and gift exchange*, which read: "Janet Landa has pioneered a new area which may be called 'The Economics of Identity,' which distinctly extends the scope of economic analysis, and is especially vital for development economics."
18. Rowley (2009, p. 283) said that Akerlof and Kranton's (2000) claim that their 2000 paper introduces identity into economics is "egregious." See also Akerlof and Kranton's (2010) book, where in chapter 1, the authors said that they began their work on identity and economics in 1995 (p. 5). In chapter 4, they repeated their 2000 priority claim that they introduced identity into economics: "Identity economics is at the frontier. We follow the trajectory of the past fifty years and bring economics closer to reality. We change economics by closely observing economics and social life and transforming existing theory (p. 27)." The fact is that before 2000, I have published at least seven economic articles which incorporate identity: (a) Four of them in my book (Landa 1994), *Trust, Ethnicity, and Identity: Beyond the new institutional economics of ethnic trading networks, contract law, and gift exchange*: Landa (1981), Carr and Landa (1983), my Kula Ring paper (Landa 1983), and a co-authored paper with Anthony Wallis on honey bees; (b) Three of them published elsewhere: Landa's (1991) article on culture and entrepreneurship (ch. 9, in this volume), my theory of Chinese middleman success (Landa 1999, ch. 14, in this book), plus a 1990 Working Paper, "Sows, cows, and Coase" (ch. 12, in this book) presented at Oliver Williamson's "Workshop on Institutional Analysis," (ISD 270), April 26, 1990, 122 Barrows Hall, University of California, Berkeley.
19. Rowley also mentioned the names of authors, including Bowles and Gintis (2004), MacLeod (2007), and Dixit (2003, 2007, 2009), whose work on the economics of social networks are very similar to my 1981 theory of EHMG, but failed to cite my paper.
20. Robert Ellickson (1986, 1991), whose work on the role of informal norms of neighborliness which cattlemen in California's Shasta County relied on to resolve cattle trespassing disputes, has been credited by legal scholars, for example, Lessig (1998)—who calls the law-and-norms literature "The New Chicago School"—as the founder of the "law-and-norms" literature. However, I wish to point out—besides McAdam's article (1997) and my article (Landa 2005) setting the priority record straight, that before 1986, I already published

four papers that incorporated social norms: Landa (1981), Carr and Landa (1983), my "Kula Ring" paper (Landa 1983), and Cooter and Landa (1984) paper. For a more recent application of signaling theory to social norms, see the book by Eric Posner (2000).

21. In 1980, I was an assistant professor, affiliated with the Department of Economics, University of Toronto. I befriended sociologist Janet Salaff, Department of Sociology, U. of Toronto, who invited me to attend Harrison White's lecture with her because she has read my early version of my theory of the EHMG (Landa 1979) and realized that I would be interested in hearing Harrison White's lecture.
22. Although James Coleman (1985) had contributed to the "social capital" literature, the credit must go to French sociologist/anthropologist Pierre Bourdieu (1977) for pioneering the social capital concept "capital of trust" (1977, p. 185):

    > The trust in which they are held, and the connections which they can mobilize, enable them to "go to the market with only their faces, their names, and their honor for money"—in other words, the only things which can take the place of money in this economy—and even "to wager [to make an offer], *whether they have the money on them or not*."

    The literature on social capital is vast and scattered through the disciplines of sociology, economics, and political science. For a sample of the literature, see Ostrom and Ahn [Eds.] (2003); see also Gert T. Svendsen and Gunnar L. H. Svendsen. (Eds.) (2009, p. 1) who, unlike most of the contributors to the social capital literature, acknowledged the seminal contributions of Pierre Bourdieu.
23. For the "Coase Theorem" see, for example, Chipman (1998); and Parisi (2007).
24. My "Sow, cows, and Coase" paper was written in 1990, before Samuel Huntington's (1993) thesis of "clash of civilizations" where he argued that the primary source of conflict in the future will be along cultural and religious lines. For example, Huntington argued that civilizational conflicts are "particularly prevalent between Muslims and non-Muslims." Whereas Huntington focused his attention on clash of *cultures between different civilizations,* in my paper I showed that clash of cultures can take place between different ethnic/cultural groups *within* the boundaries of a "plural society" like Malaysia.
25. For a discussion of "cultural essentialism" in the context of my theory of Chinese middleman networks, see Landa (2013, pp. 58–59).
26. The Wenzhou Model, according to Ding (2012, note 9, p. 15) "is a typical Chinese rural industrialization model of the 1980s, characterized by the large presence of specialized markets, which have provided a platform that acts as an interface to bring together the large numbers of domestic factories in the Wenzhou industrial clusters and the 100,000 Wenzhou salesmen (*tuixiao yuan*) in the domestic market."
27. Why are Wenzhou people more entrepreneurial than the rest of Chinese people in China? Wu and Zanin (2007, p. 4) offered an explanation: "It has been a tradition that for thousands of years, merchants have been highly valued and respected in Wenzhou. It is rooted in the 'Yongjia School,' an independent

school of thought originating from this region, which defends the value of commercial behaviour and emphasized the equal importance of production and circulation. This is quite different from the mainstream culture based on Confucianism, which ranks merchants last behind intellectuals, farmers, craftsmen and soldiers. Many local scholars believe that the Yongjia School has had a profound impact on Wenhounese thinking and behaviour and continues to do so even today." Compare this with Wang Gungwu's explanation, at note 15.

28. For a historical account of various trade diasporas in world history, see Curtin (1984). For a discussions of the concept of "diaspora," see Kokot *et al*. (2004, 2012).
29. The reader may wish to compare my NIE/transaction cost theory of Chinese middleman success with, for example, descriptive explanations offered by historian Wang Gangwu (1991, ch. 10), economist Thomas Sowell (1994), sociologist Edna Bonacich (1973), and the so-called culturalist/Confucian values explanation of Chinese merchant success. See Rupert Hodder's (1996) critique of the "culturalist/Confucian" explanations of Chinese merchant success. My theory of Chinese merchant success while emphasizing the importance of informal norms (Confucian ethics), is a broadly-based *economic* theory and hence my theory does not fall under the rubric of non-economic "culturalist/Confucian" explainations of Chinese merchant success.

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PART II
Empirical Studies of Chinese Mutual Aid (*Pang* 帮) and Economic Organizations in Singapore and Malaysia

Chapter 2
Chinese Mutual Aid (*PANG* 帮) and Economic Organizations: General Background

1 Introduction

Large-scale Chinese immigration into British Malaya[1] (see also Appendix A. Map of British Malaya) in response to the development of rubber industry in the late nineteenth and early twentieth century created a plural society: the Europeans were the exporters of rubber, the Malays were the producers of smallholders' rubber, and the Chinese were the middlemen who linked Malay producers with the Europeans in the export sector. While it is known that Malaya exhibits the classical features of a Furnivallian plural society, it is less well known that the Chinese community itself forms a plural society within the wider plural society. For example, the *Teochews* dominated the production and marketing of pepper and gambier in the mid-nineteenth century; the *Hokkiens* dominate the marketing of smallholders' rubber (including the export of smallholders' rubber) in the second half of the twentieth century, and the *Hakkas* dominate the pawnshops and Chinese medicinal shops.

An adequate economic theory of the ethnically-homogeneous Chinese middleman group should be able to provide an explanation not only of the wider phenomenon of the plural society in Malaya, but also the empirical reality of the Chinese plural society. But this theoretical understanding is not possible without first grasping the basic fact that the Chinese plural society itself is a manifestation of the Chinese mutual aid (*pang* 帮) system as it

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evolved in Malaya. Basic knowledge of the nature and functions of the Chinese *pang* system is therefore required.

Section 2 will describe the Chinese kinship system in traditional China, and the *pang* system as it evolved in Malaya. Section 3 will describe the Chinese *pang* system, as it manifests itself in the numerous mutual aid associations, in terms of Chinese social organizations. Section 4 will describe the Chinese *pang* system, as it manifests itself in the homogeneous social groups that exist within Chinese firms and across markets, in terms of Chinese economic organizations. Section 5 will provide some concluding remarks.

2 The Chinese kinship and *pang* (mutual aid 帮) system

2.1 The Chinese kinship system in traditional China

There is a very close relationship between the Chinese kinship system of "traditional" China[2] and the overseas Chinese *pang* (mutual aid) system; the latter evolved out of the former in response to local conditions. An understanding of the nature of Chinese kinship system in traditional China will greatly help in understanding the overseas Chinese *pang* system.

Many villages in Fukien (Fujian) and Kwangtung provinces in traditional Southeast China were homogeneous *single-surname* communities composed of large common descent groups of *patrilineally-related* families who traced their descent from one common ancestor. These single surname communities were called *lineage organizations*.[3] The lineage organizations owned certain communal property such as ancestral temples, ancestral graveyards, and performed social welfare, ancestral, ritual, jural and political functions. The single-lineage community was thereby a *corporate group*, i.e. a group which endures over time despite changing membership, has internal organization and leadership and its members have rights and duties. The fact that a single-surname group was not localized in one village, but was spread over several villages or even in another province means that these single-lineage communities were only *localized lineages*. If localized lineages acted independently of each other, then the whole surname group formed only a loosely structured organization called a *clan*. A clan was not a political unit. Its primary function was to define the exogamous unit (i.e. the unit within which members of the same clan cannot inter-marry). If, on the other hand, localized lineages combined to form a political unit for joint action (e.g. for defense), they were once more transformed into a lineage, although this time, a *higher-order lineage*.

The Chinese *nuclear family*,[4] the smallest kinship unit in a system of kinship units, was the basic Chinese institution in traditional China. It was the basic unit for procreation. It was also the basic economic unit for production and consumption. The traditional Chinese economy was overwhelming a peasant economy. The peasantry, forming more than eighty percent or more of the Chinese population, was divided into family units that carried self-sufficiency in both production and consumption to considerable lengths. Ownership of land was of crucial importance to the Chinese family since only through ownership could a peasant assure that he and his family could operate as an economic unit. Except for certain personal property, everything in a family farm was owned in common by the family as a whole. The family members, rather than outsiders, produce collectively for the family. All income produced by family members was pooled and distributed by the head of the household, usually the father. Beyond the Chinese nuclear family, was the *joint family*, the most prevalent and most important kind of extended family. The joint family was not universal in traditional Chinese society but was found only in the gentry class.

The Chinese kinship system or structure can, thus, be viewed in terms of a series of concentric circles with ever-widening kinship links and kinship units: the *nuclear family* at the center, then the *joint family*, then the component families making up the *lineage*, and finally the whole surname group making up the *clan*. Each kinship unit had its own specialized function or functions to perform. In order that the kinship system maintain itself and function effectively as a system or an organized whole, there must be institutions whose primary function is to regulate behavior of members within kinship units and the relations among them.

In traditional China, the institution existed in the *Confucian code of ethics*. The central core of Confucian ethics is the principle of *reciprocity* (*pao* 报) as an important basis for social relations among kinsmen (Yang 1957). All members of the Chinese kinship structure were bound by complex privileges, duties, and obligations to give and receive aid. And because of the all importance of the family as the basic economic organization in traditional China, it was necessary that the family functions as a highly cohesive and organized work group to ensure that family requirements could be met by its own family workers. The Confucian code of ethics ensured this by *prescribing differences in the degree of obligations for mutual aid among the various categories of kin*. An individual's obligations, loyalty and solidarity, were first and foremost to his own family, and were expressed in the content of two strategic family relationships: filial piety of son to father, and of solidarity and mutual aid between brothers. Even though the head of the household was invested with great powers and authority to use force to make members comply with his orders, a great part of the compliance and cooperation of family members was achieved by filial piety.[5] Beyond one's own family, loyalty was extended to kinsmen of the lineage, and finally to one's own clan. *The Confucian code of ethics constituted the rules of behavior, rules which were strongly institutionalized in traditional China*. Traditional Chinese society, with members functioning within a well-defined kinship-oriented social structure, was characterized by the following features:

(a) a predominantly *particularistic*[6] structure of social and economic relationships;
(b) the *prevalence of feuds* between different lineages, especially in Fukien and Kwangtung where lineage organizations developed in its full-blown form;
(c) the *stability* of kin groupings based upon the *patrilineal* kinship system which, unlike the *bilateral* kinship system, provides an *invariant* group membership because the individual cannot work out alternative coalition alignments with his mother's kin group[7]; and
(d) the relative *unimportance of the dialect/ethnic* principle as a basis for social and economic organization even though Southeast China, unlike North China, is characterized by a wide diversity of different spoken dialects.[8]

2.2 Overseas Chinese *Pang* system in Malaya and Singapore

How did the overseas Chinese *pang* system evolve out of the traditional Chinese kinship system? Chinese immigrants, mostly male adults from the villages of Fukien and Kwangtung provinces, came to Malaya and Singapore in the nineteenth century in search of livelihood. For much of the nineteenth century, in the pioneer phases of overseas immigration, they had to organize all the social, political and economic functions for themselves because of: (a) the policy of non-intervention adopted by the British colonial administrators toward the immigrants[9]; and (b) the inadequacy of the infrastructure within which they had to operate. In this task of fending for themselves, the Chinese had to club together. The homeland institutions, which promoted mutual aid and solidarity among kinsmen and clansmen, were not barriers but advantages in the process of adaptation to the new environment which included new ethnic groups (Europeans, Indians and Malays).

In an immigrant community, however, an overseas Chinese cannot always find himself in the company of his kinsmen or clansmen. Consequently, in addition to kinship/clanship bonds, new *territorial* bonds were created. Chinese immigrants from the same village or from the same county in China, tended to group together for mutual aid because they recognized a common bond in coming from the same locality or neighborhood in China. Furthermore, in an overseas Chinese community composed of immigrants who spoke mutually unintelligible dialects, the overseas Chinese also began to identify themselves on a speech (ethnic) basis (Crissman 1957; Suyama 1962). Therefore, when wider groupings for mutual aid were needed, bonds of solidarity were extended to those who spoke the same language. A wider ethnically-homogeneous community for mutual aid and cooperation, beyond the kinship group, was evolved. Within the wider ethnic community, an individual's loyalty was first and foremost to his family members; loyalty was then extended to fellow-clansmen, fellow-villagers, and finally to members of his own ethnic group. Ethnicity became the major structural principle which segmented the whole Chinese community in Singapore and Malaya into five major distinct and separate Chinese ethnic/dialect communities—Hokkien, Teochew, Cantonese, Hakka, and Hainanese. See Appendix B. The Chinese call these five ethnic/dialect communities the *Wu Pang* (五帮), and this itself is indicative of the Chinese awareness of the separateness of the different Chinese ethnic communities, on the one hand, and the ethnic solidarity of members within each ethnic community or *Pang*,[10] on the other.

The ethnic boundary typically defines the limits of cooperation for members of the group. That is, an ethnic community is typically the constituency for its mutual aid associations, and for the formation of economic relationships with various cooperating partners (e.g. partners of a firm, as employees of a firm, as trading partners, as debtors), as shall be seen below.The Chinese *pang* system can be thought of as: (a) Social organizations: interlocking systems of mutual aid associations; and (b) Economic organizations: homogeneous social groups that exist within firms and across markets. Each of the aspects of the Chinese *pang* system will be discussed in turn.

3 The Chinese *Pang* system as social organizations

By far, the most significant Chinese voluntary associations in nineteenth-century Malaya were the secret societies (Blythe 1969). These secret societies flourished in Malaya as instruments of political control and courts of law within the Chinese society. The disorder caused by fights between different secret societies of different Chinese communities, particularly in the tin-mining communities in Perak and Selangor, finally led to the British government adopting a policy of suppression of secret societies between 1887–1890.

Chinese mutual aid associations began their phase of rapid development only after the secret societies were suppressed. These associations, taken collectively, are known as *Pang Hui* (帮会). The following discussion of Chinese mutual aid associations in Malaya will be limited to Singapore only: that city with a predominately Chinese population had at least 900 associations in 1959.[11] They can be classified into the following categories: (a) Locality Associations: dialect-locality associations, county associations, and village associations; (b) Clan associations: dialect-clan associations and village-clan associations; and (c) Guilds or trade associations.

In general, the functions of the mutual aid associations include the promotion of good feelings (*ganching* 感情) and mutual help among members and the provision of social welfare services. Many of these associations also conduct ceremonial and ancestor worship at graveyards on appropriate occasions, usually at *Ch'ing Ming* (清明) festival. The specific functions of the guilds include maintaining prices, discouraging competition, standardizing goods, and settling disputes within the guild and between guild members often by the use of arbitration. The dialect-locality association is the ethnic community's apex organization. It arbitrates disputes among members and establishes schools and offer scholarships for the children of poorer members of the community. Chinese leadership of the various Chinese ethnic communities is embodied in the office bearers of dialect-locality associations. For example, to become a leader of the Hokkien community in Singapore, the individual must be an office-bearer of the community's apex organization, the *Singapore Hokkien Huay Kuan* (新加坡福建会馆). To become an office-bearer of the apex organization, the individual must be a wealthy businessman. Business entrepreneurship and community leadership are inextricably intertwined.[12] Furthermore, a leader of the Hokkien community usually holds a number of offices in a guild, county or a village-clan association. The various associations are interconnected through a network of interlocking office-bearers to form channels of communication and influence that knit the Hokkien community into a cohesive community vis-à-vis other Chinese communities. The system of interlocking mutual aid associations taken together provides the overall political structure for the community. The various Chinese ethnic communities, in turn, are knitted together into a cohesive Chinese community with the *Singapore Chinese Chamber of Commerce* (SCCC), established in 1906, at the apex of the Chinese associational structure. Leaders of the Chinese ethnic communities are represented in the SCCC working committee, representation being proportional to the number of the business members of the various *Pangs* represented in the SCCC; the Hokkiens are the most numerous and thus the Hokkien *Pang* dominate the SCCC in power and influence. The SCCC leaders, themselves the leaders of the various Chinese ethnic communities also become the leaders of the Singapore Chinese community as a whole.[13] The functions of the SCCC include: (a) improving and developing the commercial activities of Chinese businessmen; (b) arbitrating disputes among Chinese businessmen and between parties affected by business failures; (c) conducting statistical surveys and compilation of statistics on commerce and industry and publication in a journal.[14] Chinese society in Singapore can be thought of in terms of five discrete ethnic groups, each with its own political structure. The SCCC integrates the five different ethnic communities to form a united Chinese business community vis-à-vis non-Chinese business communities in Singapore. From the discussion of the Chinese mutual aid system as a set of social organizations, it is clear that each of the five different Chinese ethnic communities is to be seen as a corporate group. Furthermore, the Chinese community, as a whole, is also to be viewed as a corporate group vis-à-vis non-Chinese communities. The Chinese in Cambodia and elsewhere in Southeast Asia, as William Willmott (1967, p. 92) correctly pointed out, "... cannot be seen merely as a conglomeration of individuals. The community exhibits organization that limits and directs individual behavior in various spheres." Because of this, Willmott (pp. 92–93) suggested a revision of J.S. Furnivall's (1948) concept of "plural society" to take account of the realities of the Chinese communities in Southeast Asia:

> Furnivall's original conception of the plural society explicitly rejected the idea of each ethnic segment itself exhibiting a social structure. He painted a picture of a society in which, because of the ethnic divisions, all relationships were economic, where individuals did not feel community loyalties that might mitigate against economic self-interest. When one introduces the idea that each ethnic segment is itself internally organized, with a class hierarchy, a political structure, and organized expressions of solidarity, then the concept of plural society can be revised to bring it more in line with what was and is the situation in Southeast Asia.

Willmott's suggestion for revision of the concept of plural society is important because of the recognition of the existence of social structure and loyalty of members within each Chinese ethnic group. The existence of social structure is manifested in the numerous mutual aid associations within each Chinese ethnic community. It is also reflected in the *particularistic* economic relationships that exist within Chinese firms and between

Chinese firms; this latter aspect of Chinese mutual aid system, as *Chinese economic organizations*, will be discussed below.

4 The Chinese *pang* system as economic organizations[15]

Economic cooperation among Chinese manifests itself in a less obvious, but more fundamental form: in the *particularistic economic relationships that occur in Chinese economic* organizations.[16] Since the characteristic of particularism in economic relationships is empirical in nature, it can be factually investigated and hence either confirmed or refuted. If the empirical reality is confirmed, it would appear that the forms which occur in Chinese economic organizations are "peculiar" to students of Western economic organizations and require some explanation (i.e. to ascertain their functions). The study of the structure and functions of Chinese economic organizations, then, becomes crucial to the understanding of the nature and decisive functions of the Chinese mutual aid system.

The empirical task of investigating the structure and functions of Chinese economic organizations in several widely different contexts is therefore needed. In order to carry out this task, decisions must be made on the relevant sets of social structures to be included. Clearly, the most obvious sets of social structures must be included; these are discussed in the headings of the following sub-sections 4.1, 4.2 and 4.3.

4.1 Within firms

4.1.1 Chinese business partnerships

Chinese business partnerships typically occur among family members, close relatives or close friends.[17] The primary reason for the choice of family partnerships, when the partnership form of organization is chosen, has to do with the problem of organization of the relations of mutual trust among partners. This is because the structure of ownership creates some difficulties under the law of partnership whereby partners are liable for business debts up to the limits of their financial liability. A firm may cease to operate because of a dishonest partner; partners, therefore, must be chosen carefully. Furthermore, there is the possibility of a partner shirking. Because of the existence of the Confucian code of loyalty and mutual trust between individuals with particularistic ties, Chinese family partnerships or partnerships between close friends are "self-monitoring partnerships" (Alchian and

Demsetz 1972, p. 790) which not only reduce the risks of failure of partnerships but also the costs of organization and of monitoring the behavior of partners.

Pawnshop partnerships are chiefly of interest here, because they illustrate in a dramatic way the problem of organization of the relations of mutual trust among partners. Cheah Kam Ooi (1965, chapter 5) describes pawnship partnerships in a particular context where individual partners have shares in two or three pawnshops in Singapore and Malaya:

> These kinds of partners would not feel safe unless one of their own people whom they trust is there to supervise business in another part of the city or in the Federation. Therefore, each partner will attempt to recruit an assistant closely related to him or at least one from the same neighborhood or village in China to work in a new shop. Hence, if a new pawnshop started with two partners and they are normally people of the same origin (same district in China), each will try to recruit employees as closely related to him as possible; the order would be from one's own relative to the same village and then to the same neighbourhood. If two partners are from different villages, they would find employees (assistants) from two different villages or neighbourhoods… it is a common presumption that in this way no one particular partner can easily misappropriate the whole of business by some foul means. The quota of employees of each individual partner is equal—either two or two or four and four, or more if needed but very seldom an odd number.

In the setting described by Cheah Kam Ooi, self-monitoring partnerships alone are not sufficient to ensure honesty of partners and must be supplemented by other monitoring devices such as employee monitoring of partners and by a quota system, involving an *even* number of employees, which can be interpreted as a stabilizing device to reduce the risks of a majority forming a coalition to defraud the minority. But since costs must be incurred to monitor partners by the use of additional devices, this might help to explain why half of the pawnshops in Singapore in 1969 were organized as sole proprietorships and half were organized as partnerships, with the *Lam* (蓝) clan dominating the *Tai-pu* Hakka pawnshop business.[18]

This may also explain the pre-dominance of Chinese sole proprietorships and partnerships in Malaya in 1954.[19] By the same token, it may also explain why the corporate form is seldom used by Chinese businessmen: the impersonal joint-stock company is apt to be unworkable because management has no compelling reason for honesty towards it shareholders. Thus there are economic advantages in choosing the family partnership and sole proprietorship forms of organization of the firm. This is especially true in an environment where the legal framework is not fully-developed so that shareholders cannot always be legally assured of protection via fraud, embezzlement and other laws. The major offsetting disadvantage, of course, is that these two traditional forms of organization of Chinese firms, as a rule, remain small-scale business concerns, because of the inevitable emphasis on internal financing; important economies of integration and scale may, therefore, remain unexploited.

4.1.2 Employer-employee relationships

A number of studies of Chinese firms in Singapore and Malaya reveals that Chinese employers exhibit strong preferences for recruiting employees from the following categories, ranked in descending order of preference (Goh Joon Hai 1962, chap. 5; Tan Tin Seng 1966; Chen Lean Kiow 1967/68): (a) family members and relatives; (b) people from the same village or neighborhood in China; and (c) people belonging to the same ethnic group (Cheah Kam Ooi 1965). As a result of this pattern of recruitment exclusively on a kinship or particularistic basis, small Chinese firms, without exception, employ only family members or relatives; while in most Chinese firms a high percentage of employees consists of family members, relatives, friends and those belonging to the same dialect/ethnic group. A homogeneous employer-employee group reduces the incidence of employee shirking/dishonesty. This is especially important in businesses like pawnshops.

According to Cheah Kam Ooi (1965), there were thirty-nine pawnshops in Singapore in 1965, of which thirty-five were owned by the *Tai-pu Hakka* group. The *Tai-pu* Hakkas employers recruit only Hakkas from *Tai-pu* county (大埔县)—a district of Meizhou, Guangdong Province of China—as their employees. According to another study, the employees of a pawnshop consist of several successive grades: the "first hand" (*tou-shou* 头手) the "second hand" (*erh-shou* 二手), and the apprentice. The most important employee is the *tou-shu* who is responsible for appraising the value of the pawned items. This skill may take ten or twenty years to acquire. But the essential condition for the appointment of an employee to the position of *tou-shou* is that the employee either has a kinship relationship with the employer or he must earn the employer's trust.[20] A trustworthy *tou-shou* reduces the risks of valuable pawned items like diamond rings from being stolen. Pawnshop employers must choose employees whom they can trust and these usually are the employers' relatives. As a pawnbroker puts it:

> A pawnbroker cannot accept a person as an apprentice without somebody introducing or guaranteeing him. This is because distrust of outsiders exist. A pawnbroker, when he takes on an apprentice, already has a clear understanding of his background, behavior and character.[21]

4.1.3 Chinese cooperative loan societies

Known by various names, the Chinese cooperative loan society, also called the *tontine*[22] (in Malaya) is essentially a non-profit credit institution that lends money to members only. The organizer of a *tontine* is typically the person who is in need of financial help. He gathers a group of people, usually ten to twenty members, to form a *tontine*. The members contribute towards a common pool of funds by monthly subscriptions. This common pool of funds can be drawn upon by members in times of need via bidding.[23] Because *tontine* members are not protected by law in Malaya (Gamba 1958), organizers who abscond with members' funds and defaulting members cannot be brought to court. To establish the trust necessary for a *tontine* to function, *tontine* members are typically homogeneous groups built around a kinship nucleus (Gamba 1958; Goh Joon Hai 1962; Goh Peng Wee 1960; Tan Kim Swee 1962). The details of a *tontine* group organized by a Teochew lady teacher in Singapore are shown in Table 2.1.

Table 2.1 A Tontine group organized by a Teochew lady-teacher in Singapore

Amount of Money	Membership	Relationship
$ 100	1	Ego (lady-teacher)
$ 100	2	Husband
$ 100	3	3rd sister
$ 100	4	4th brother
$ 100	5	4th sister
$ 100	6	mother
$ 100	7	Ego's colleague
$ 100	8	Ego's colleague
$ 100	9	Ego's colleague
$ 100	10	6th brother
$ 100	11	4th sister-in-law
$ 100	12	maternal uncle
$ 100	13	mid-wife who attended Ego when children were born
$ 100	14	aunt from native village
$ 100	15	husband's business friend
$ 100	16	husband's business friend
$ 100	17	husband's business friend
$ 100	18	husband's business friend
$ 100	19	husband's business friend
$ 100	20	husband's business friend
—	—	
$2,000	20	

Source: Goh Peng Wee. (1960). *A study of the kinship relations of some Teochew nuclear families in Singapore,* (p. 119). Singapore: B.A. Thesis, Department of Social Studies, University of Singapore.

4.2 Homogeneous social groups across markets

4.2.1 Creditor-debtor relationships between firms: The "comprador" system

The *comprador* system, widespread in nineteenth-century Malaya, was a system whereby Western banks and Agency Houses conducted most of their transactions with members of the Chinese community through Chinese employees called *compradors*.

The primary function of the *comprador* was to guarantee the loan contracts of Chinese borrowers. To protect loan contracts, the *comprador* invariable extended credit to Chinese borrowers on a kinship or particularistic basis.[24]

4.2.2 The indigenous Chinese banking system: Creditor-debtor relationships

Indigenous Chinese commercial banks emerged in Malaya during the first three decades of the twentieth century. The distinctive feature of these local Chinese banks, in the beginning, was that they were organized along ethnic lines: The Cantonese community was served by the Kwong Yik Bank (1903–1912); the Teochew community was served by the Sze Hai Tong Banking and Insurance, Ltd., (1907); and the Hokkien community was served by the Chinese Commercial Bank Ltd. (1912), the Ho Hong Bank (1912), and the Overseas Chinese Bank (1919) which amalgamated in 1932 to form the Overseas Chinese Banking Corporation Ltd.[25] As S. Y. Lee (1967) puts it:

> . . . in the beginning not only the directors and officers but also the customers and depositors were mainly drawn from the same community . . . the loan policies were often based on good faith arising from personal and communal relationships rather than on property or other collaterals for the loan. This type of personal guarantee or trust would not be regarded as a sound banking principle by Western standards, but in the Chinese social setting, family and communal relationships played an important part in credit and finance.

4.3 Homogeneous social groups within production and marketing organizations

4.3.1 The "Kangchu" system in Johore

In nineteenth-century Malaya, gambier and pepper were grown in Singapore and, especially, in Johore. In Johore, the production and marketing of gambier and pepper came within the organizational framework known as the *Kangchu* system (Jackson 1968, chap. 1). The *kangchus* were headman-organizers of the agricultural communities in Johore. They were responsible for collecting taxes for the Malay ruler of Johore, for maintaining law and order of their own communities, and for organizing defense. In the initial stages of opening up the *kangkars* (river valleys), the *kangchus* were also responsible for recruiting labor and for credit-extension to planters. The *kangchus* themselves borrowed money from Singapore planters and traders. In Johore, each *kangkar* contained several plantations; each plantation was worked by a different group of planters and traders; each planter employed about ten laborers. All the planters and laborers in a *kangkar* came under the judicial authority of the *kangchu*.

According to Jackson (1968, p. 12) , over ninety percent of the gambier and pepper planters in Singapore were Teochews. In Johore, Teochews also dominated the pepper and gambier planting both as planters and as laborers.

From Chinese sources, I pieced together a more detailed picture of the degree of social homogeneity of the individuals involved in the production and marketing of gambier and pepper and the concrete relations among individuals of the group. Of the one hundred and thirty eight *kangkars* in Johore, ninety percent were opened up by Teochew *kangchus*; a well-defined group—Teochews with the same surname, Tan, who came from the same district of Kim Sar (金沙) in Teo-Ann (潮安) county of China—dominated *kangchu* roles in Johore.[26]

It appears that many of the *kangchus* in Johore were not the real *kangchus*, but were, in fact, agents or managers of the real *kangchus*; the real *kangchus* were, in most cases, themselves the wealthy Singapore planters and traders. These agents or managers were invariably the relatives of the Singapore *kangchus*.[27] The group involved in the production and marketing of gambier and pepper were organized in a guild (*Kongkek*) established in 1867 in Singapore. Many of the *kangchus* in Johore were also leaders of the Teochew branches of the secret societies. The *kangchu* system, thus reveals itself to have been a more complex system, while the social group involved was a much more close-knit and highly organized system than Jackson had thought. The *kangchu* system was a genuine non-market form of organization which utilized four non-market constraints, in varying degrees of coerciveness—kinship, ethnicity, the guild and secret society leadership—for the organization of behavior. As a result, the agricultural communities in Johore were peaceful and orderly. The *kangchu* system ended with the decline in the profitability of pepper and gambier planting at the end of the nineteenth century. The "Golden Era" of Teochew *Pang* dominance in wealth and influence in Malaya ended with the structural shift away from pepper and gambier planting to rubber planting. The Hokkiens emerged to dominate the role of middlemen in this important trade and emerged to become the most wealthy and influential Chinese *Pang*.

4.3.2 The "Kapitan China" system in Selangor

An increasing number of Chinese immigrants, attracted by the rich tin deposits, came to Selangor in the mid-nineteenth century. By 1870s many Chinese tin mining communities had been established; the most important being at Kanching, Ampang and at Kuala Lumpur. The Chinese tin mining communities were highly homogeneous communities dominated by the Hakka and Cantonese groups. In Kanching, for example, the tin miners and laborers were mainly *Kah Yeng Chew* Hakkas (i.e. Hakkas from the district of *Kah Yeng Chew* in China), while those in Kuala Lumpur were mainly *Fuichew* Hakkas. The tin-mining communities were governed by their own headmen, called *Kapitan China*, with duties and privileges very similar to the *kangchus* in Johore; the most famous Kapitan China in Selangor was Yap Ah Loy of Kuala Lumpur.[28]

The existence of a highly homogeneous community of *Fuichew* Hakkas in Kuala Lumpur under Yap Ah Loy contributed much to the peaceful conditions prevailing in the tin mines. Furthermore, Yap Ah Loy kept law and order with the help of his right hand man and clansman, Yap Ah Shak, who was the leader of the Hai San secret society in Selangor. Unlike the Teochew agricultural communities in Johore, however, the history of tin mining communities in Selangor was inseparable from the disorder resulting from fighting between the *Kah Yeng Chew* Hakkas and the *Fuichew* Hakkas over the exclusive control of mining fields. The fighting was intensified by the fact that Hakkas, unlike other Chinese ethnic groups, do not cooperate on a pan-Hakka basis but cooperate on a narrower basis, according to the place of origin. Thus Hakkas from different place of origin in China not only formed separate mining communities but also joined different secret societies: the *Fuichew* Hakkas belonged to the Hai San secret society, while the *Kah Yeng Chew* Hakkas belonged to the Ghee Hin secret society.

The fights between the two factions of the Hakka community were exacerbated by political unrest among the Malay aristocracy fighting for the right to be chief, in order to collect export duty on tin and enlisting the help of the two different Hakka factions. Civil war broke out in 1867 and created such chaotic conditions that all mining activities were severely affected. The anarchistic conditions finally ended when the British government intervened to restore law and order in Selangor by introducing the British Residential system in 1894.

5 Concluding remarks

The investigation of the structure of Chinese economic organizations in widely different contexts in Singapore and Malaya reveals that the hallmark of Chinese economic organization lies in the *particularism* in economic relationships, as manifested in homogeneous Chinese social groups existing within firms and across markets. The particularism of economic relationships was a conscious effort by Chinese in Singapore and Malaya to elicit reciprocity and mutual aid, based on Confucian code of ethics, so as to reduce non-cooperative behavior such as fraud, shirking, stealing etc. It is the particularism in Chinese economic relationships that distinguish *Chinese* form of economic organizations from *Western* economic organizations which rely on formal contracts—between employers and employees within firms, and between firms across markets—for monitoring and coordinating behavior.

In the next chapter, we will describe the results of my fieldwork on the marketing of smallholders' rubber by Hokkien merchants in Malaysia and Singapore in 1969, and the various mutual aid arrangements they made among themselves to facilitate them in their middleman-entrepreneurial roles

Appendix A. Map of British Malaya

Source: Charles Hirschman (1986). "The Making of Race in Colonial Malaya: Political Economy and Racial Ideology," *Sociological Forum*, 1(2), p. 335.

Appendix B. Chinese Ethnic/Dialect Communities in Singapore & Malaya, 1947 and 1957

Table 1 **Chinese Ethnic/Dialect Communities in Singapore, 1947 and 1957**

Specific Community	1947 No.	1947 %	1957 No.	1957 %	Percentage Increase 1957 over 1947
Hokkien	289,109	39.6	442,707	40.6	53.1
Teochew	157,186	21.6	245,190	22.5	56.0
Cantonese	157,598	21.6	205,773	18.9	30.6
Hainanese	52,117	7.1	78,081	7.2	49.8
Hakka (Kheh)	39,988	5.5	73,072	6.7	82.7
Foochow (Hokchia)	9,461	1.3	16,828	1.5	77.9
Henghua	7,445	1.0	8,757	0.8	17.6
Hokchia	6,323	0.9	7,614	0.7	20.4
Kwongsai	681	0.1	292	—	-57.1
Shanghainese	n.a.	—	11,034	1.0	
Others	9,564	1.3	1,248	0.1	28.4
All Communities	729,473	100	1,090,596	100	49.5

Source: S.C. Chua. (1964). *Report on the Census of Population 1957* (p. 68). Singapore: Lim Bian Han, Government Printer.

Table 2 **Chinese Ethnic/Dialect Communities in Malaya, 1947 and 1957**

Specific Community	1947 No. thousands	1947 %	1957 No. thousands	1957 %
Hokkien	538.2	28.6	740.6	31.7
Hakka (Khek)	397.4	21.1	508.8	21.8
Cantonese	484.0	25.7	505.2	21.7
Tiechieu (Teochew)	207.0	11.0	283.1	12.1
Hainanese	105.5	5.6	123.8	5.3
Kwongsai	71.1	3.8	69.1	3.0
Hockchiu	38.6	2.0	46.1	2.0
Henghua	9.6	0.5	11.9	0.5
Hokchia	6.4	0.3	9.8	0.4
Other	26.7	1.4	34.3	1.5
Total	1,884.5	100	2,333.8	100

Source: H. Fell. (1960). 1957 Population Census of the Federation of Malaya, Report No. 14 (p. 14). Kuala Lumpur: Department of Statistics, Federation of Malaya.

Endnotes

1. *British Malay* refer to the period when the *Malaya Peninsula* came under British colonial rule (1874–1946). *The Malay Peninsula* comprised the *Straits Settlements* (Singapore, Malacca, and Penang), the *Federated Malay States* (Selangor, Perak, Negeri Sembilan, and Pahang) and the *Unfederated Malay States* (Perlis, Kedah, Kelantan, Terengganu, and Johore). The *Malaya Union* was formed in 1946, with Penang and Malacca grouped with the Federated Malay States and the Unfederated Malay States. It was replaced by the *Federation of Malaya* in 1948. Federation of Malay achieved independence on 31 August 1957. On 16 September 1963, the Federation merged with Sabah and Sarawak on the island of Borneo and became *Malaysia*; Singapore became part of Malaysia. Following the expulsion of Singapore from Malaysia on 9 August 1965, Singapore gained its independence and became the *Republic of Singapore* (1965-present).
2. The term "traditional" is used in the sense defined by Marion J. Levy, Jr.(1968, p. 41): "The term 'traditional' applies to those institutional patterns which for the most part trace their pedigree with remarkably slight change well back into Chinese history, sometimes going as far back as the Han emperors (206 B.C.–220 A.D.) ... [and] those prevalent in the Ch'ing dynasty (1644 A.D.–1911 A.D.) which immediately preceded the present Republic of China."
3. The discussion of Chinese lineage organizations is based on Maurice Freedman (1966, Chapter 1).
4. The discussion of the Chinese family system is based on Marion J. Levy, Jr. (1968 Chapters 1 and 5).
5. For a discussion of the family unit as the basic unit of kinship solidarity in traditional Chinese society in which overwhelming emphasis was on the loyalty of family members to one another, see Marion J. Levy Jr. (1968, Chapters 4 and 5).
6. The term "particularistic" is used throughout the chapter in the manner defined by sociologist Talcott Parsons (1958, p. 11) as follows: "The standards and criterion which are independent of the particular social relationship to a particular person may be called universalistic, those which apply by virtue of such relationship, are particularistic."
7. For a discussion of the different effects of a patrilineal kinship system and a bilateral kinship system on the stability of kin groupings, see T. R. McHale (1960).
8. For a discussion of the Chinese language and the great diversity of spoken dialects in Southeast China, see William S-Y Wang (1973).
9. For a brief account of British rule in Malaya in the pioneering phases of Chinese immigration to Malaya, see, for example, Wilfred Blythe (1969).
10. Strictly speaking, there are six "Pangs." The Hakka community, unlike the other Chinese communities, do not cooperate on a pan-Hakka basis but forms

separate *Pangs* according to the place of origin. In the Singapore Chinese Chamber of Commerce, for example, the Hakka community is represented by two "Pangs": the *Tai-pu Pang* and the *Mei-hsien Pang*. I thank Mr. Tan Yeok Seong, Vice Chairman of the South Seas Society, for pointing this out to me in a personal interview conducted in Singapore, 1969.

11. For a discussion of Chinese mutual aid associations, see Charles Gamba (1966).
12. For a discussion of the relationship between business entrepreneurship and leadership community in Singapore, see Yong Chin Fatt (1968).
13. For a discussion of the background of the SCCC leaders between 1900–1941, see Yong Chin Fatt (1968).
14. For a discussion of the history and the functions of the SCCC, see Lawrence Mani (1964, pp. 67–138).
15. This section is a revised version of a paper presented at the Public Choice Society Annual Meetings in New Orleans, La. March 13, 1977, at the session "Ethnic Groups, Identity Groups and Public Choice," chaired by Janet Landa.
16. A group of anthropologists and sinologists, studying various aspects of Chinese economic organization in Chinese society, point to the *particularism* in economic relationships as the essence of *Chinese* economic organization. See William. E. Willmott (Ed.). (1972).
17. See the various biographies of Chinese businessmen in Song Ong Siang (1967). See also Goh Hoon Hai (1962).
18. Interview with Low Shu Khuan (刘叔宽), an authority on the Singapore Hakka community, Singapore, 2 December, 1969.
19. According to Goh Joon Hai (1962, p. 90), out of the 58,005 Chinese businesses registered in the Federation of Malaya in 1954, 57,096 were sole proprietorships and partnerships, while only 909 were limited liability companies. Limited liability companies accounted for less than two percent of the total figure; of the remainder, about seventy percent were sole proprietorships.
20. See 南大同 学[Nanyang University students] (1971). 新加坡華族行業史調查報告/新加坡华族行业史调查报告[A Report on a Survey of Chinese Businesses in Singapore].
21. *Ibid*., (translation), p. 22.
22. According to Charles Gamba (1958), the name "tontine" is the Westernized term for the Chinese "Wui" or Chinese cooperative loan society; it originated from Lorenzo Tonti—a Neopolitan banker—who in France, circa 1653, initiated a similar scheme to the "Wui."
23. For a description of how the *tontine* system works, see E. W. Jacques (1931); see also Goh Peng Wee (1960).
24. For a discussion of the "comprador" system, see G. C. Allen and Audrey G. Donnithorne (1957, pp. 205–208); Thomas Rawski (1970).
25. For a detailed discussion of indigenous Chinese banks in Malaya, see Tan Ee-Leong (1953). The Hakka community did not have their own bank until the Chung Khiaw Bank Ltd. was established in 1950.

26. From my analysis of the biographies of the *kanchus* in Johore in 潘醒農 [Phua Chye Long], (Ed.) (1950), pp. 216–232.
27. See Hsu Yun-Ts'iao [許雲樵] (1961).
28. The discussion is based on S. M. Middlebrook (completed by J. M. Gullick) (1951).

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Chapter 3
Marketing of Pontian Smallholders' Rubber: Mutual Aid Arrangements Among Hokkien Dealers

1 Introduction

This chapter will describe the marketing of Pontian smallholders' rubber through the various levels of middlemen, and the mutual aid arrangements among Hokkien dealers to facilitate them in their middleman roles. Section 2 will provide the background for understanding the Chinese middleman system involved in the marketing of smallholders' rubber in Singapore and West Malaysia.[1] Section 3 will describe the organization of the marketing of Pontian smallholders' rubber, paying special attention to the functional specialization and division of labor among the various levels of middlemen. Section 4 will describe the various forms of mutual aid arrangements Hokkien dealers made among themselves for the organization of: (a) contract-protection; (b) acquisition and transmission of price and non-price information; (c) credit; and (d) debt settlement. Section 5 will provide a summary of ten case studies of successful rubber dealing firms that began as small firms and expanded into large firms. The case studies provide insights into the dynamics of Chinese firm expansion, the patterns of integration, as well as further insights into forms of Chinese mutual aid. My concluding remarks are contained in Section 6.

The materials presented in sections 3 to 5 are based mainly on my fieldwork data which I gathered from a survey questionnaire of a sample of rubber dealers in Singapore and West Malaysia in 1969, supplemented

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by depth interviews with various prominent members of the Chinese community, together with a questionnaire survey of some aspects of Malay smallholders' rubber in Pontian district, Johore.[2]

2 Marketing of smallholders' rubber in Singapore and West Malaysia: Background

West Malaysia (Peninsula Malaysia) has an economic structure built on the production of primary raw materials for export. The important exports are rubber and tin. Singapore, on the other hand, is primarily a trading intermediary, earning her living in trade, commerce and ancillary services such as banking, insurance, and shipping. As a trading intermediary, Singapore performs the function of transmitting the flow of primary products from countries in the Southeast Asian region to buyers outside the region, exchanging them for manufactured goods which are, in turn, distributed to countries within the region. The economy of West Malaysia and Singapore, taken as one economic entity, with heavy dependence on a few export staples and on imported manufactures from industrial countries, exhibits the characteristic feature of a dual economy.

Of the two major exports, rubber has been the single most important source of the Malaysian national income.[3] Internationally, West Malaysia is the world's largest producer of natural rubber, supplying 923,300 tons or 37.8 percent of the total world production of about 2.4 million tons in 1967.[4] Practically all of the Malaysian output is exported via the ports of Penang, Malacca and especially Singapore. The largest buyers are the Soviet Union, United States, Eastern Europe, United Kingdom, West Germany, and Japan.

The smallholder rubber is an important component of the Malaysian rubber industry. Approximately 67 percent of the estimated total of 6.4 million acres of cultivated areas were under rubber in 1967.[5] Of the total rubber acreage, smallholdings (i.e. holdings of less than 100 acres) accounted for about 60 percent[6] while estates accounted for about 40 percent. In terms of output, smallholdings accounted for about 43 percent of the total output.[7]

On ethnic structure, Malays were the most important participants in the smallholders' rubber industry. Malays owned 47.3 percent of the smallholdings, Chinese owned 40.1 percent and Indians owned 8.7 percent.[8] Malay smallholdings, however, were small compared to Chinese or Indian smallholdings: 41 percent of Malay smallholdings in 1960 were below three acres each; 46 percent ranged from 3–10 acres in size.[9]

Unlike the marketing of estate rubber, which involves direct marketing to overseas buyers, smallholders' rubber is marketed via the indirect system of marketing via middlemen. The broad features of the middleman system of marketing smallholders' rubber are well known.[10] The central marketing institutions involved in the marketing process are a group of rubber dealing firms. They function as the middlemen between smallholders and the ultimate overseas buyers in the marketing process. They operate as village dealers, town dealers, and packer-exporters. The members of the middlemen group are arranged in a hierarchy with division of labor among the different levels of middlemen. Village-dealers (first-level dealers), by far the most numerous, buy rubber sheets from smallholders, grade and sell them to town dealers. Town-dealers (second-level dealers), the next largest group, process and smoke the rubber prior to resale to packer-exporters. Packer-exporters (third-level dealers), at the apex of the hierarchy and located in towns or ports (Kuala Lumpur, Penang, Malacca and Singapore) sort, re-grade, and pack the rubber into bales for export to buyers overseas. In addition to this group, there are the re-millers and the commission agents. The re-millers, located in big towns, buy scrap and cuplump and manufacture this material into crepe. The commission agents, located in Penang, Malacca and Singapore, act only as representatives of their clients. They do not take title to, and therefore do not own, the products they handle. Unlike the other rubber dealers whose incomes are derived from the profit margin between buying and selling prices, the commission agent receive his income in the form of a commission, which is usually 1–2 percent of the value of transactions.

As participants in the marketing of smallholders' rubber, the middlemen occupy an important economic position in the economy of Singapore and West Malaysia. How large is the group of middlemen and who are they? There were a total of 2,240 licensed dealers operating in West Malaysia in 1967.[11] Of these, approximately 1,500 or 67 percent were estimated to be village dealers, about 667 or 30 percent were estimated to be town dealers, and about 63 or 3 percent were large-scale packer-exporters. Of the estimated 1,500 village dealers, about 800 were very small-scale Malay dealers who were concentrated in four states—Kedah, Perak, Kelantan, and Terengganu. Most of the town dealers and exporters were Chinese. See Appendix A. In Singapore, there were at least seventy-two rubber-dealing firms in 1969. Of these, at least thirty-seven packing-exporting firms, including the three largest, were Chinese-owned.[12] The Chinese in Singapore and West Malaysia, by virtue of their monopolization of town-dealer and exporter roles, dominate the trade in smallholders' rubber.

The Chinese dominance of the marketing of smallholders' rubber, however, is a relatively recent phenomenon. According to James Putchucheary (1960, pp. 130–131):

> In 1956 there were altogether about 2,500 licensed dealers in the Federation of whom 79 were Europeans, 600 were Malays and the rest Chinese. The proportions indicated by these figures are not a picture of the division of trade. The structure of the trade is some sort of a pyramid with all the 79 European dealers and some Chinese dealers on the top. Most of the Chinese and probably all the Malays operate near the base of the pyramid and collect for those on the top.

Thus in 1956, the ethnic structure of the smallholders' rubber trade provides an example par excellence of Furnivall's "plural society." Sometime between 1956 and 1969, however, the Chinese emerged to become the dominant group at the exporter-packer level as well. One explanation for the change in the ethnic structure of the smallholders' rubber trade is that many second-level Chinese rubber dealers were able to make enormous profits during the Korean war boom, 1950–1951, and were able to establish packing-exporting firms. The three largest Chinese exporter firms in Singapore and West Malaysia, with their many branch firms, emerged during the Korean boom. Once Chinese emerged in the role of packer-exporter, it appeared that Chinese second-level dealers switched from a European-Chinese trade network, to an all-Chinese trade network, by-passing the European packers.

A closer analysis of the Chinese middleman group involved in the marketing of smallholders' rubber reveals a tightly-knit socially homogenous group of *Hokkien* Chinese rubber dealers dominated by six clans—Tan, Lee, Ng, Teh, Lim and the Gan clans—from Chuan-chow and Yung-chun counties in Fukien province. See Appendix B.

Hokkien rubber dealers face four major problems:

(1) The problem of price-uncertainty. In periods of violent price fluctuations, fortunes have been made and lost. A dramatic example of great fortunes being lost in this manner is provided by the collapse of "Rubber King" Tan Kah Kee's *Khiam Aik Company* in 1934 caused, in part, by insolvency, which, in turn, was caused by the drastic fall in rubber prices in the 1930s.[13] See Chapter 11 in this book.

(2) The threat of elimination of village dealers. The establishment of Group Processing Centers (GPC) threatens to eliminate village dealers. These GPC were established with the aim of remedying the so-called "monopsonistic exploitation"of Malay smallholders by Chinese middlemen. The GPC buy latex from smallholders and process it into smoke sheet, which when sold loose to large dealers, by-pass village dealers.[14]

(3) The threat of central marketing organizations to replace the present private network of Chinese middlemen. This appears to be a possibility as demand for natural rubber increasingly shifts towards the Sino-Soviet

countries; this may require the Singapore and West Malaysian governments to establish bilateral trading agreements to trade with these countries.[15]

(4) The threat of increased competition with synthetic rubber that would diminish the demand for natural rubber.

These four problems confronting Hokkiens in their middlemen roles are exogenous factors beyond their control. However, the Hokkiens have been viable in their role as middlemen. What contributes to their viability will be the subject matter of the remaining sections of this chapter.

3 Marketing of Pontian smallholders' rubber: Functional specialization and division of labor among dealers

The empirical materials presented in this section are based on data collected through a questionnaire survey of nineteen Pontian dealers and eight Singapore dealers (six packer-exporting firms and two commission agents). For aspects of my fieldwork, see Appendix C.

Pontian district, one of the eight districts in Johore (the southern-most state in West Malaysia, located north of Singapore) is an important smallholders' rubber producing district.[16] In 1969, there were 49 licensed dealers operating in Pontian, of whom 40 were village dealers, and nine were town dealers. All nine town dealers were Chinese, while at least thirty of the forty village dealers were Chinese. There were no dealers in Pontian that functioned as packers; the bulk of Pontian smallholders' rubber was sold to Singapore packers. A description of the marketing of Pontian smallholders' rubber through the three different levels of the marketing structure—the village dealers, town dealers, and packers—should, therefore, also include the packers in Singapore.

(a) *Pontian village dealers*. All twelve Chinese village dealing firms interviewed were organized as sole-proprietorships.[17] The average size of these firms—measured in annual purchase for 1969—was about 5,210 pickuls per firm (1 pickul = 100 katis or 133 pounds). Only two of the twelve dealers were specialized as rubber-dealers; the other ten dealers combined additional functions: three were grocers, two were suppliers of rice and sugar, three were suppliers of farmers' inputs (fertilizer, formic acid, etc.) and two were pineapple-dealers.

The number of smallholders supplying rubber to village dealers varies greatly. However, on the average, the village dealers interviewed purchased rubber from about eighty suppliers. Additional information from five of the dealers interviewed revealed that these dealers had a high proportion of non-regular customers: three dealers reported 50–80 percent of their total customers were non-regular customers, while two reported 30–50 percent of their total customers were non regular customers.

With a large number of suppliers per dealer, how did village dealers purchase their rubber? Eight dealers purchased rubber in their licensed premises, four dealers purchased rubber in their own shops, as well as sending out lorries to the farms, or to other dealers' private smokehouses where some smallholders had deposited their rubber designated for sale to specific dealers. This means that while the village dealers were responsible for the function of buying and hence of initial assembling rubber from numerous smallholders, the function of transportation of rubber from farms to dealers' premises or smokehouses—points of rubber assembly—was performed mainly by smallholders.

Most of the rubber purchased by the twelve dealers was in the form of unsmoked rubber sheets (USS). The survey of fifty Malay smallholders in Pontian, revealed that the average size of the smallholdings was about 5.9 acres. Each transaction was small, about 30–70 katis of unsmoked rubber. In purchasing rubber from Pontian smallholders, dealers were therefore buying non-standardized rubber so that dealers must estimate its grade in order to determine the price that they were prepared to offer to smallholders.

At the time of purchase, the function of grading of rubber was performed by dealers. There were five different grades of rubber in the form of ribbed smoked rubber sheets (RSS): RSS 1, 2, 3, 4, and 5. The standards were set by the Rubber Association of Singapore that follow closely the standards set by the Rubber Manufactures Association, Inc. (RMA) in the United States. The majority of the twelve dealers interviewed reported that the rubber they purchased was usually assessed as grades 3 and 4. Because of the presence of moisture content, the grading of USS, in contrast to the grading of RSS, was by weight. The weighing instruments used by all twelve dealers were small weighing scales and the "daching" (Chinese steelyard).

Rubber that was purchased was stored as inventories until needed by buyers and also for speculative purposes since there is the possibility of favorable movements in rubber prices. Nine dealers stored their rubber in warehouses behind their shop premises; two dealers stored rubber in rented premises, and the remaining dealers stored rubber in both their shops and rented premises. The majority of the twelve dealers performed the function of storage themselves.

All twelve dealers sold their rubber to one or a few regular buyers: seven dealers sold to only one Pontian town dealer; two sold to two to six Pontian dealers; one dealer sold to a Pontian town dealer and to a dealer in Johore Bahru; and two dealers each sold directly to Singapore buyers. The rubber sold by the twelve dealers was transported by lorries to buyers. However, only six dealers provided their own transportation: four dealers used their own lorries, while two dealers rented lorries for transportation of rubber. The other six dealers—who did not own lorries—depended on their buyer/ buyers to provide the transportation in such circumstances. The buyers provided the transportation free of charge. Incidentally, the six dealers who did not own lorries were among the eight dealers who purchased rubber on their premises. Thus the function of bulking and lorry-transportation of rubber from village dealers to buyers was partly performed by village dealers and partly performed by buyers.

(b) *Pontian town dealers*. The seven second-level firms interviewed, all Hokkien-owned firms, were organized as sole-proprietorships (two firms), as partnerships (three firms) and as private limited companies (two firms). The average size of these firms was about 31,400 pickuls per firm. Thus the second-level dealing firms in Pontian were about six times the size of the village-dealing firms. Of the town dealers, four dealers were specialized in rubber dealing: one dealer was also a supplier of rice and sugar; one dealer was an occasional supplier of farmers' inputs.

Town dealers purchased rubber directly from smallholders as well as from Pontian village dealers. In this respect, they functioned both as first-level and second-level buyers. On the average, Pontian town dealers purchased rubber from about seventy smallholders. However, when a dealer who purchased rubber from three hundred smallholders is omitted, the average per dealer was about thirty smallholders. On the average, each of the Pontian town dealers had about eight village dealers as regular customers. In purchasing rubber, four town dealers purchased rubber solely or predominately in their premises; two dealers purchased rubber in the premises as well as purchasing rubber at the farms; only one dealer purchased rubber solely at the farms. The rubber purchased by town dealers was usually assessed as grades 2, 3, 4, and 5. Thus compared to village dealers, town dealers purchased more of the better grade of rubber (grade 2) and more of the worst grade (grade 5).

Before resale to Singapore packer-exporters, the town dealers processed and smoked the USS into RSS; on the average each of the two dealers interviewed owned seven smokehouses. Investment in smokehouses ranged from \$4,000–\$6,000 per smokehouse.[18] The smoked rubber sheets remained in storage until needed by packers. The rubber was also stored for speculative purposes. All seven dealers stored rubber in their warehouses behind their premises.

Six of the seven Pontian town dealers sold their rubber to Singapore packers; on the average, each sold to about three Singapore packers. Only one dealer sold to a Johore Bahru dealer and to a rubber manufacturing company in Pontian. All seven dealers provided their own transportation of rubber to their buyers: Six of them owned one lorry each; one of them owned five to six lorries. The cost of lorry transportation from Pontian to Singapore worked out to be about sixty cents per pickul transported.

Pontian town dealers thus specialize in two functions: (a) the processing and smoking of USS into RSS; and (b) the bulking and transportation of smoked sheets from Pontian to packers in Singapore.

(c) *Singapore packer-exporters*. All six packing firms interviewed, like the majority of packing firms in Singapore and West Malaysia, were organized as private limited companies. At this packing level, because of the great variation in size of the packing firms, there is no meaningful average size of the firm. But just to get an idea of the size of a packing firm: one of the six firms interviewed—by no means the largest—had an annual purchase of about 6,000 tons or 100,800 pickuls (1 ton = 16.8 pickuls) in 1969. This means that this particular packing firm was roughly twenty times the average size of the Pontian first-level firm.

All six packer-exporter firms were completely specialized in rubber dealing; there were no transactions between packers and smallholders, hence no services to smallholders incidental to the main business of rubber dealing. Packers purchased the bulk of their rubber from second level dealers in West Malaysia and from Singapore commission agents who imported rubber from packers in the surrounding countries, especially from Indonesia. On the average, the number of dealers supplying each packer ranged from twenty to fifty dealers. Because of the size of their operations, large storage facilities were required.

Four packers owned their storage facilities and hence performed the storage function themselves; one packer rented his storage facilities; and one packer owned as well as rented his warehouses. Three of the six packers processed and smoked the rubber they purchased. Packer-exporters specialized in the function of selection and re-grading of rubber—which include cutting imperfections out of the rubber sheet—and packing them into 250 lb. bales for export to overseas buyers. To perform the grading-packing functions, large areas of "godown"[19] space and a large labor force were required. Four of the firms that supplied information concerning the size of their labor force, on the average, employed three hundred workers (mostly women) per firm.

3.1 Overview of the marketing of Pontian smallholders' rubber

The marketing of Pontian smallholders' rubber conforms to the general pattern of marketing of smallholders' rubber in West Malaysia, as described in section 1. The rubber is marketed through three levels of middlemen: village dealers, town dealers, and packers in Singapore. The middlemen at each level of the marketing structure perform specialized functions, although there are some unavoidable overlapping marketing functions performed by middlemen at all levels of the marketing structure. Functional specialization and division of labor is a characteristic feature of the marketing of smallholders' rubber through the middleman system. But the counterpart of functional specialization and division labor is the *functional interdependence* of middlemen at different levels of the marketing channel. The middleman system, with its hierarchy of levels of middlemen, therefore must be viewed as a vertical market structure, in which middlemen at different levels are linked together in networks of exchanges, based on functional specialization and division of labor, to form a system. As a system, the middlemen at different levels of the vertical market structure all must cooperate in moving rubber from one geographical location to another, from one level of middlemen to another, from one specialized role to another. In the process the rubber is transported, assembled, graded, stored, processed, packed in 250 lb. bales to be exported to overseas buyers. What kind of cooperative arrangements Chinese middlemen made among themselves to facilitate the smooth flow of rubber from smallholders to overseas buyers is discussed in the next section.

4 Mutual aid arrangements among Hokkien dealers: The organization of contract-enforcement, credit, information pooling and transmission, and debt settlement

The empirical material in this section is based on information collected through:

(a) a questionnaire survey of nineteen Pontian dealers and eight Singapore dealers; and (b) depth interviews with thirteen dealers, at the packer-exporter and at the second-level in Singapore and Kuala Lumpur. See Appendix C.

In a functionally interdependent middleman system, certain functions are essential to the effective flow of the physical rubber through the marketing system. These include: (a) the organization of contract-protection among the large number of interdependent buyers and sellers, creditors and debtors; (b) the pooling and transmission of nonprice and price information; (c) financing of dealers which facilities the physical flow of rubber; and (d) debt settlement.

The section below will describe how the Hokkien-Chinese dealers, through their mutual aid arrangements, have organized these functions.

4.1 The organization of contract-protection: The role of trust and particularization of exchange relations

The existence of contract-uncertainty, itself intangible, is manifested in the subjective outlook of those who perceive it and by the precautions they take to cope with it. The following statements, from five of the rubber dealers in Singapore and Kuala Lumpur I interviewed in 1969, revealed the importance of trust and particularistic relations in handling the problem of contract uncertainty. As Dealer 1 (a Hokkien packer-exporter in Singapore) puts it:

> The way we Chinese operate in the rubber trade is that once a verbal agreement is reached, it is expected to be kept; it is based upon 100 percent mutual trust. Written legal contracts, for us, are only a formality. We make a big transaction over the phone, and sometimes we sign the contract maybe a week later. But tomorrow, due to price changes, there may be a profit or loss of $1,000 or one million dollars; but the transaction has already being made over the phone, and must be kept by both parties. It is a matter of trust, very similar to operations in the stock market: once transactions are closed, one doesn't change one's mind. If we know that a trader is well-known and reliable, we are prepared to do business with him. What the Chinese call "ganching" is very much also a matter of "hsin-yoong" (trust). If I have confidence in a person, then I develop a "ganching" relationship with him. If I have "ganching" with a person, I also trust that person.

Or Dealer 2 (Hokkien packer-exporter in Singapore):

> Because of the risk involved in advancing money without security, based purely on trust, we tend to trade with those whom we trust; they are often kinsmen, friends, people from the same place in China, and those who speak the same dialect. Because of the longer association of Hokkiens with each other in the rubber industry, we find it easier to give credit to a fellow-Hokkien because there are ways of finding the creditworthiness of that person—about his background, his associates, his ethical code, etc.

Or Dealer 3 (Hokkien packer-exporter in Singapore):

> Confidence takes a long to build up; therefore our regular customers tend to be friends, those whom we have kinship ties, and whose background are known.

Or Dealer 4 (Teochew commission agent in Singapore):

> In our business dealings, we do not trade with those whom we do not know or do not trust.

And Dealer 5 (Hokkien packer-exporter in Kuala Lumpur):

> Because they are from the same Hokkien community and knowledge of their character among associates are better known, they are more able to receive our trust, and so able to get the money to finance their business.

The problem of choosing trustworthy trading partners is also expressed by Wee Mong-Cheng (1970, p. 14) with reference to the black pepper trade:

> Black pepper from Telok Betong had been steady in the range of \$110/\$120 per picul for many years. Owing to a reported crop failure, its price shot up to over \$250 last September, a difference of over \$130 per picul or \$2,000 per ton. Anyone in short position of 500 tons will cost him one million dollars. Traders in international produce are therefore very careful in the choice of their counterpart overseas....In fact, many leading traders in Singapore were originally from Indonesia, though their business in the old country, left in the hands of their own people, are still quite active. This has no doubt strengthened the blood relationship of the economic ties.

What emerges most forcefully from the above statements is the Chinese trader's conscious *particularization* of exchange relations as his main method of establishing trust or of coping with the problem of contract-uncertainty. How extensive is this practice of particularization of exchange relations? The very fact that the marketing of smallholders' rubber in 1969 was dominated by six clans—Lee, Tan, Ng, Teh, Lim, Gan—from Chuan-chow and Yung-chun counties in Fukien province is itself indicative of the importance of kinship and ethnic ties among Chinese middlemen. See Appendix B.

A closer look into the exchange relations of sixteen rubber-dealing firms revealed remarkable regularities: the predominance of kinship and particularistic ties between traders. The information was based entirely on materials gathered in interviews with sixteen dealers. Information was sought regarding the social background of the dealer (e.g. place of origin/dialect he speaks), the number of traders he traded with, who these dealers were, or the nature of the social relationship between the dealer and his trading partners. See Appendix D.

The role of trust, as it manifests itself in particularization of exchange relations among Chinese middlemen, is dramatically demonstrated in the case of the Teochew commission agent firm and the Foochow commission agent firm: the fact that they could successfully penetrate a Hokkien monopoly at the level of the commission agent is due to, a large extent, the loyalty and support they received from fellow kinsmen and fellow-ethnics from the same dialect/ethnic group in the surrounding countries of Southeast Asia. See Appendix D (Figure 15 & Figure 16).

The importance of trust in exchange relations is further revealed in a number of statements[20] I obtained from interviews with some prominent members of the Chinese community in Singapore in 1969. As Dr. Yap Pheng Geck[21] puts it:

> Chinese started being clannish. Besides being clannish, they also have locality ties. People from the same place in China club together to help each other. There is quite a lot of mutual help including extending credit to each other. Credit system among the Chinese is a loose system because there are no hard and fast rules. It is based purely on trust or "ganching" based on kinship ties, and on long association. This mutual trust has been responsible for the collective success of the Chinese. The secret of Chinese success is mutual aid/mutual trust based on surname, family ties, clan ties, etc. The Chinese have this kinship bond. They club together to help each other. I've seen it in all the Chinese communities I have visited—in Thailand, in Philippines, in San Francisco and in New York. This mutual trust means that the Chinese are very good at using credit; they seldom fail. We must not loose this spirit of mutual cooperation and become individualistic. We are individualistic in spirit, but collective in enterprise. If we are on our own, our resources are limited.

Or C.M. Wong[22]:

> In Chinese business transactions that are oral promises, the oral promises are as good as gold because they are based on mutual trust. All the terms agreed upon must be carried out. Once you have made a promise, you cannot retract it.

Or Lam Thian[23]:

> We tend to trade with our own kinsmen or clansmen because we feel we can trust them. Chinese kinship/clanship relationships are highly respected; they hardly ever break off.

And Hsu Yun-Ts'iao[24]:

> Chinese way of doing business is based on trust. This is very important because it is in tune with local conditions.

Beyond the role of trust as manifested in particularistic exchange relations, what are the sanctions for punishing those who deliberately breach the trust of their trading partners? Two forms of sanctions exist and may be discussed in terms of Albert Hirschman's (1970) concepts of "voice" and "exit."

In a segmented society like the Chinese society where the exit option is not feasible or very costly, "voice" becomes an important device for regulating behavior. In a closed Chinese ethnic community where dense face-to-face communications networks exist, word gets around very quickly of anyone who deliberately breaks his promise. "Voice" in this context takes the form of gossip about the behavior of the offending party. The result of such gossip is that the offending party "... will be shamed: he will 'lose face'" (C. M. Wong[25]). This Chinese fear of "losing face" is proverbial, and even extends to the offending party's kinsmen and friends. As Dr. Yap Pheng Geck[26], puts the issue of "losing face" in terms of Chinese "peculiar sensitivity":

> When a man has been declared bankrupt, usually this means that the man has not been honest about his commitments. He must have played people out. If he had not, or even if he had, relations come out. The Chinese also have this peculiar sensitivity: we do not like people with the same surname or people seen with us a lot to go down. If that person is a family friend, the community will say "What sort of a man are you to allow your friend to go down?" So, I feel an obligation to assist him; otherwise it also reflects on me. We have this peculiar sensitivity that induce us to mutual assistance.

One social sanction for punishing a Chinese trader who deliberately breaks promises is to make him "lose face." Another sanction exists to punish an offender. This sanction may be discussed in terms of the concept of "exit" and take three forms: (a) withdrawal of credit by a creditor; (b) resort to the courts to bankrupt the offending party by creditors; and (c) exclude the offending party from future transactions. As Tan Ee Leong[27] puts it:

> If a person has promised to sell certain goods at a stipulated price, he must sell the goods even if price has changed in the meantime. If a person breaks his promise/trust, then he will have to deal on a cash basis. This would be very difficult for a person with no capital or limited capital....When a business fails because of genuine losses, creditors may write off the debt if they feel that he cannot pay, or they may accept composition if they feel he has some means to pay the debt. But if the person has been cheating his creditors, then the creditors will bankrupt him just to punish him.

Or Dr. Yap Pheng Geck[28]:

> Rarely do creditors take debtors to court. Taking debtors to court is a method of last resort, and usually this is done because a debtor misbehaves or has been fraudulent.

An actual case of Chinese creditors who resorted to the courts because of the unethical behavior of their debtor is given below.

> Mr. X was sued by his creditors. He was unable to pay his debts. To make matters worse, he showed contempt and spite towards his creditors. Mr. Y, the creditor whom I interviewed, was very angry with his debtor. He was on a business trip to Hong Kong but flew back to Singapore to attend the court case. The case was initiated by the whole group of creditors. Mr. Y said that the case involved only a few thousand dollars. But he was willing to pay for the trip back to Singapore and then return to Hong Kong to finish his business deal. The airfares plus lawyers' fees all add up to a significant amount. In fact, he will loose more money by prosecuting the debtor. But he did it simply because the debtor did not show respect for the principles of Chinese methods of conducting business. When he could not pay his debt, instead of attempting to remedy the situation, he worsened it by showing contempt for his creditors. In other words, Mr. Y told me that "this man is not suitable to remain in the business community; he does not deserve any cooperation or help from his colleagues."[29]

Finally, the offending party who breaks the trust of his trading partner and the trading group of whom he is a member will be *excluded* from future transactions by the whole group as word gets around of his anti-social behavior; he will be *ostracized.* As dealer 4 (a Teochew commission agent) puts it succinctly: "… we do not trade with those whom we do not know or do not trust," as noted earlier.

Thus, in terms of Chinese method of protection against breach of trust/promise, the existence of mutual trust as manifested in particularistic exchange relations provide the chief means for the protection of contracts. Additional sanctions of "voice" and "exit" supplement "trust" whenever trust fails.

4.2 The organization of information-pooling and transmission

The importance of non-price information under contract-uncertainty is explicit or implicit in the statements made by the five dealers we have earlier quoted. In particular, the statements made by dealers 2 and 5, taken together, suggest that one important reason why Hokkien traders prefer to trade with fellow-Hokkiens is due to the fact that trustworthiness/creditworthiness of fellow-Hokkiens can be relatively more easily assessed because there are ways of finding out their background. My interviews with Hokkien dealers in Singapore and Selangor revealed that Hokkien dealers can acquire non-price information from various sources:

(1) In their regular interaction amongst themselves, and among the members of the wider Hokkien community—for example, at dinner parties, and social gatherings—non-price information is pooled and transmitted, free of charge, to those who deliberately seek such information concerning a customer or a potential trading partner. Usually members of the same community are unanimous in their assessment of the reputation of a particular trader. A trader, seeking such information pays attention to the "character and credit ratings" of a particular individual made by a number of persons known personally to him. This type of "collective" assessment by friends and associates helps the dealer in his decision-making as to whether or not to adjust credit terms, to withhold credit, or even to refuse to trade with a particular customer. Much of the pooling and transmission of information is, thus, organized on an informal basis. The dinner parties, social gatherings, etc. so often held in the Chinese world of business, can be said to perform an important economic function in that they facilitate the mutual inter-exchange of non-price information.
(2) A more formal and direct mechanism for a dealer to acquire non-price information is to request the potential trading partner to obtain a letter of recommendation from a person of standing in the community—usually a wealthy businessman who is also a leader of the community—or even better, to ask that prominent person to act as guarantor.
(3) Rubber dealers belong not only to rubber associations. They also belong to one or more of the Chinese clan, county, and dialect associations. These Chinese associations, whose functions include the promotion of better "ganching" among members, serve also as sources of information for a dealer who wishes to obtain information from the mutual aid associations within his own dialect community.

Apart from non-price information, traders also require quick, up-to-date and reliable price information. How do traders obtain price information? The Singapore packer-exporters who were interviewed obtained price information directly from their overseas buyers by telephone and telegraph and sometimes through brokers. The nineteen Pontian dealers who were interviewed received their daily market report, via telephone messages at noon and at five o'clock, from the Pontian Rubber Dealers' Association, of which they were members. Some of the Pontian dealers also received price information via telephone messages from their buyers; but the trade association was their main source for market information. A secondary source of information obtained by Pontian dealers from newspapers was, however, often out-of-date.

4.3 The organization of credit

Credit flows through the marketing system have been depicted as one-way credit flows: banks→packer-exporters→town dealers→village dealers→ small holders.[30] A description in some detail of the actual credit practices of the firms surveyed and interviewed in 1969, however, revealed greater complexity and diversity in the organization of credit.

4.3.1 Varying importance of credit transactions

Credit transactions did not play an equally important role in the different segments of the marketing structure. In the top segment, transactions between packers (packer-exporters) and town dealers were not always conducted on a credit basis since town dealers can themselves borrow from banks. Of the nine packing firms interviewed (six packers in Singapore, three packers in Kuala Lumpur), three firms operated strictly on a cash basis. Of the six firms that extended credit to their suppliers, the method of credit extension was as follows: the supplier delivered rubber to the packer's godown before sale, and the packer advanced the dealer about 80 percent of the market price of the rubber delivered; 80 percent being the usual ceiling on cash advances. The loan was unsecured, but based on trust that the debtor would sell rubber to his creditor at the prevailing price within a given period (usually two weeks). Instead of selling rubber to the packer at the time of delivery, the dealer took a cash advance based on 80 percent of the estimated current value of rubber, and left the rubber with the packer until such time as he decided to sell. This provided the dealer a chance to speculate on a rise in the price of rubber between the time of delivery and the time he sold the rubber. It also gave the dealer free storage space provided by the packer for up to two weeks. The loans extended by packers were short-term loans, and had to be repaid after two weeks. The amount of credit injected into the top segment of the marketing structure appeared to be quite substantial. By way of an example, one large Singapore packing firm had lines of credit with several commercial banks and could obtain large overdrafts as high as five million dollars to begin its credit cycle; bank credit being based upon 80 percent of the rubber in the company's possession as security, and obtained at the banks' rate of interest. The firm then distributed the bank loans to its various branch firms for credit extension to its many suppliers.

In the middle segment of the marketing structure, transactions between town dealers and village dealers were invariably based on credit since village dealers do not have access to bank loans. The credit arrangements were similar to those described earlier. However, there appears to be a greater degree of flexibility in terms of the amount of loan extended and the period of repayment: depending upon the circumstances of the individual debtor and his personal relationship with his creditor, the creditor may adjust the 80 percent ceiling on cash advances upward, or may extend the period of repayment. Because town dealers typically extend credit to their suppliers, town dealers may be regarded as the key financial intermediaries in the marketing channels in the sense that they borrowed from packers/ banks and lend to village dealers.

At the bottom of the marketing structure, transactions between village dealers and smallholders were predominately on a cash basis. Fifteen of the nineteen Pontian dealers surveyed operated predominately or wholly on a cash basis in their dealings with smallholders: twelve dealers reported 70–90 percent of their purchases were cash purchases; three reported only cash transactions. Only four of the nineteen dealers operated predominately on a credit basis. The switch from credit to predominately cash transactions by the majority of the Pontian dealers surveyed in 1969 appears to be in response to two events in the 1960s. Most Pontian dealers had drastically curtailed credit transactions and some had actually ceased to provide credit to smallholders as a result of: (a) their experiences with debt defaults by smallholders unable to repay debts during the period of drastic fall in rubber prices which began in 1966; and (b) their experiences with difficulties in collecting debts during and after the May 13, 1969 racial riots against Chinese by Malays.

It is worth noting that all those creditors surveyed or interviewed in depth reported that the credit they extend were "interest-free." Without further investigation into this "interest-free" loan phenomenon, it is not possible to know whether there were hidden charges involved in these loans, or whether the "interest-free" part of the loans were gifts to maintain goodwill between creditors and debtors, especially in the context of two-way credit flows.

4.3.2 Two-way credit networks

Credit need not flow one way only, from creditor to debtor: creditors, when faced with temporary shortage of funds, could borrow from their own debtors. They could do this by adjusting the usual 80 percent ceiling on lending downward, or in the case of cash transactions, pay the supplier after he has sold rubber to him. This may be said to represent a re-routing of credit upwards from debtor/supplier to creditor.[31] According to some Pontian dealers I interviewed, flexibility in creditor-debtor roles was a very common practice among Pontian dealers since good "ganching" developed from long years of trading, characterized their relationship. "Ganching" involve such things as mutual understanding, mutual dependence and mutual aid. Interviews with some dealers in Singapore and in Kuala Lumpur in Selangnor further confirmed the fact that the practice of creditors borrowing from their own debtors existed, even for packers at the top of the marketing structure. Thus, to the extent that creditors may themselves borrow from their debtors, the credit network may be represented as two-way credit networks, based on the reversibility of creditor-debtor roles.

4.4 The organization of debt settlement

Credit extension means that loans must be repaid in the form of a reverse flow of rubber from debtor to creditor. But because of price-uncertainty, a dealer is liable to default partially or totally on payment in periods of falling rubber prices and may be forced into liquidation. Dealers therefore face risks of going bankrupt. Dealers therefore need to organize their debt settlement in such a way as to reduce the risk of a firm going bankrupt.

Available data obtained from twenty-seven dealers surveyed or interviewed in depth, showed that rarely creditors settle debts through courts: only three of the twenty-seven dealers had ever resorted to the courts for the enforcement of debts. The majority of these dealers preferred to settle debts privately with their debtors, and also be flexible in their methods of debt settlement. Creditors prefer to extend the repayment period, writing off bad debts, extending more credit to tide over debtors' temporary difficulties, and, especially, resorting to the "composition" method for debt settlement. In Pontian, for example, fifteen of the nineteen dealers surveyed resorted to the "composition" method for debt settlement, with five dealers, in addition, also extending the period of repayment. In fact, discussions with Pontian and Singapore dealers as well as certain persons long associated with the Chinese business world, revealed that the composition method was the most popular method Chinese businessmen used for debt settlement. The procedure for debt settlement via the composition method is that the debtor and his creditors get together privately to negotiate the percentage of repayment (typically a 50 percent repayment) to creditors. Often, major creditors themselves will put pressure on non-consenting creditors to accept the compromise arrived at. This is because a non-consenting creditor can sue the debtor in court and hence may force the debtor into bankruptcy.

Chinese creditors seldom resort to courts for enforcement of debts; only as a method of last resort and usually because the debtor has not been honest in his commitments.[32] The method of composition was the predominant method in debt settlement that provided relief to debtors. Mutual aid in debt settlement is also manifested in another form as the following case study shows[33]:

> In 1956, Tai Joo, a big rubber firm which started in Indonesia began to expand into Singapore. It had many branches and expanded in a big way. But because it speculated and failed, the firm collapsed. Singapore, being the biggest rubber market, had numerous buyers and sellers closely linked together, with a lot of transactions passing through their hands, before reaching the final buyers. Because of this close interdependence, this means that when Tai Joo collapsed, it would have to get rid of the 10,000 tons of rubber on the market resulting in a collapse of the rubber market. Because of self-interest and the close links everyone has with everyone else, the Singapore Rubber Association people got together. They decided that the banks would take over the assets of the company while the rubber dealers (members of the Association) would pay off the firm's debts to its European creditors and call off their own. The losses they bear are much smaller than the larger loses they have to bear if the rubber market had collapsed.

This aspect of mutual aid among Chinese has been noted by Joan Wilson (1958, p. 58): "It is also interesting to note that members of the trade will help each other in times of difficulty and carry a firm's liabilities in order to tide them over and avoid a failure, which would usually bring a string of failure in its train, incidentally thus preserving the business integrity of the Singapore Rubber Market."

5 Aspects of Chinese economic organization and patterns of firm expansion

This section will present a summary of case studies of ten successful Chinese rubber dealing firms (seven packer-exporter firms, one second level firm, and two commission agent firms), with a view of obtaining information on aspects of Chinese economic organization and patterns of firm expansion.[34] Almost all the firms began at the level of the village-dealing firm. With accumulated savings out of profits, many of the firms gave up their village-dealing firms in order to establish larger, second-level firms. During the Korean boom, rubber dealers made enormous profits. All of the packing firms studied emerged during or after the Korean boom. Once emerged as packer-exporters, with the exception of one rubber-dealing firm, these firms gave up their firms operating at the second level. Vertical integration as a mode of Chinese firm expansion is insignificant. Once a firm became a packer-exporter, further expansion take the form of: (a) establishing branch firms throughout West Malaysia—horizontal integration; and (b) diversifying into new lines of business such as pineapple canning, banking, shipping as a means of reducing risk of bankruptcy.

In the initial establishment of the firm and its subsequent expansion, mutual aid among kinsmen, fellow-villagers and fellow-Hokkiens played a very important role. The mutual aid arrangements take such forms as: (a) acquiring knowledge of rubber dealing by working in a rubber firm owned by a kinsman or fellow-Hokkien, knowledge useful for the person later on to start his own firm; (b) capital borrowed from kinsmen or fellow-Hokkiens to establish a firm organized as sole-proprietorship, or capital provided to form partnerships or limited companies; and (c) mutual trust so necessary to reduce contract-uncertainty provided by kinship and ethnic ties, and (d) the mobilization of the support of kinsmen and fellow-ethnics as rubber suppliers in order to break into a trade monopolized by another Chinese ethnic group. The success stories of the Teochew commission agent firm and the Foochow commission agent firm provide dramatic examples.

Finally, successful rubber dealers were also leaders of their own community. They held offices in the various mutual aid associations as well as hold positions in the Singapore/Malaysia Chinese Chamber of Commerce.[35]

6 Concluding remarks

My empirical study of the organization of Pontian smallholders' rubber by middlemen in Singapore and West Malaysia in 1969 reveals the following characteristics:

(1) The marketing of smallholders' rubber was characterized by specialization and division of labor between three different levels of middlemen: village dealers, town dealers, and packer-exporters. The three levels of middlemen were arranged, in terms of the number and size of firms, in a pyramidal structure, with packer-exporters at the apex of the structure, town dealers at the second level of the marketing structure, and village dealers at the bottom of the marketing structure. Specialization and division of labor between the different levels of middlemen necessitated cooperation and coordination of middlemen in the marketing network.

(2) Mutual cooperation among middlemen was achieved by the formation of an "ethnically homogeneous (Hokkien-Chinese) middleman group" (EHMG), dominated by six clans from Chuan-chow and Yung-chun counties in Fukien province. Trust and identity of trading partners played a crucial role in individual Hokkien-Chinese merchant's choice of trading partners, resulting in the conscious particularization of economic relationships, manifesting itself in the phenomenon of the EHMG. My empirical findings of the importance of trust and identity of cooperating

partners in the marketing of smallholders' rubber by Chinese merchants in 1969, further strengthen what is known about Chinese economic organizations described in the previous chapter (Chapter 2), i.e. the importance of Confucian ethics in the formation of particularistic exchange relations which facilitated reciprocity and mutual aid among Hokkien Chinese merchants.

(3) The EHMG facilitated Chinese middleman-entrepreneurial roles, enabling merchants to enforce contracts; mobilize information from members of the middleman group and from members of the wider Hokkien community; mobilize capital via credit flows through the middleman economy; and reduce risks of bankruptcy by creating two-way credit networks and by flexibility in debt settlement.

Appendix A

Table 1 Number of dealers in West Malaysia, December 1967 by trade level

Trade Level	Dealers No.	Dealers %
Packer	63[a]	3.0
Second Level Dealer	677[b]	30.0
First Level Dealer (Village Dealer)	1,500[c]	67.0
Total	2,240[d]	100.0

[a]There were 63 dealers who held export licenses in 1977. See Table 11.1 *Rubber Statistics Handbook* (1967), p. 123.

[b]Total dealers less first level dealers less packers.

[c]The estimate of 1,500 first level dealers is based on the assumption that all 1,294 dealers in the monthly purchases "0–200" piculs category were village dealers, plus about half of 441 dealers operating in the "201-500" piculs category. The estimate is based on Lim Sow Ching's (1968, p. 17) findings that the average monthly purchases of 150 village dealers in Selangor in 1964 were 398.3 piculs per dealer.

[d]Table 11.2, *Rubber Statistics Handbook* (1967), p. 124.

Number of Dealers by Ethnicity. There were about 800 Malay dealers in West Malaysia in 1967. This figure was obtained from the Department of Statistics, Kuala Lumpur (private communication). The Malay dealers were concentrated especially in four states: Kedah, Perak, Kelantan and Terengganu. All 800 Malay dealers were assumed to be village dealers. This assumption is based on Lim Sow Ching's (1968, p. 17) findings that Malay dealers in Selangor in 1964 had monthly average purchases of only

122.3 piculs per dealer. The majority of second level dealers and packers in Malaysia in 1967 were Chinese. This information was obtained from Mr Ng Choong Leong, Statistician of the Rubber and Oil Palm Statistics Section, Department of Statistics, Kuala Lumpur, Malaysia.

Appendix B

Hokkien-Chinese Dominance of the Smallholders' Rubber Trade, 1969

Evidence that a specific Chinese ethnic group, the Hokkiens, dominate the trade in smallholders' rubber in 1969 can be seen from the following facts:

1. There were 221 dealers operating in Selangor in 1965. According to Lim Sow Ching (1968, p. 14), "Except at the exporter level, about 80 per cent of the dealers were Chinese and nearly all of these belonged to the Hokkien clan. The export trade was handled by both Chinese and European dealers, however, mainly the former."

2. The sample questionnaire survey of 19 Pontian dealers in 1969 revealed that 17 of the 19 dealers were Hokkiens. The remaining two, a Teochew and a Hakka, were village dealers.

3. All seven rubber dealers—rubber tycoons in Singapore and Malaysia, including the three largest rubber packing-exporting firms, listed in Sung Chek Mei (1969) (Ed.) *Who's Who in Singapore and Malaysia* for 1969 were Hokkiens. See Table 1.

4. The smallholders' rubber trade in Singapore and Malaysia in 1950 was dominated by six clans: Tan, Lee, Ng, Teh Lim and Gan. See Table 2.

5. Six clans dominated Hokkien middleman group was confirmed in my 1969 interviews with Mr Tan Yeok Seong,[1] Dr Ho Pao Jin[2] and Professor HsuYun Ts'iao.[3]

[1] Mr Tan Yeok Seong is an "Expert of Southeast Asian Studies."

[2] Dr Ho Pao Jin has been a close observer of the rubber industry for many years. Included among his many friends were the late Tan Kah Kee, the "Rubber King" of the 1920s, the late Tan Kai Poh of the famous firm of "Hiap Hoe Bee" in Malacca. Both Tan Kah Kee and Tan Kai Poh were *Chuan-chow* Hokkiens.

[3] Professor Hsu Yun Ts'iao is the editor of the *Journal of Southeast Asian Research* and the Director of the Southeast Asian Research Centre, Singapore.

Table 1 **Rubber dealers included in "Who's Who in Singapore and Malaysia, 1969"**

Name of Dealer	Name of Firm	Place of origin in China	
Lee Kong Chian	Lee Rubber Co. Ltd	Nan-an	Fukien
Tan Lark Sye	Aik Hoe & Co. Ltd.	Tung-an	Fukien
Ng Quee Lam	South Union Co. Ltd.	Hui-an	Fukien
Gan Teck Yeow	n.a.	Yung-chun	Fukien
Peh Seng Khoon	n.a.	An-Chi	Fukien
Lee Yan Lian	Ban Lee Co. Ltd.	Yung-chun	Fukien
Tan See Gak (son of Tan Kai Poh)	Hiap Hoe Bee Co. Ltd	Tung-an	Fukien

Source: Sung Chek Mei (1969) (ed.). *Who's Who in Singapore and Malaysia, 1969* (pp. 173–178). [in Chinese].
Note: Nan-an, Tung-an, Hui-an, An-Chi are prefectures in Chuan-chow county, Fukien Province.

Table 2 **Dominance of Six Clans in the Committees of Rubber Associations in Singapore and Malaysia, 1950**

	SIX CLANS							
	Tan	*Lee*	*Ng*	*Teh*	*Lim*	*Gan*	Total[1]	% of Total[2]
Singapore	6	7	5	-	3	2	27	85
Johore	9	8	10	7	5	2	76	53
Malacca	5	1	1	2	3	1	24	54
N. Sembilan	1	1	1	1	-	-	9	44
Selangor& Pahang	6	11	8	4	5	6	52	76
Perak	2	2	1	4	-	-	31	29
Kedah	1	1	2	1	-	-	12	41
Penang	3	1	1	-	-	-	13	38
	33	32	29	19	16	11	244	57

Source: Based on an analysis of the raw data of the members of the committees of the rubber associations in Singapore and Malaya for the year 1950, in Wu Tee Jin (1950), pp. 86–89. *Economic Plants in the Tropics: Rubber*. [In Chinese]

[1]Total refers to the total committee members listed by names of dealers.

[2]% of total refers to the percentage of committee members bearing the six surnames to total committee membership.

Appendix C

Notes on aspects of my fieldwork, 1969

Our procedure for securing primary data included:

A. A questionnaire survey of 19 dealers in Pontian district, and 8 dealers in Singapore;
B. Depth interviews with 13 dealers in Singapore and Selangor.
C. A questionnaire survey of 50 Malay smallholders in Pontian district.

The fieldwork was undertaken in Singapore and Malaysia during the six months period, July-December, 1969, and was supported by a grant from the Agricultural Development Council, Inc., U.S.A.

A. Questionnaire Survey of 19 Pontian Dealers and 8 Singapore Dealers

Pontian district is one of 8 districts in Johore; Johore being the southernmost state of Malaysia.

Basis for Selecting Pontian District. The main reasons for choosing Pontian District for our interviews with village and town dealers were:

(a) its proximity to Singapore, the writer's home base;
(b) its importance as a smallholder rubber producing district. Its importance can be seen from the fact that it was one of the 11 districts, out of a total of 72 districts in Malaysia, that produced over 10,000 tons of smallholder rubber in 1967; Pontian's production being 10,399 tons.[4]
(c) the sizable number of dealers operating in Pontian district: it was one of the 32 districts, out of 72 districts, which had 40 or more licensed dealers operating in the district; Pontian had 48 dealers operating in the district in 1967.[5]

How sample dealers were chosen. Information from the Pontian Rubber Dealers Association revealed that there were about 49 licensed dealers in Pontian in 1969, of whom about 40 were village dealers and 9 were town dealers. All nine town dealers were Chinese, while at least thirty of the forty village dealers were Chinese. All Chinese dealers were members of the Pontian Rubber Dealers Association. A sample of about 19 to

[4] *Rubber Statistics Handbook* (1967), p. 56.
[5] *Rubber Statistics Handbook* (1967), p. 121.

20 dealers to be drawn from the members of the trade association were decided upon.

The procedure for selecting Pontian village dealers for interview was as follows. A list of the firm members of the PRDA was obtained. The list of members were classified according to the specific areas in Pontian in which they were operating; the firms were also identified as to their trade level. The population from which the sample was to be drawn was therefore clearly defined. Roughly, every fourth firm on the list was selected to be interviewed. If the fourth firm so selected turned out to be a second level dealing firm, the firm was dropped and the next village dealing firm that appeared on the list was then chosen. Thus there was some sort of random sampling of the Chinese village dealers chosen for interviews. Twelve village dealers and seven town dealers were interviewed.

Since the bulk of Pontian smallholders rubber flowed south to Singapore dealers, the latter also had to be interviewed. Six packers and two commission agents in Singapore were interviewed. Since very large packing firms dominate the packing level, a study of the activities of packing firms should, whenever possible, include these dominant firms. The larger of the packing firms were therefore chosen for interviews. Clearly the six packers chosen for interviews were not randomly selected.

The questionnaire schedule. The questionnaire schedule is shown in Exhibit I below.

How the Survey was conducted. The questionnaire survey of nineteen Pontian dealers was mainly carried out by the writer's research assistant, Mr. Goh Choo Keng—a graduate of Nanyang University—who is fluent in the Hokkien and Malay languages. The survey of eight Singapore dealers was carried out by myself together with the writer's research assistant, Miss Gan See Khem, a graduate of University of British Columbia.

EXHIBIT I–Dealer Questionnaire Schedule

(1) Volume of rubber purchased in 1969?
(2) How do you purchase your rubber?

  (a) at the farm
  (b) send lorry to farm to fetch rubber
  (c) at your own premise
  (d) others

(3) How many customers regularly sell rubber to you?
(4) What proportion of transactions are conducted:

  (a) on credit
  (b) cash
  (c) others

(5) How much cash did you advance, and at what rate of interest?
(6) What is the total amount of "bad debt"?
(7) How do you deal with bad debt:

  (a) composition
  (b) more time
  (c) sue in court
  (d) break off relations
  (e) no more cash in future
  (f) others

(8) Who do you sell your rubber to? How many buyers?

  (a) small town dealer
  (b) city-town dealer
  (c) direct to Johore Bahru? Kuala Lumpur? Singapore?
  (d) export directly overseas
  (e) others

(9) Where do you store your rubber?

  (a) warehouse
  (b) rented premises
  (c) others

(10) What facilities do you own? How much investment?

  (a) smoke house
  (b) lorry
  (c) boat
  (d) others

(11) How do you transport rubber to your buyers? How much transportation cost?

  (a) railroad
  (b) road
  (c) boat
  (d) others

(12) What other line of business are you in?
(13) How do you obtain price information from: Johore Bahru? Kuala Lumpur? Singapore?

(a) newspaper
(b) telephone
(c) direct contact
(d) others

(14) What proportion of small holders' rubber do you access as:

(a) Grade: 1 2 3 4 5

(15) Personal data of dealer:

(a) name
(b) ethnicity
(c) age
(d) how many years in business

B. Depth Interviews with Thirteen Dealers in Singapore and Kuala Lumpur

The purpose of these depth interviews was to secure as much information as possible from those interviewed regarding the following aspects: (a) horizontal and vertical integration arrangements of the firm; (b) the history and growth of the firm; (c) the economic and social connections between the dealer interviewed and the dealers (and the number) he traded with; (d) financing the trade in smallholders' rubber; (e) the types of contract uncertainty, and how dealer cope with it; and (f) how dealer obtained information; (g) how dealer settled debts; (h) why the Chinese emerged to dominate packer roles; (i) roles of Chinese associations, including the *Chinese Chamber of Commerce and Industry* in Singapore and Malaysia.

Miss Gan See Khem and myself usually went together during these intensive interviews, so that one of us could take extensive notes during the interviews. Whenever permission was granted, depth interviews were also tape recorded.

C. Questionnaire Survey of Fifty Malay Smallholders in Pontian District

Only two questions from the questionnaire survey of fifty Malay smallholders in Pontian District have been used in this chapter. My assistant, Mr. Goh Choo Keng interviewed the Malay smallholders (This questionnaire survey was designed for a larger project "The Impact of Chinese Middleman on Peasant Supply Response.") The relevant questions are as follows:

1. Tanah di-gunakan untok chochok tanam
   (Land farmed)

Tahun (Year)	Jumlah Ekar (No. of Acres)
1969	
1968	
1967	

2. Bahan Penghasilan: Tanah di-gunakan untok sa-suatu tanaman, hasil tanaman, dan harga-nya
   (Production data: Land used for certain crops, output, selling price)

Jenis tanaman	Tanah di-gunakan (jumlah ekar)	Hasil Tanaman	Harga yang diterima	Bila di-jual
(Name of crop)	Land used in (acres) -	(Output)	Price received	When sold
Getah				
(Rubber)				
1969				

Appendix D

Trading Networks of 16 Rubber Dealing Firms

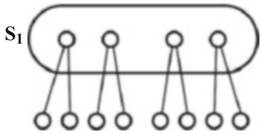

Fig. 1 Chuan-chow Hokkien packer 1 in Singapore

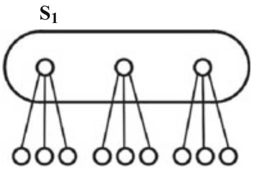

Fig. 2 Chuan-chow Hokkien packer 2 in Singapore

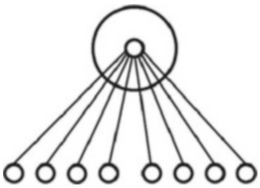

Fig. 3 Chuan-chow Hokkien packer 3 in Singapore

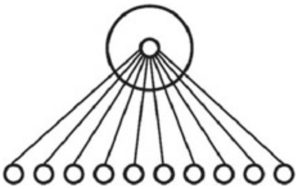

Fig. 4 Chuan-chow Hokkien packer 4 in Singapore

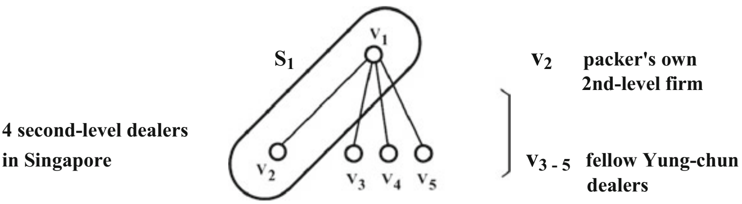

Fig. 5 **Yung-chung Hokkien packer 5 in Kuala Lumpur**

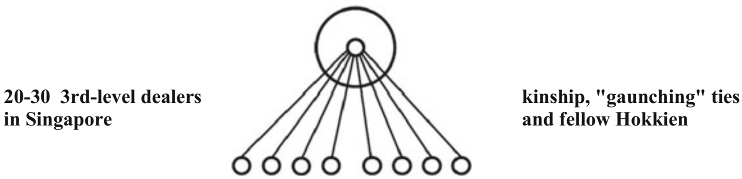

Fig. 6 **Yung-chun second-level dealer 6 in Kuala Lumpur**

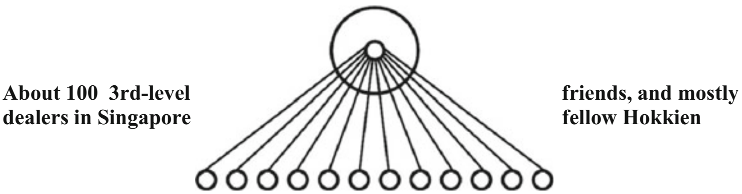

Fig. 7 **Chuan-chow Hokkien second-level dealer 7 in Kuala Lumpur**

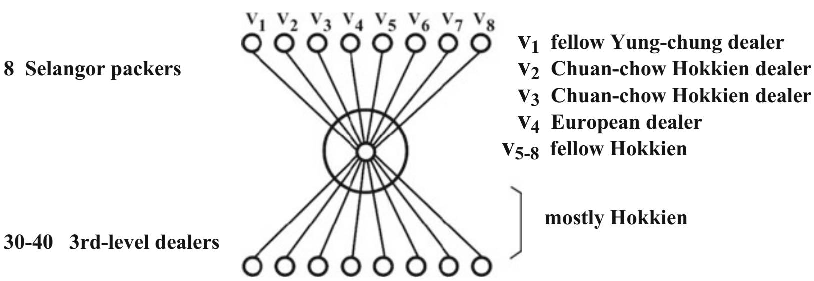

Fig. 8 **Yung-chun Hokkien second-level dealer 8 in Kuala Lumpur**

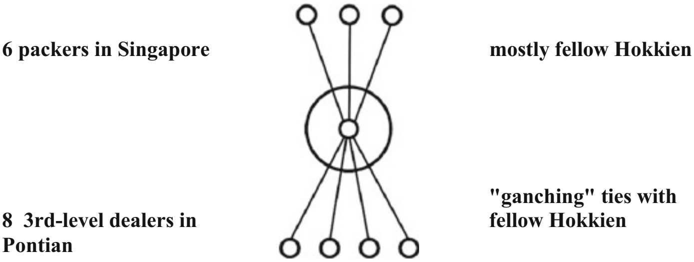

Fig. 9 Chuan-chow Hokkien second-level dealer 9 in Pontian district

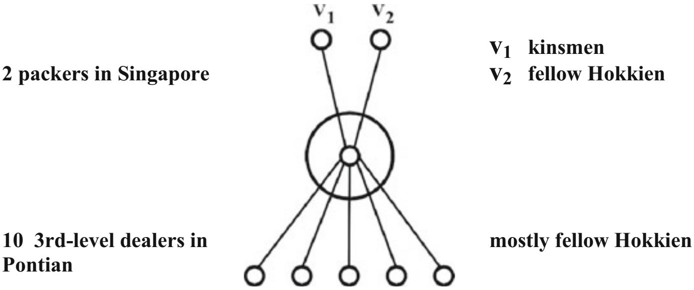

Fig. 10 Hokkien second-level dealer 10 in Pontian district

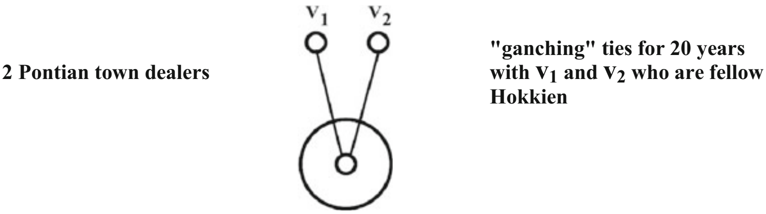

Fig. 11 Hokkien village dealer 11 in Pontian district

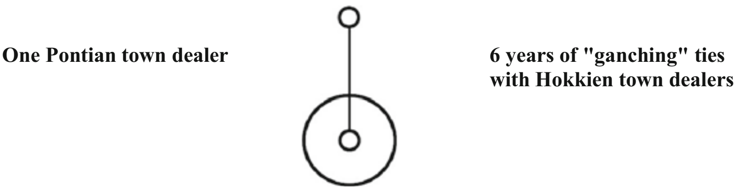

Fig. 12 Hokkien village dealer 12 in Pontian district

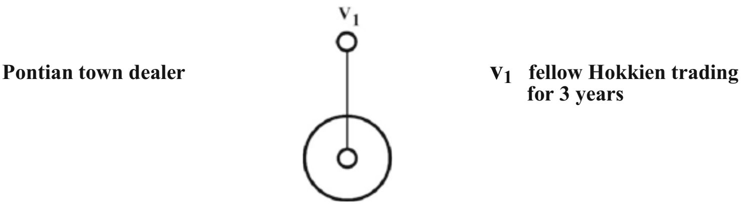

Fig. 13 Hokkien village dealer 13 in Pontian district

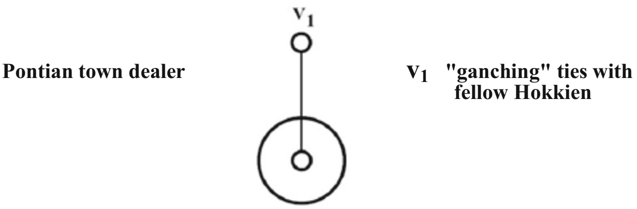

Fig. 14 Hokkien village dealer 14 in Pontian district

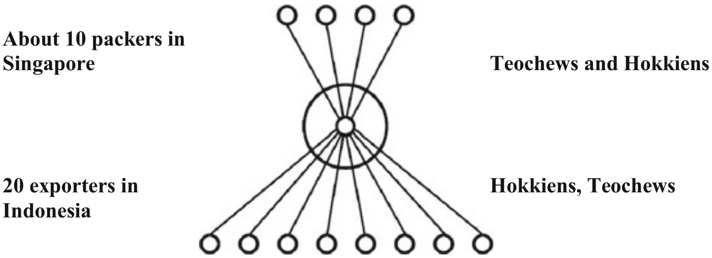

Fig. 15 Teochew commission agent 15 in Singapore

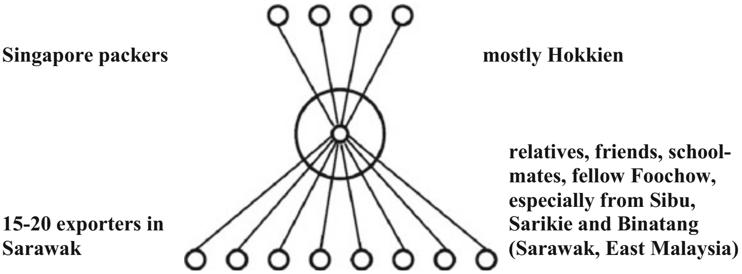

Fig. 16 Foochow commission agent 16 in Singapore

Endnotes

1. The Federation of Malaysia, officially formed September 16, 1963, consisted of The Federation of Malaya (11 states), Singapore, North Borneo (now Sabah) and Sarawak. Singapore left Malaysia on 9 August, 1965 and became an independent nation, the Republic of Singapore. Malaya, now known as West Malaysia or Peninsula Malaysia, while East Malaysia comprise the states of Sabah and Sarawak, and the federal territory of Labuan. See Map 1, chapter 1. *Lee Kuan Yew (Sept. 16, 1923-March 23, 2015) was the first Prime Minister of Singapore, governing for more than three decades from 1959 to 1990. [Note added March 2015]
2. The material was gathered in 1969 as part of a larger project on the impact of Chinese middlemen on agricultural supply response in Malaysia. The author gratefully acknowledges a research grant from the Agricultural Development Council, Inc., U.S.A.
3. See McHale (1965).
4. See Table 13.1, *Rubber Statistics Handbook* (1967), p. 137.
5. Calculated from Table 29, *Kementerian Pertanian Dan Sharikat Kerjasama Malaysia. Rumus Perangkaan* (March 1969, p. 132). (Statistical Digest) (Bahagian Peranchang Dan Penyelidekan).
6. Calculated from Table 29, *Kementerian, ibid.*
7. Calculated from Table 4.1, *Rubber Statistics Handbook* (1967)*,* p. 51.
8. See Lim Chong-Yah (1967), p. 114.
9. See Selvadurai (1962).
10. See Puthucheary (1960), Chapter 3; Lim Sow Ching (1968).
11. See Table 11.2, *Rubber Statistics Handbook* (1967), p. 124.
12. Based on an interview with an official of the Rubber Association of Singapore. Interview was conducted by my research assistant, Miss Gan See Khem, in Singapore, October 1969.
13. See the biography of Tan Kah Kee in Wu Tee Jin (1966), ch. 4.
14. See Colin Barlow and Lim Sow Ching (1965).
15. See McHale (1965).
16. Pontian district was one of the eleven districts, out of a total of seventy-two districts in Malaysia, that produced over 10,000 tons of smallholders' rubber in 1967; Pontian's production was 10,399 tons. See *Rubber Statistics Handbook,* (1967), p. 56.
17. Information on the type of organization of the firm was obtained from *Pontian Rubber Dealers' Association* and from *Rubber Association of Singapore*.
18. Whenever the "$" is mentioned, it refers to the Malaysian/Singapore dollar. In 1969, one U.S. dollar was roughly equivalent to $3.00.
19. In Southeast Asia, a warehouse or other storage space is known as a "godown."

20. These statements obtained in personal interviews in 1969 are to be considered part of the "evidence." On the nature of such oral statements as "evidence," G. Boggars (1969, pp. 20–21) said:

> The essential factors in this evidence are memory and authority. An event or personality can only be historically known if someone was acquainted with them. This person then must be able to recall in the mind the event or personality and then state his recollections in terms intelligible to posterity. Finally, posterity must accept the recollections as true. Such statements reconstitute historical evidence, and this implies that historical truth is available in ready-made statements. The historian's story therefore stands in close relationship to this something that I have called evidence....In a customary society, ... the past are transmitted by tradition and oral means.

21. Dr. Yap Pheng Geck, Manager of the *Chung Khiaw Bank Ltd*., and Honorary President of the *Singapore Chamber of Commerce and Industry,* 1969. Interview conducted at the *Chung Khiaw Bank*, Singapore, 6 October, 1969.
22. C. M. Wong, Secretary of the *Singapore Chinese Chamber of Commerce and Industry,* 1969. Interview conducted at the SCCCI in Singapore, 9 October, 1969.
23. Lam Thian, leader of the Hakka community; Vice-Chairman, Commerce Sub-Committee, SCCCI, 1969. Interviewed by my research assistant, Miss Gan See Khem, 15 October, 1969.
24. Tsu Yun-Ts'iao, editor of the *Journal of Southern Asian Research,* and Director of the *Southeast Asian Research Center*, Singapore, Interview conducted at the *Southeast Asian Research Center*. Singapore, 27 October, 1969.
25. See note 22.
26. See note 21.
27. Interview with Tan Ee Leong (1953), author of "The Chinese Banks Incorporated in Singapore and the Federation of Malaya." Interview conducted at the SCCCI, 19 December 1969.
28. See note 21.
29. This case study was obtained by my research assistant, Miss Gan See Khem, interviewing "Mr. Y" in Singapore, October 1969.
30. See, for example, J.J. Puthucheary (1960), pp. 65–66.
31. This information was obtained in the course of my lengthy conversations with some Pontian dealers.
32. See also the remarks by Dr. Yap Pheng Geck, see note 21.
33. Interview with a Packer-Exporter in Singapore, October 1969.
34. The case studies were obtained from intensive interviews.
35. The interested reader may find strong parallels to these case histories by reading the biographies of successful Chinese businessmen in Singapore and Malaysia by Sung Chek Mei (Ed.) (1969).

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PART III
The Ethnically Homogeneous Middleman Group and the Chinese Family Firm: Theoretical Approaches

Chapter 4
Coasean Foundations of a Unified Theory of Western and Chinese Contractual Practices and Economic Organizations

1 Introduction

It is not easy for western economists or western businessmen to understand the Chinese way of doing business because the Chinese do not rely on formal contracts but place great emphasis on the importance of personal relationships/connections—*guanxi*—and trust in their business dealings with fellow-Chinese.[1] Because of this difference in contractual practice, it has long been recognized by western investors that doing business with the Chinese in China (People's Republic of China) and elsewhere in the overseas Chinese diaspora (Hong Kong, Taiwan, Vietnam, Singapore, Malaysia, and Indonesia) is difficult. This is because to many western economists and investors:

> A modern legal system as practiced in a Western developed economy is sometimes considered essential for the proper functioning of a market economy: The non-Western legal system in China is considered deficient . . . [because] under Chinese law a contract is enforced partly by an informal social relationship known as "guanxi." Guanxi plays an important role in insuring that a contract is honored (Chow 1997, p. 322).

This chapter will show that it is possible to understand the Chinese preference for informal or extra-legal *guanxi* way of doing business, manifesting in Asian/Chinese particularistic modes of economic organization, as an efficient system of contracting under conditions of contract-

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uncertainty. I will do this by developing a unified theory of Western and Chinese contractual practices and modes of economic organization resting on Coasean-transaction cost foundations.

In an assessment of the influence of Ronald Coase's (1937) seminal article, "The Nature of the Firm," which laid the foundations of transaction cost economics, Coase (1988, pp. 34–35) said that the article was ignored for over 30 years. It was only in the 1970s and 1980s that there was a renewed interest in his paper by a growing number of economists, particularly those trying to explain aspects of the organization of industry, for example, in Oliver Williamson's (1975, 1985) work on vertically-integrated firms. The importance of that article, in Coase's (1988, p. 34) view, was the "explicit introduction of the concept of transaction costs into economic analysis" to explain the existence of the institution of the firm. Coase also attributed the renewed interest in his 1937 article to the immediate success of his paper, "The Problem of Social Cost," (Coase 1960) which also incorporated the concept of transaction costs to explain the way in which the legal system could affect the performance of the economic system. Coase (1988, p. 35) went on to say that he did not know:

> . . .at what point it became apparent to me that the whole of economic theory would be transformed by incorporating transaction costs into the analysis—probably this was a gradual process .... How far other economists now share my view of the significance of transaction costs for economic theory I do not know. But there is no question that, starting in the 1970s, a number of economists began to explain the adoption of various business practices (including the emergence of the firm) as a response to the existence of transaction costs.

Unknown to Coase in 1988, he would go on to win the Nobel Prize in Economics in 1991; these two articles were cited for his winning the award. Also unknown to Coase was the great impact of his 1937 paper on my work on the transaction cost implications of social norms (the Confucian code of ethics) embedded in Chinese economic organizations—such as Chinese family firms and Chinese trading networks—for co-ordinating the interdependent activities of economic actors within firms and across markets. My work on Chinese economic organizations—Chinese family firms (Landa 1978, chap. 2; Landa and Salaff (1980, 1986 revised) and ethnic trading networks (Landa 1978, chap. 5; Landa 1981)—was part of a larger study explaining why overseas Chinese were so successful as middlemen-entrepreneurs in Southeast Asia (Landa 1978, 1999).

This chapter is an attempt to show in what ways my work on Chinese contractual practices and economic organizations rested on Coasean foundations, even though it went beyond traditional transaction cost economics—part of New Institutional Economics (NIE)—to incorporate key concepts in sociology and anthropology. The rest of the chapter is organized as follows. Section 2 reviews key aspects of Coase's theory of the firm. Section 3 discusses my theory of contract law, which is an extension of Coase's theory of the firm to the contractual relations between firms in western economies with well-developed legal infrastructure. Section 4 discusses my theory of the ethnically homogeneous middleman group (EHMG)/ethnic trading network, and is an extension of my theory of contract law to less-developed economies or developing economies in which the legal framework for contract enforcement is not well-developed. In my theory of ethnic trading networks, one can still see clear traces of Coase's (1937) paper even though certain concepts are drawn from sociology and anthropology. Section 5 discusses my theory of ethnic networks and how it provides a conceptual link between the "embeddedness-social networks" approach of economic sociology with the Coase-Williamson's "markets-hierarchies" paradigm. The result is an extended "markets-hierarchies-ethnic networks" NIE unified paradigm of western and Chinese contractual practices and economic organizations. Finally, section 6 suggest some testable hypotheses that flow from my theory of ethnic trading networks, hypotheses which have important policy implications for understanding institutional arrangements that facilitate global business transactions.

2 Coase's (1937) theory of the firm

In neoclassical economics there are only decentralized markets where the price mechanism co-ordinate the activities of economic agents who conduct transactions directly with each other. In 1937, Coase published his paper "The Nature of the Firm," in which he posed a puzzle: if all transactions are coordinated by the price or market mechanism, why do we observe the existence of the institution of the "firm" in the real world? Why are "firms" necessary? And why outside the firm:

> ...price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production. It is clear that these are alternative methods of co-ordinating production (Coase 1937, reprinted in Stigler and Boulding 1952, p. 333).

Coase set out to answer this question by introducing the concept of transaction costs explicitly into economic analysis. Coase argued that there are costs of using the price mechanism to organize production. These costs include: (a) the costs of discovering what the relevant prices are; and (b) the costs of contract negotiation for each exchange transaction that takes place in the market. Coase concentrated on contract negotiation costs. He argued that if the price mechanism is used, a factor of production would have to negotiate a number of contracts separately with each of the factors with whom he is co-operating; these costs could be greatly reduced by organizing a firm. By organizing a firm, the entrepreneur-coordinator substitutes a series of contracts for only one employer-employee contract. Not only does the entrepreneur-co-ordinator economize on transaction costs by reducing the number of separate contracts he must enter into, but also there is no need to specify in detail the various contractual obligations with each of the factors he is co-operating with. According to Coase, the defining characteristic of the employer-employee contract is that:

> …for a certain remuneration (which may be fixed of fluctuation) [the employee] agrees to obey the direction of an entrepreneur within certain limits. The essence of the contract is that it should only state the limits to the powers of the entrepreneur. Within these limits, he can therefore direct the other factors of production (Coase 1937, reprinted in Stigler and Boulding 1952, p. 333).

The firm emerges when the entrepreneur, rather than the price mechanism, has the authority to direct the activities of employees, within certain limits; this discretion is not found in contracts between economic actors where the mutual contractual obligations are spelled out explicitly. Where a long-term contract is called for, a firm may emerge to reduce such contracting costs by organizing a firm. He summed up his theory of the firm by saying that: “the operation of the market costs something and by forming an organisation and allowing some authority (an ‘entrepreneur’) to direct the resources, certain marketing costs are saved” (Coase 1937, reprinted in Stigler and Boulding 1952, p. 333).

Coase then turned his attention to the question of the limits to the size of the firm. He argued that the firm will tend to expand until the costs of organizing an extra transaction within the firm becomes equal to the costs of carrying out the same transaction through the market. Coase also addressed the question of when a firm will choose vertical integration, which is when transactions which were previously carried out between entrepreneurs are now organized within one firm. Finally, Coase addressed the question of when a single-product firm will expand into a multi-product firm. He asked us to imagine a town in which there are series of industries, A, B and C, located around a central point in a series of von Thünen rings. Assume that the entrepreneur starts from the central point within the innermost ring, A. As he extends his activities in product A, the cost of organizing increases until it becomes equal to that of a different product, B; thus as the firm expands it will, from that point on, include both products A and B.

3 Landa's (1976) theory of contract law

Coase's contribution in his 1937 paper is to explain the firm as a non-market form of economic organization that is alternative to the price mechanism in co-ordinating the activities of production. So the "firm" and the "market," in Coase's paradigm, are alternative co-ordinating mechanisms. What is missing in this Coasean scenario, however, is the role of the state in enforcing contracts between firms. Since all market transactions involve contracts, and contracts in advanced western capitalist economies are enforced by the state, a theory of contract law is also necessary to explain the role of contract law in co-ordinating the activities between firms. Landa (1976; reprinted in Landa 1994 chap. 2) provided such a theory of contract law, using a transaction cost/property rights-public choice approach, part of the New Institutional Economics (NIE), to explain the emergence of contract law in an exchange economy, characterized by specialization and division of labor among producers, middlemen and final consumers.

In my theory of contract law, the focus on transaction costs is shifted from contract negotiation costs to the costs of breach and the costs of enforcing contracts. My theory rethinks the concept of market relations between firms in terms of the concept of legally binding contractual relations, in which the rules of the game (contract law) are enforced by the state. I showed that the game is played very differently if there is or if there is no external enforcement of the agreements between players in the market. Not only did I shifted the emphasis from market relations to contractual relations, I also shifted my emphasis to the role of specialized traders (merchants) that link producers and consumers together. In this sense, my theory of contract law and the theory of EHMG/ethnic trading networks (next section) is not merely a simple extension of the Coasean theory of the firm—in that Coase's theory of the firm is a theory of production—while my emphasis on the role of contract law and ethnic trading networks is a theory of exchange.[2]

Imagine there are three traders, A, B and C, in which B is assumed to be the middleman. Assume that B has located a supplier, A, and has negotiated a contract with him. Imagine the following terms of the contract. Trader A promises to transfer to B rights to the ownership of a specified quantity and quality of a specified commodity and promises to deliver the goods to B at a specified future date, t + 1. (Note that when market exchange involves a contract, the goods to be exchanged are rights to ownership of goods, and not exchange of goods themselves.) In consideration of A's promise, B promises to transfer to A rights to the ownership of a specified sum of money (say, $100) and promises to pay that sum to A at a specified future date, t + 2. Once the terms of the contract are mutually agreed upon and the contract is signed, a legally binding contract emerges; a person who breaches a contract will be required to compensate monetary damages to the plaintiff when the latter sues him in court. Trader B is now the owner of a "claim to A's goods contract" (Cg) against A. Expecting to receive the goods from A at a specified future date, t + 1, B now sells forward his Cg to C at a higher price. Trader B promises to deliver goods to C at a specified future date, t + 1 in exchange for C's promise to pay a specified sum of money (say, $110) to B at t + 2. As soon as B has made the contract with C, B becomes the profit-seeking middleman who buys low and sells high in order to reap his profits. More precisely, B has a set of expectations—to receive goods from A at t + 1, deliver goods to C at t + 1, and receive payment from C at t + 2—out of which arise B's expectations of future profits ($10). If all three traders honor their contracts, then all the traders' plans and expectations are fulfilled. The legally binding contract plays an important role in co-ordinating the interdependent activities of all three traders, linked by market transactions/contracts.

To appreciate the role of the state in enforcing contracts, let us assume a market economy without a state to enforce contracts, i.e., a market economy characterized by Hobbesian anarchy or contract uncertainty. In such a market economy, any trader can break a contract whenever it is profitable to do so. Let us assume that A, after signing a contract with B, gets a better offer from another middleman (say, $105). With no constraints on contractual behavior, A would be better off by breaking the contract with B and re-contracting with the other middleman. Assuming that B has made no private provisions against A's breach of contract to deliver the goods, B will be forced to break his contract to deliver goods to C. As a consequence, B's profit expectations will be disappointed because C will not pay him the $110 as originally promised. Trader A's breach of contract has imposed social costs or externality on B: middleman B is the victim of an "exchange externality."

Since B cannot go to court to recover monetary damages, hence allowing him to internalize the exchange externality, B must make private provisions to protect his contracts. Trader B can choose one or more of the several methods for the private protection of contracts:

(1) B can search for information regarding A's reputation prior to entering into a contract with A; however, B must incur information costs;
(2) B can personalize exchange relations by trading only with those traders that B can trust; however, B must incur the opportunity costs of excluding outsiders from trade (see Section 3);
(3) B might try using the "discipline of continuous dealings" (Tullock 1972) to mitigate against breach; however, this method by itself is not sufficient to constrain a trader from breach of contract;
(4) B can extend credit and threaten the withdrawal of credit; however, B must take on a money-lending function and hence face the risk of loan default;
(5) B can hold commodity inventories as buffers; however, B must incur storage costs;
(6) B can hold cash balances which allow him to adjust quickly to A's breach by going into the market to buy goods from another supplier so as to deliver the goods to C; however, this increases the information costs of finding a new supplier;
(7) B can pool and spread risks of breach by buying from many suppliers instead of from only one supplier, A; however, this increases the costs of contract negotiation;
(8) B can integrate vertically backward to the source of supply; however, B must incur costs of intrafirm co-ordination, and this also may not be a feasible solution for B if he is short of capital.

Thus, each one of the private solutions for the protection of contracts generates its own transaction costs. To minimize the transaction costs of private protection of contracts, traders can form a merchant guild, with guild rules of the game constraining traders from breach. But as the trading population expands in size, it becomes less efficient for traders to rely on the guild solution for the protection of contracts; the state becomes a more efficient contract enforcer.

Once the state emerges to enforce contracts, all exchange externalities are internalized since a trader now has to weigh the benefits of breach with the costs of breach (in the form of paying monetary damages).[3] Occasionally, a trader might still engage in "efficient breach" (Goetz and Scott 1977), in that the breaching party can compensate the victim of breach but still be made better off by breaching. However, contract law, by assigning liability for breach of contract to the breaching party, introduces an element of inertia into the trader's choice calculus: once a trader signs a contract, the trader has a strong incentive to honor it. Thus, the role of the state in enforcing contracts, according to my theory of contract law, is that the state economizes on the transaction costs of private protection of contracts and hence allows traders to shift some of the scarce resources to trade rather than the protection of contracts. The state, through its role in protecting contracts, "may be viewed as a super-coordinator of inter-firm transactions creating a super-vertically integrated firm, which is, in reality, a well-functioning and efficient exchange economy" (Landa 1976, p. 917; reprinted in Landa 1994, p. 63).

4 Landa's (1981) theory of the ethnically homogenous middleman group (EHMG)/ethnic trading networks[*]

My theory of the EHMG, based on my fieldwork (Landa 1978, chapters 3) on Hokkien-Chinese rubber traders in Singapore and West Malaysia in 1969 explains why the middleman group involved in the marketing of small-holders' rubber was dominated by a close-knit homogenous group of Hokkien-Chinese related to each other by particularistic ties of kinship and ethnicity.

I argued that under conditions of contract uncertainty, with positive transaction costs of breach and enforcement costs, a rational trader will not indiscriminately enter into impersonal exchange relations with anonymous traders. Instead, the rational trader (Ego) will arm himself with—what anthropologist Myer Fortes (1969) called—a "calculus of relations" which, in the context of Chinese merchants imbued with Confucian social norms/ code of ethics, allows the trader to classify all his potential trading partners into seven grades, according to degree of kinship or "social distance," in descending order of trustworthiness in honoring contracts.

The system of discriminatory rankings can be represented by a series of seven von Thünen concentric circles/rings[4] to depict seven grades of trading partners, with the best grade (most trustworthy trader i.e. Ego's kinsmen) located at the center within the innermost ring. In order for Ego to choose his least-cost trading network as Ego extends the size of his trading network, Ego will choose all his trading partners from ring 1 before moving on to ring 2 and then moving further outwards, stopping at the major ethnic boundary—where there is a sharp kink in transaction costs—separating

[*] This section has been abbreviated because my theory of the EHMG (Landa 1981) is presented in full in chapter 5 of this book.

Chinese from non-Chinese traders. The existence of a sharp kink in transaction costs at the Chinese ethnic boundary is the main reason why Ego prefers to trade with “insiders” (Chinese traders) who share the same Confucian ethics rather than trade with “outsiders” (non-Chinese). For those Chinese traders—village dealers—who must cross the ethnic boundary in order to obtain supplies from the Malay smallholders, cash transactions were used to reduce the costs of breach of contract.

In a functionally inter-connected marketing network, the aggregative results of the rational choice of individual Chinese traders is the emergence of the macro phenomenon of the EHMG, with Confucian ethics embedded in the group; this is the “micro-macro” link in sociology. The EHMG, a club-like institutional arrangement, alternative to contract law and the vertical-integrated firm, economizes on the traders’ costs of enforcing contracts under conditions of contract uncertainty.

In summary, even though my theory of the EHMG/ethnic trading networks included important sociological and anthropological concepts such as calculus of relations, social distance, social norms/codes of ethics, it is clear that my theory of the EHMG rests squarely on Coasean-transaction cost foundations.

5 Landa’s (1981) theory of EHMG: Links with the “markets-hierarchies,” “embeddedness”/social network research programs

Oliver Williamson (1975, 1985) has done a great deal to promote transaction cost economics. His analysis of the vertically-integrated firm is an important extension of Coase’s theory of the firm. Williamson shifted his emphasis to the *ex post* contractual problem of exchange and argued that asset specificity of a contracting firm allows a contracting partner to act opportunistically to the detriment of the contracting firm. Vertical integration, a private ordering governance structure, thus emerges to cope with the problem of contracting across markets where contractual relations could be costly under conditions of bounded rationality, asset specificity and opportunism. My theory of ethnic trading networks is also a theory of private ordering type of governance structure to cope with the problem of opportunism, specifically breach of contract where the legal framework for enforcement is not well-developed; hence relying on the state to enforce contracts by traders is costly. Instead of choosing vertical integration, Chinese middlemen in developing economies choose to particularize exchange relations as a way of economizing on transaction costs under conditions of contract uncertainty.

My theory of ethnic trading networks (Landa 1981) is also related to sociologist Granovetter's (1985) "embeddedness" approach to social networks. Granovetter's article began with a critique of the economists' "methodological individualism" approach to the study of economic man in general, and in particular against Williamson's "markets-hierarchy" approach to the study of methods of coordinating economic activities. Specifically, Granovetter criticized economists for adopting an "undersocialized" rational choice view of the economic man, an atomized man who has no social ties with others. Taking account of the fact that in the real world economic relations are often embedded in social relations, Granovetter argued that mutual trust exists to mitigate against malfeasance—or opportunistic behavior—of members embedded in such networks. Thus, social networks function to co-ordinate inter-firm transactions under conditions in which Williamson would predict the emergence of the vertically-integrated firms. Granovetter advocated a research program for the development of the "new economic sociology" (see also Swedberg 1991; Smelser and Swedberg 1994), different from the "old economic sociology" and from neoclassical economics, that will incorporate the embeddedness approach as its core.[5]

Looking back at my theory of ethnic trading networks (Landa 1981), it is clear that when the theory is stripped of both its Coasean transaction costs foundations as well as its rational choice foundations, my theory is, in essence, the same as Granovetter's (1985) embeddedness-social network "new economic sociology" approach. But his theory of social networks is incomplete because his theory cannot explain the emergence of trust embedded in personalistic social networks; Granovetter simply assumed the existence of trust embedded in personalistic exchange networks. As Frieland and Alford (1991, pp. 252–253) put it:

> Mark Granovetter stress that both market exchange and bureaucratic hierarchy are embedded in social relations which affect their action (Granovetter, 1985). But how these relationships affect exchange and hierarchy is still ambiguous. In the essay he points out that these relations may hinder or facilitate the operation of the structure.
>
> ....However, social networks per se do not have any content and as such do not entail interests, values, motives, beliefs ... [and] without content, that is, the distinctive categories, beliefs, and motives, created by a specific institutional logic—it will be impossible to explain what kinds of social relations have what kind of effect on the behavior of organizations and individuals. That content can best be understood by situating those social relations within a particular context. Otherwise, the "embeddedness" approach can easily be assimilated to a rational individualist perspective...or

> to the functionalism of the new institutional economics wherein social relations are derived, just like hierarchy through the limits of exchange. Without the content, of these social relationships, we are unable to understand what trust—so central to these discussions—actually means.

My theory of ethnic trading networks shows that it is, indeed, possible to assimilate the sociological embeddedness approach to a rational choice approach resting on Coasean transaction cost/NIE foundations. My theory of EHMG thus provides a conceptual link between the embeddedness-social network approach of the new economic sociology, and Coase-Williamson's "markets-hierarchies" NIE analysis of alternative forms of western economic organizations. The result is an extended "markets-hierarchies-ethnic networks" unified theory of western and Chinese contractual practices and economic organizations resting on Coasean transaction cost foundations.

6 Implications of a theory of EHMG for formulating some (testable) hypotheses

The following (six) hypotheses flow from my theory of EHMG/ethnic trading networks; hypotheses 2, 3, 4 and 5 are especially relevant for research on the kinds of institutional arrangements which will facilitate global economic transactions:

(1) The function of the EHMG as an efficient network form of economic organization for contract enforcement under conditions of contract-uncertainty may become increasingly redundant as the nation-state plays an increasingly important role in the creation and enforcement of contract law in developing economies (Landa 1981; Landa 1998). Even then, the EHMG may still play an important role in an advanced capitalist economy with well-developed legal infrastructure when members of an EHMG can enforce contracts more efficiently than resorting to the law courts. A good example of this is the diamond trade in New York City, which is dominated by a close-knit group of Hassidic Jews (Landa 1988). The diamond trade involves a great deal of trust and the close-knit trading community of Hassidic Jews was able to dominate this trade because the Jews had a long history of enforcing contracts within the Jewish diaspora of Medieval Europe.

(2) With globalization of economic transactions, and the growing economic importance of East Asia, ethnic trading networks/EHMG will become even more important in international and regional trade. Thus I agree with Appelbaum's (1998) analysis that Chinese/East Asian forms of

network organization will be increasingly important, not only because of the importance of trust and *guanxi* in enforcing contracts emphasized in this chapter, but also because of an additional reason not mentioned in my work, i.e., that such network organizations, with their emphasis on informal relations, are a flexible type of economic organization highly adaptable to the needs of global buyer-driven commodity chains (Appelbaum 1998; Gereffi and Korzeniewicz, ed. 1994). Hence, network organizations are more efficient than the rigid state-enforced contractual relations between firms.[6]

(3) Western companies contracting for joint ventures in China will be more successful in doing business in China if they have an ethnic Chinese joint venture partner, with extensive connections with Chinese officials and other Chinese businessmen. This is especially important in China (PRC) in transition to a market economy where many local Chinese cadres are entrenched in strategic "gatekeeping" roles in the granting of quotas, permits, licenses, etc. (Appelbaum 1998; Landa 1998). Here trust embedded in particularistic networks, unfortunately, can be exploited for the purposes of unproductive rent-seeking activities on the part of cadres (Landa 1998), giving rise to bribery and corruption.[7]

(4) In joint venture contracts between Western and Chinese partners, detailed and elaborate terms of contract are more likely compared with joint venture contracts between Chinese joint venture partners. This reflects the formal contractual system favored by Western companies and their hired big Western law firms when negotiating with Chinese partners. Chinese joint venture partners, on the other hand, are likely to have simpler, less elaborate contracts, relying more on the trust and goodwill of the partners in dealing with problems that might arise.

(5) Western manufacturers wishing to have access to supplies from Chinese factories would be more successful if they use the service of a Chinese firm to act as its agent; the Western firm signs a legally binding contract with its agent. The agent works through a Chinese factory, which in turn establishes a network of Chinese subcontractors linked by particularistic ties. These informal networks, based on trust, make the Chinese network of subcontractors highly flexible and adaptive to changing market conditions, especially important in buyer-driven commodity chains (Appelbaum 1998).[8]

(6) In joint venture contracts between Chinese partners, it is likely that partnerships are formed along dialect lines. These include, for instance, joint venture contracts formed between Cantonese-speaking Hong Kong partners with partners from Guangdong province, joint venture contracts formed between Hokkien-speaking Taiwanese partners and partners in

Fujian province, and joint venture contracts formed between Hokkien-speaking Singapore partners and partners in Fujian province. This is due not only to common dialect but also to the Chinese sense of belonging to their "native place," and hence the greater the degree of trust towards partners from their native place.

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Endnotes

1. In a headline entitled "Friendship, Trust, and the Chinese Way of Doing Business," the *Straits Times Weekly Overseas Edition* (24 August 1991 p. 13) reported that the first and biggest gathering of overseas Chinese businessmen—800 overseas delegates from 30 countries—had attended a three-day "World Chinese Entrepreneurs Convention" in Singapore. Noting that the main purpose of the convention was to enable overseas Chinese entrepreneurs from different parts of the world to meet with each other in order to establish "business deals and social ties," the article states that "[d]oing business the Chinese way, especially if it were to culminate in a successful deal, has always been more effective if it is done in an informal atmosphere with someone you trust as a friend. Even for other delegates with no strong historical bonds, it was enough that one shared the same surname, or spoke the same dialect with an otherwise near stranger. The handshakes, the karaoke sessions and the customary 10-course dinners have, in their unobtrusive ways, strengthened friendship and established trust." The delegates spoke of the need to promote "Confucian values as a means to understand thrift, hard work and group cohesion."
2. Thanks to Gary Hamilton for pointing this out to me at the AEA Conference in New Orleans in January 1997.
3. See Landa (1987) for a more sophisticated theory of contract law which takes account of: (a) the foreseeability doctrine of *Hadley v. Baxendale* with respect to the recovery of lost profits; and (b) the distinction between fungible and unique goods in contract remedies for breach.
4. Recently I came across the work of Chinese sociologist Fei Xiaotong (1992), who described the basic characteristic of traditional Chinese society in terms of the concept of "*chaxugeju*" (differential mode of association): each individual is at the center of a series of widening concentric circles of networks of overlapping kin and social relationships. Confucian ethics supply both objective structural framework and the cognitive foundations for such a system of ranking

and classification. Fei's analysis made me very aware of how overseas Chinese in Southeast Asia have adapted the traditional Chinese social structure to the social structure of the host country to which they emigrated.

5. For some of the sociological literature using the "embeddedness-social network" approach in analyzing Chinese and other East Asian forms of economic organization, see the collection of papers in Hamilton (Ed., 1996). See also the collection of papers in Fruin (Ed., 1998).
6. Thanks to Richard Appelbaum for pointing this out to me (e-mail correspondence, 7 January 1999).
7. In Landa (1998), I made an analytical distinction between gift-giving among members of a EHMG as investment in trust, and gift-giving used as bribes in unproductive rent-seeking activity.
8. Karen Lee wrote an essay for me in 1998, in my graduate law-and-economics course, on aspects of Asian business network. She provided a case study of her Hong Kong-based firm, which acts as an agent or middleman between an American company and a Hong Kong hand-knitting factory. The Hong Kong factory, in turn, subcontracts the major process—hand-knitting—to kinsmen, clansmen and those living in Chaozhou, China; there are no formal contracts signed between the Hong Kong factory and its network of subcontractors in Chaozhou. Trust is very important in assuring timely delivery of products. For a game-theoretic analysis of the principal-agent relationship in the context of Asian business networks, see Huang and Landa (1999).

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Chapter 5
A Theory of the Ethnically Homogeneous Middleman Group: An Institutional Alternative to Contract Law

1 Introduction

Central to the economics of property rights-public choice theory[1] is the recognition that laws and institutions are important in promoting the efficiency of an economy. One of these institutions is the law of contracts. Contract law, via its role in constraining traders from breach of contract, reduces transaction costs and hence facilitates exchange.[2] But how do traders cope with the problem of contract uncertainty in an environment where the legal framework is nonexistent or poorly developed? The work of anthropologists such as Alice Dewey (1962) on Chinese traders in Java, and Cyril Belshaw (1965) on traders in "traditional" markets suggests that traders *personalize* or *particularize* exchange relations as a way of coping with contract uncertainty.

Since the details of how personalistic exchange relations function as substitutes for contract law have not been discussed by these writers nor by others working in this field, first-hand fieldwork was necessary. Questionnaire surveys of and interviews with Chinese middlemen engaged in the marketing of smallholders' rubber in Singapore and West Malaysia in 1969 revealed that (a) the marketing of smallholders' rubber—through the various levels of the vertical marketing structure—was dominated by a middleman group with a tightly knit kinship structure consisting of six clans[3] (Tan, Lee, Ng, Teh, Lim, and Gan) from the Hokkien-Chinese ethnic group;

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(b) that mutual trust and mutual aid formed the basis for the particularization of exchange relations among Chinese middlemen; and (c) that within the Chinese economy transactions among middlemen were based on credit, while Chinese middlemen used cash transactions with indigenous smallholders to reduce contract uncertainty.

The fieldwork, the subsequent analysis of data, and the findings revealed that Chinese middlemen were not just a random collection of Chinese traders. Rather, they were linked together in complex networks of particularistic exchange relations to form an ethnically homogeneous middleman group (EHMG). But the real significance of the visible, surface structure of the EHMG lies in its underlying deep structure: the invisible codes of ethics, embedded in the personalized exchange relations among the members of the EHMG, which function as constraints against breach of contract and hence facilitate exchange among Chinese middlemen. The EHMG thus reveals itself to be a low-cost club-like institutional arrangement, serving as an alternative to contract law and the vertically integrated firm, which emerged to economize on contract enforcement and information costs in an environment where the legal infrastructure was not well developed.

Two recent studies confirm my findings. Clifford Geertz (1978) rationalizes the "institutional peculiarities" of the bazaar economy (e.g., "clientalization," the pairing off of buyers and sellers in recurrent transactions) in terms of the bazaar's function in reducing information costs under contract uncertainty. Richard Posner (1980, p. 26), in his insightful paper on institutions of primitive societies, discusses alternative responses for coping with the costliness of contract uncertainty:

> Another response to market transaction costs is the transformation of an arms-length contract relationship into an intimate status relationship. In some primitive societies if you trade repeatedly with the same man he becomes your blood brother and you owe him the same duty of generous and fair dealing that you would owe a kinsman. This "barter friendship" resembles the pairing of buyers and sellers in bazaars that Geertz noted. It is a way of bringing reciprocity into the exchange process and thereby increasing the likelihood that promises will be honored despite the absence of a public enforcement authority.

Independent of the work of Geertz and Posner, in this chapter, I develop a theory of the EHMG, using a property rights-public choice approach and drawing on the economics of signaling. Section 2 develops a theory of the emergence of the EHMG as a result of individual choices, on the part of many interdependent traders, to join a network of personalistic exchange relationships. Section 3 develops a theory of codes of ethics, embedded in kinship/ethnic relations, as a functional equivalent of the law of contracts.

Section 4 develops a theory of the EHMG as an efficient institutional arrangement for economizing on information costs in an environment characterized by imperfect information. The concluding section, Section 5, will suggest some implications of our theory for further research.

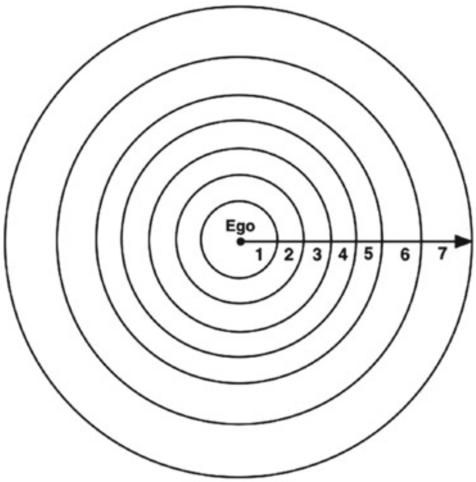
2 A theory of the formation of the ethically homogenous middleman group: An analysis of particularistic exchange under contract uncertainty

Standard theories of exchange (Edgeworth and Walrasian models) depict competitive trade as an impersonal process of exchange, because these theories refer to a zero transaction costs economy with no contract uncertainty. In such an economy, there is no need to identify trading partners nor any reason for the institution of contract law since trading partners can be regarded as homogeneous with respect to contract behavior. Thus, impersonal market forces alone determine the pairing of buyers and sellers. Under conditions of contract uncertainty with positive transactions costs, on the other hand, a rational trader will not indiscriminately enter into impersonal exchange relations with anonymous traders. At any particular point in time, an individual is embedded in a "social structure"[4] with "rules of the game" that serve to constrain his behavior. Hence, a rational trader will enter into particularistic exchange relations with traders bound by institutional constraints whom he knows to be trustworthy and reliable in honoring contracts.

In order to choose a particularistic network of trading partners that will minimize the out-of-pocket costs of protection of contracts, a rational trader will equip himself with a "calculus of relations" (Fortes 1969). Such a calculus allows the trader to rank all traders in a market according to a small number of categories corresponding to different "grades" of traders, in descending order of trustworthiness.[5] Consider the system of discriminatory rankings established by a typical Hokkien trader (call him "Ego") as shown in Table 5.1. The system of discriminatory rankings of traders can be represented by the use of a von Thünen series of concentric circles to depict differences in grades of trading partners, with the best grade located at the center. Assume smooth differences in the grades of trading partners up to the first ethnic boundary separating Hokkiens from non-Hokkiens; thereafter assume a significant change in the grade of partners after crossing the Hokkien-Chinese boundary, and an abrupt change as the major ethnic boundary is crossed. See Figure 5.1.

Table 5.1 A rational trader's ranking of trading partners

	Categories of Social Relations	Grades/ Ranking
A. (Insiders)	1. Near Kinsmen from family	1
	2. Distant kinsmen from extended family	2
	3. Clansmen	3
	4. Fellow villagers from China	4
	5. Fellow Hokkiens	5
B. (Outsiders)	6. non-Hokkiens (Teochews, Cantonese, etc.)	6
	7. non-Chinese (Malays, Europeans, etc.)	7



1. **Near kinsmen from family**
2. **Distant kinsmen from extended family**
3. **Clansmen**
4. **Fellow villagers**
5. **Fellow-Hokkiens**
6. **Non-Hokkiens**
7. **Non-Chinese**

Fig. 5.1 Von Thünen concentric circles depicting seven grades of trading partners

Assume that Ego, equipped with this subjective calculus of relations, begins his choice of a least-cost network of trading partners. The cost implications of five homogeneous trading networks of size *N,* each composed of a different grade of traders, are illustrated in Figure 5.2. Note that each transactions-cost curve rises as the size of the trading network increases. The rising transaction-cost curve is due to two kinds of costs:

(a) Coordination costs of interdependent traders rise as the network increases in size, because the coordination costs of two isolated pairs of traders are lower than the coordination costs of two pairs of traders connected in a network. If we start from two traders at point *a,* the movement will not be from *a* to *b* on the horizontal transaction-costs curve T_1, as the size of the network increases from two to four traders. Rather, the movement is from *a* to *b*′ on the rising transaction-cost curve T_1'; and

(b) Costs of contract enforcement rise as the number of interdependent traders in the trading network increases. As a trading network increases in

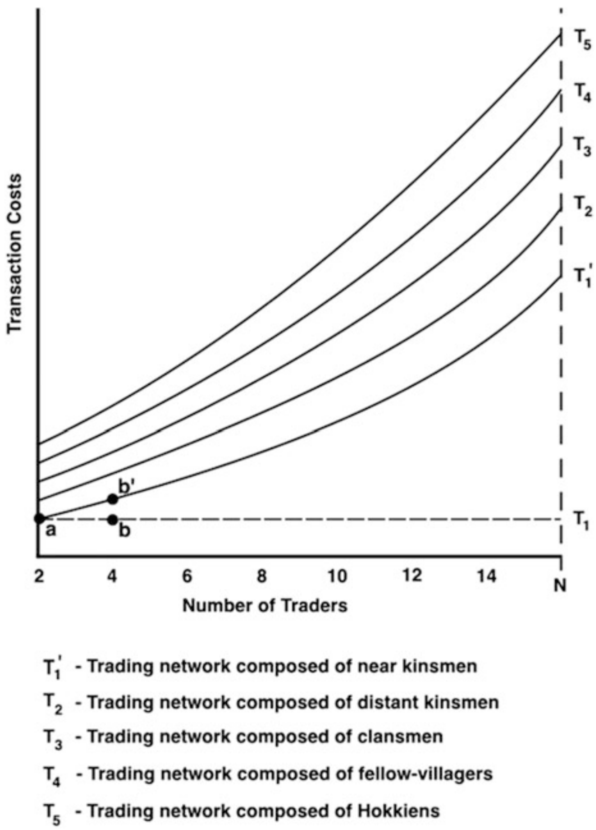


Fig. 5.2 Cost implications of five homogeneous trading networks composed of different grades of traders

size, it is increasingly vulnerable to the antisocial behavior of even one trader who, in breaking his contract, may cause "chain reaction" effects of a breach (Landa 1976).

Faced with five trading networks of size *N*, a rational trader will choose the least-cost trading network, $T'_1(n)$ since $T_5(n) > T_4(n) > \ldots T'_1(n)$. With a larger network of trading partners, with fixed group size *K*, Ego will choose all his trading partners from category 1 before moving outward to the next category. As Ego moves outward from the center, members of his trading network or "club" will be chosen from ever-widening circles with the result that "club" members become increasingly more heterogeneous as more than one grade of trading partners are included. The transaction-cost implications of two trading networks, T_1 and T_2, for a fixed group size *K*, each with a different "mix" of trading partners, are illustrated in Figure 5.3. T_1 is drawn with a discontinuity at *Y* to denote that beyond *Y*, costs rise abruptly as trading partners are chosen from a different ethnic group (outsiders). Such a discontinuity manifests itself by Ego's choice of a well-defined ethnically homogeneous middleman network, with membership size *Y*. The relevant transaction-costs curve for the homogeneous network is T_1, which has a sharp kink at the group boundary. For transactions outside the ethnic boundary, Ego resorts to the use of cash to reduce contract-

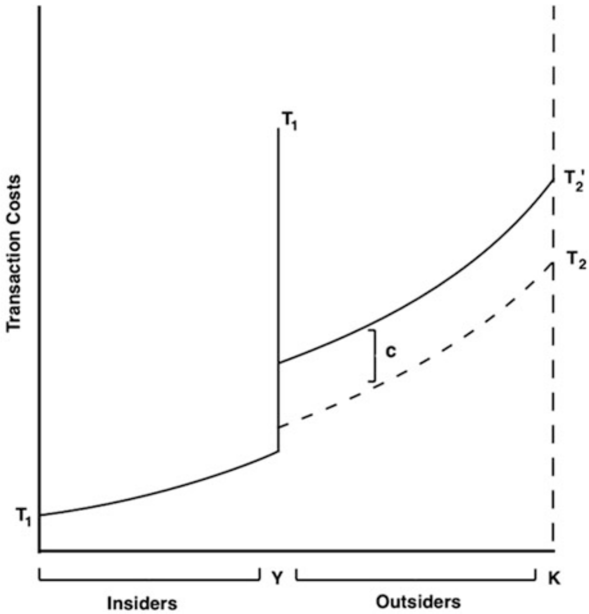


Fig. 5.3 **Cost implications of two trading networks with differences in the "mix" of trading partners**

enforcement costs to zero. Were there no opportunity costs in using cash, the relevant transaction-cost curve for the heterogeneous trading network with membership size K would be T_2 . But since there are opportunity costs associated with the use of cash transactions, the relevant transaction curve is T'_2 which exhibits a discontinuity at Y. The vertical distance, c measures the opportunity costs incurred by Ego in using cash transactions with outsiders. For some traders, T'_2 is the relevant transaction-cost curve associated with a heterogeneous trading network. This would involve a situation where the Chinese middleman, in his role as village dealer, has to enter into exchange relations with a large number of smallholders belonging to a different ethnic group. If the Chinese middleman refuses to trade with "outsiders," he must incur the opportunity costs of exclusion, the costs of foregone profits. So long as the opportunity costs of excluding outsiders from trade exceed transaction costs, a trader has an incentive to cross ethnic boundaries to incorporate outsiders into his trading network. The importance of Ego's *subjective* calculus of relations in determining the *objective* optimal "mix" of trading partners therefore depends upon the number of members in the constituent concentric circles, the degree of heterogeneity of the population, and a balancing off, at the margin, between transaction costs of including outsiders and the opportunity costs of exclusion of outsiders. The outcome of Ego's discriminatory choice of trading partners is the formation of a particularistic trading network comprising members who share the same (Confucian) code of ethics. Given a nondecomposable middleman economy, the structural effect of many individual Chinese middlemen's discriminatory choice is the formation of an EHMG.[6]

3 Code of ethics as the functional equivalent of the Law Merchant or Law of Contracts

Under conditions of contract uncertainty, kinship/ethnic status embodying the Confucian ethics is a valuable intangible asset for a potential trading partner because of the "priority rights" Ego confers upon his trading partner; kinship/ethnic status is an essential input in the middleman's transaction technology. But the costs of obtaining this valuable input is zero for the trading partner possessing a kinship/ethnic status. Kinship or ethnic status is not a "right" that can be purchased by those who do not possess the requisite status.[7] Status is acquired by virtue of a person being born into a particular kinship/ethnic group. Kinship/ethnic rights may therefore be regarded as a species of "status rights" (Dales 1972), the set of rights lying between the subset of private property and common property rights. These rights are equivalent to rights of citizenship, including preferential access to job opportunities, but are accessible only to subsets of the total population.

Since status rights, as an essential input, are nontransferable and nonmarketable by nature—it is a human capital *(in personam)* assignment—the opportunity sets of traders are *not* the same in markets dominated by a particular kinship/ethnic group. Only those "insiders" who can marshal all the essential inputs, including kinship/ethnic status, can become middlemen. The "outsiders," being de facto without status rights, are excluded from middleman roles because they cannot obtain an essential nonmarketable input necessary for middleman-entrepreneurship under conditions of contract uncertainty. If industry conditions are favorable for expansion of middlemen activities, the value of status rights as an entry ticket into personalistic markets rises. Thus under conditions of contract uncertainty, "insiders" have a differential advantage vis-à-vis outsiders in appropriating new middleman roles for themselves. To neutralize somewhat the unequal access to trading opportunities, outsiders may substitute reputation for kinship/ethnic status. But, acquisition of reputation is not costless.[8] The transaction costs of an outsider, in the role of middleman, are higher than his counterpart who is an insider. The higher transaction costs of outsiders constitute an entry barrier into personalistic markets. Because of the low costs of entry into one's own trading community in contrast to the high costs of entry into another ethnic trading community, a partner has a strong incentive to remain loyal to his own trading partner and the kinship/ethnic group of which he is a member. Furthermore, the economic sanctions facing a trader who violates group norms take the following forms: (a) withdrawal of credit so that the trader has to deal on a cash basis; (b) exclusion from future dealings; and (c) "expulsion" from the group via bankruptcy proceedings. The code of ethics, embedded in kinship/ethnic networks, functions to deter Ego's trading partner from breach of contract and hence may be seen as the functional equivalent of the Law Merchant or modern law of contracts.

Once the code of ethics emerges in a Chinese middleman economy, all externalities are internalized.[9] The existence of an ethical code of conduct helps to achieve efficiency in several ways. First, Chinese middlemen are able to appropriate profit expectations as intangible assets with a high degree of certainty, thereby facilitating middleman-entrepreneurship. Second, Chinese middlemen are able to reduce out-of-pocket costs of private protection of contracts; this shifts the total transaction-cost curve of a middleman firm downward. Third, middlemen are able to economize on the holding of commodity inventories and money by the creation of an efficient forward market in goods and money within the boundaries of the Chinese middleman economy. The result is the creation of "dual markets": the existence of forward markets and credit transactions within the Chinese middleman economy side by side with spot markets and cash transactions within the indigenous economy.

4 The "calculus of relations," informal social networks, and mutual aid associations: Efficient information screening and mobilizing devices

To this point, we have proceeded on the implicit assumption that Ego possessed the requisite nonprice information about the trustworthiness of a potential trading partner. This assumption must now be relaxed to include Ego's search for nonprice information and the strategies Ego invents for economizing on information costs. An ingenious strategy Ego can use is to equip himself with the "calculus of relations" (Fortes 1969). The calculus of relations, as will be shown, is an informationally efficient screening device because it enables Ego to pick up nonprice market signals directly from social characteristics of the potential trading partner (such as kinship distance, ethnic identity, etc.), and hence predict the contractual behavior of his potential trading partner with a high degree of accuracy.

To equip himself with an informationally efficient calculus of relations, Ego must be able: (a) to establish a system of discriminatory rankings of all traders in a market into a small number of categories corresponding to "grades" of traders, in descending order of reliability; and (b) to identify his potential trading partner at low cost. It may be inferred from a typical Hokkien trader's system of discriminatory rankings that Ego uses four basic structural principles to classify all traders into seven categories of traders: kinship, clanship, territory, and ethnicity; the general classificatory principle being based on the degree of "social distance" (Sahlins 1965) between Ego and his potential trading partner. Ego's discriminatory system of ranking of trading partners reflects the *content* and the *limits* of the Confucian code of ethics.[10]

Confucian ethics, in overseas Chinese society, prescribes differences in the patterns of mutual aid obligations between people with varying degrees of social distance within a well-defined social structure—near kinsmen, distant kinsmen, clansmen, fellow villagers, and fellow Hokkiens. Kinship relations, in which social distance is at a minimum, are strong ties that involve the severest degree of constraint in dealings among kinsmen. Kinship relations are the irreducible jural and moral relations, and kinsmen are thus the most reliable people with whom to trade. Because of differences in the degree of behavioral constraint, each of the five categories of members occupies a special place within the overall social structure of the Hokkien ethnic community. This implies that different behavioral patterns can be predicted for each category of members corresponding to their location in the social structure. The most orderly or reliable pattern of contractual behavior is predicted for close kinsmen and the least reliable or most disorderly behavior is predicted for fellow Hokkiens. This, then, forms the basis for Ego's internal differentiation of Hokkien traders into five different categories of traders.

The limits of Confucian ethics form the basis for Ego's classification of all traders into two categories: (a) the "insiders" (the Hokkien traders) who, by virtue of their shared code of ethics, form a "moral community" of reliable traders; and (b) the "outsiders," not constrained by Confucian ethics, who are perceived by Ego to be unreliable. Since non-Hokkien Chinese traders are socially closer than non-Chinese traders, the former are perceived to be more reliable than non-Chinese traders and hence non-Hokkien traders are assigned to category six. Between Ego and a non-Chinese trader, social distance is at a maximum. Ego perceives cooperation with a non-Chinese to be difficult since an outsider may withhold cooperation or may even exhibit "negative reciprocity" (Sahlins 1965, p. 144) behavior. Thus, non-Chinese traders are assigned to category seven.

In a society in which members adhere strictly to the code of conduct of the group and have a clear idea of who is an "insider" and who is an "outsider": (a) consistency in subjective discriminatory rankings of trading partners is to be expected of members of the group;[11] and (b) consistency in behavior is expected of different categories. This being the case, Ego is able to establish a small number of categories of social relations for the discriminatory ranking of all traders in a market.

Having established his system of ranking of traders, it remains for Ego to identify a potential trading partner in order to place him in the proper category. To do this efficiently, Ego looks for certain relational attributes of his potential trading partner. The ethnic attribute of a non-Chinese trader is highly visible and distinguishable to a Chinese trader. This means that Ego, when encountering a non-Chinese trader, needs to acquire only one piece of information by a mere glance to completely remove uncertainty regarding the identity of the non-Chinese trader and hence assign him to the proper category (i.e., category seven). To correctly identify a Chinese trader and hence assign him to his proper category, Ego needs to acquire at most only four pieces of information—what dialect he speaks, his place of origin, his surname, and his relationship to Ego. Ego can acquire information necessary to identify all his potential trading partners at a very low or virtually zero cost. Kinship/ethnic attributes are thus non-price market signals that convey valuable information to Ego about the reliability of his potential trading partner at low cost.[12] The trader's calculus of relations may be regarded as a *low-cost screening device*. Once a trading partner is identified, he is assigned to his proper category and hence "graded." Ego then proceeds to use the calculus of relations as a tool of action for the actual choice of his trading partners in the manner discussed in section 2.

There are additional reasons why Ego prefers to choose potential trading partners from his own ethnic community. First, dense person-to-person informal communication networks within Ego's ethnic community make it possible for Ego to pool information regarding the contractual behavior of a potential partner. The exchange of non-price information among members without charge economizes on information costs. This contrasts with the higher information costs Ego may expect to incur when he searches for information regarding an "outsider" across ethnic boundaries where the withholding of information is always a possibility. Second, members of Ego's own ethnic community, being "insiders" with strong ties to Ego, are perceived to be more trustworthy than "outsiders."[13] Information acquired from insiders is therefore considered by Ego to be more *reliable;* hence he can economize on the quantity of information he collects. Third, by knowing the background of the potential trading partner—his clan, his place of origin in China—Ego can acquire information from the networks of mutual aid associations within his own community or from the community leaders who maintain extensive networks of contacts throughout the community.

Confining choice of a potential trading partner within Ego's own community therefore greatly economizes on information costs. Conceptually, however, Ego's problem does not end with searching for information regarding his potential partners. In a vertical market structure, where traders are linked directly and indirectly together by long chains of mutual interdependence, Ego needs to acquire information not only about his own set of potential trading partners but also his partner's partners. Information costs would be prohibitive. This, however, implicitly assumes impersonal networks of traders. In personalistic middleman markets, where traders are linked together by kinship or ethnic ties, if $v_1 T v_2$ (read: v_1 trusts v_2) and $v_2 T v_3$, then $v_1 T v_3$. Mutual trust, via "transitive trust," becomes *collective trust,* a public good because it enables Ego to decompose the complex network of traders into his own subset of traders and confines search to this subset.

Finally, by choosing trading partners from one's own ethnic community, Ego minimizes the presence of "semantic noise" between senders and recipients of price information thereby creating an efficient communication channel for the acquisition and transmission of fast and reliable price information.[14] This contrasts with an alternative setting in which Ego does not speak the language of the "outsiders" and must make an initial investment in learning to speak the language if he chooses a network of "outsiders" as trading partners.[15] Because of the high degree of dependence of Chinese traders on the spoken word for information, and because of the mutual unintelligibility of the different Chinese dialects, traders who speak the same dialects are thus drawn together into networks of exchange relations to form an ethnically homogeneous middleman group.

5 Conclusions

In this chapter, we have developed a theory of the ethnically homogeneous middleman group in the context of an exchange economy characterized by contract uncertainty. We have argued that the EHMG may be viewed as a club-like structural arrangement, an alternative to contract law and to the vertically integrated firm, which emerged to economize on contract enforcement and information costs.[16] The theory has broad applications and lends itself readily to extensions for further research, only two of which will be noted here:

1. *A general theory of homogeneous entrepreneurial groups engaged in either illegal or legal activities*. We may develop a theory of the ethnically homogeneous (Italian) Mafia group as a low-cost club for the enforcement of contracts since Mafia entrepreneurs, by the very nature of their illegal activities, operate outside the legal framework.[17] Similarly, the theory may explain why successful trading groups operating in other underdeveloped economies characterized by contract uncertainty are *socially homogeneous groups:* the East Indians in East Africa, the Syrians in West Africa, the Lebanese in North Africa,[18] the Jews in medieval Europe, and the Medici merchant-bankers in fifteenth-century Florence. This general theory of homogeneous trading groups would examine: (a) the assignment of property rights, the structural principles—kinship, clanship, caste, ethnicity, religion—for the delineation of the *boundaries* of groups (Carr and Landa 1980), and the institutions for facilitating exchange among members and between members and outsiders[19] as well as (b) the dynamics within the homogeneous trading group as the group responds to the development of the economy. The function of the homogeneous trading group as a low cost arrangement for contract enforcement may become increasingly redundant as the economy evolves a more developed legal infrastructure. Consequently, the particularistic exchange networks based on mutual trust will gradually be replaced by impersonal exchange networks based on contract.

2. *The economic theory of optimal jurisdictions*. Our theory of the EHMG may be extended to include the spatial dimension in which ethnic boundaries coincide with political boundaries.[20] It may be used to explain, for example, why standard marketing areas in traditional China were organized in hexagon-shaped areas where boundaries were coterminous with the existence of distinct homogeneous communities[21] and why the policing of each standard marketing community was provided by private protective agencies in the form of secret societies. That theory may also be used to explain why nation-states tend to be organized along *ethnic* lines.[22]

Acknowledgements This is a revised, shorter version of my paper (Landa 1979) entitled "The economics of the ethnically-homogeneous middleman group: A low-cost club-like economic organization for economizing on contract-enforcement and information costs," Institute for Policy Analysis, University of Toronto, Working Paper Series, No. 7924, Oct. 1979. I am indebted to Alan Abouchar, Albert Breton, Thomas E. Borcherding, James M. Buchanan, Jack Carr, John Dales, Louis De Alessi, and Allan Hynes for helpful comments on a previous draft. I also wish to thank Robert McKay and Francis X. Tannian for their comments on an early version presented at the Public Choice Society meetings, April 15–17, 1976, Roanoke, Virginia. Finally, thanks are due to Richard A. Posner and an anonymous referee for suggestions for improving this paper.

Endnotes

1. For the literature on the economics of property rights, see Furubotn and Pejovich (1972). For the literature on public choice theory, see Mueller (1976).
2. See Posner (1977, chapter 4), Landa (1976). Contract law, however, does not deter "efficient breach" where a trader can compensate the victim and himself be made better off by breach. See Goetz and Scott (1977). See also Clarkson *et al*. (1978).
3. The details of the study are contained in Chapter 3, Landa's (1978b) Ph.D. thesis. [Note: Chapter 5 of this book was originally published in *The Journal of Legal Studies* (Janet Landa 1981). In the journal article, however, I made an error by saying that the middleman group was dominated by four clans (see Landa 1981, p. 350]. In fact, it was dominated by six clans; see Appendix III, Table B. (Landa 1978b, p. 247). See also Chapter 3, Appendix B, Table 2 of this book]. (Note added by author, August 18, 2014).
4. "Social structure" is a key concept used by sociologists to describe the pattern of recurrent and regularized interaction among two or more persons, hence implying the existence of norms for regulating behavior. See, for example, Blau (ed. 1975).

5. For a theory of clubs that explicitly incorporates discrimination in the choice of consumption-sharing partners, see Tollison (1972). Tollison's theory is an extension of Buchanan's (1965) theory of clubs.
6. Ego (v_1) chooses his trading partners, v_2 and v_3 on a kinship or ethnic basis; v_2 and v_3, in turn, choose their trading partners on the same particularistic basis; the result is the emergence of an EHMG.
7. But some of these rights may be acquired by marriage or conversion.
8. For a discussion of the costs of acquiring reputation, see Landa (1976).
9. The types of exchange externalities associated with breach of contract in the context of smallholder rubber are: (a) supply-breach externalities (failure to deliver); (b) quality-externalities (delivering an inferior grade of smallholder rubber, smallholder rubber being divided into five grades); and (c) debt-default externalities.
10. For a discussion of the limits of morality, see Buchanan (1978)
11. For a discussion of this, see White (1963).
12. For the economics of signaling and screening in the context of a job market paradigm, see Spence (1974), and Akerlof (1976). For an anthropological discussion of classificatory kinship systems as signaling devices for the creation and maintenance of social order in primitive societies, see Morgan (1970), Fortes (1969), Colson (1974).
13. For a discussion of the role of strong and weak ties in transmission of job information, see Boorman (1975).
14. For a discussion of the importance of creating an efficient communication channel, see Marschak (1968).
15. For a discussion of the difficulties of communication across nations, see Arrow (1969).
16. Our theory of the EHMG may be regarded as an extension of the Alchian and Demsetz's (1972) theory of the firm: rather than ex post monitoring of team members, emphasized by Alchian and Demsetz, we emphasize ex ante discriminatory choice or screening of team members so that the efficient *form* of economic organization itself can be designed. The Alchian-Demsetz theory is an extension of Coase's (1937) classic paper on the nature of the firm.
17. This linkage was suggested to the writer by Francis X. Tannian, commenting on an early version of the paper presented at the Public Choice Society meetings, April 15–17, 1976, Roanoke, Va.
18. The major exception to our theory is the absorption of Lebanese traders into the dualistic economy of Brazil.
19. For some of these institutions which facilitate exchange between different ethnic groups, see Landa's (March 1980) unpublished paper on the Kula Ring.
20. Tiebout (1965) points out that urban areas can be efficiently organized in a system of many small homogeneous communities whose populations have similar tastes for public goods. Tiebout's "voting-with-the-feet" theory relies on the ability of people to move, in fact, to choose one's jurisdiction of residence.

21. See Landa's (1978a) unpublished paper.
22. Singapore provides an excellent example. Although Singapore and West Malaysia form an economic entity, Singapore, with its predominantly Chinese-merchant community pulled out of the Federation of Malaysia on August 9, 1965, to form an independent nation-state (the Republic of Singapore) within the Commonwealth.

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Chapter 6
The Economics of Symbols, Clan Names, and Religion

Jack L. Carr and Janet T. Landa

1 Introduction

Standard theories of exchange depict trade as an impersonal exchange between anonymous partners. Jevons's (1871) "Law of Indifference," in particular, emphasizes the impersonality of transactions: it is a matter of indifference to the buyer or the seller with whom they do business provided that they obtain the same (homogeneous) commodity at the same price. For a world of contract certainty, this is an acceptable theory. In a world of contract uncertainty, however, it is no longer a matter of indifference with whom one trades.

In economies where the legal framework is underdeveloped, one observes the ubiquity of personalistic trading networks that manifest themselves in homogeneous trading groups: the East Indians in East Africa, the Syrians in West Africa, the Lebanese in North Africa, the Chinese in

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Southeast Asia, the Jews in medieval Europe, and the Medici merchant group in fifteenth-century Florence.[1] Even in countries with well-developed legal frameworks, the identity of one's partner in exchange becomes important in a number of transactions. Old boys networks still exist where individuals prefer to enter into exchange with "old boys" rather than "new boys"[2] and certain religious groups dominate certain economic activities: for example, orthodox Jews dominate the diamond trade in New York City and the Mafia dominate criminal activity in a number of North American cities.

In this chapter, we propose to analyze the economic functions of certain institutions and customary practices of trading groups. These include kinship and ethnic groups, clan names, symbols of group identity and religious practices such as Chinese ancestor worship, the keeping of genealogical records, and religious dietary restrictions. Sociologists and anthropologists have provided explanations of these institutional practices and customs. We are providing additional and/or alternative explanations that look to the economic rationales of these phenomena.

In recent years, some economists have turned their attention to the analysis of nonmarket institutions such as marriage, the family, and the law in developed societies.[3] Richard Posner (1980), in his insightful paper, has extended the analysis to certain social and legal institutions of so-called primitive and archaic societies, including kinship groups, gift-giving, polygamy, and so on. Posner rationalizes these institutions used by primitive societies as alternative insurance mechanisms for coping with the problems of uncertainty and high information costs.[4] Our theory is a contribution to this new subfield within law and economics. We emphasize that many of the institutions and customs of trading groups in underdeveloped economies are clublike arrangements, which serve as an alternative to explicitly enforceable contracts in an environment characterized by contract uncertainty and high information costs.

In section 2, we shall examine the question of why the identity of one's trading partner may be important and why clubs based on certain shared characteristics of members are formed. In doing so, we will be utilizing the economic theory of clubs (Buchanan 1965).[5] We will develop our theory from a partial equilibrium member's "within-club" point of view and will not address ourselves to general equilibrium analysis of the model.[6] In section 3, we will extend our theory to include the economics of signaling and screening[7] in order to provide an economic rationale to a number of institutional practices and customs such as Jewish dietary laws, Chinese ancestor worship, and the keeping of written genealogical records. Section 4 will provide a brief conclusion.

2 A generalized theory of personalistic exchange

2.1 Introduction

Imagine a world in which there are no clubs and in which the state affords no protection of contracts. In such a world of contract uncertainty, any trader can break a contract whenever it is profitable to do so. Breach of contract imposes breach costs or externalities on the victim of breach. In general, five kinds of externalities, which correspond to different kinds of "games of breach," can be identified (Landa and Grofman 1981):

(a) seller's abrogation externalities: the costs of forgone profits arising from a seller's failure to deliver goods;
(b) buyer's abrogation externalities: the costs of forgone profits, arising from a buyer's refusal to accept the goods;
(c) seller's goods-defraud externalities: the loss of goods arising from a seller, who after taking the buyer's money, refuses to deliver the goods;
(d) buyer's money-defraud externalities: the loss of money which arises from a buyer who, after accepting delivery of the goods, refuses to pay the seller; and
(e) quality externalities: costs associated with a breach of contract involving the delivery of a quality of product different from that specified in the contract.

These different kinds of externalities are a major component of transaction costs in an environment characterized by contract uncertainty. Where these costs bulk large in a world of contract uncertainty, some individuals would refrain from trading altogether. Where these costs do not prohibit trade altogether, trade will take place but at a price that takes contract uncertainty into account.

2.2 Personalistic exchange

Individuals can reduce these kinds of risks by discriminatory choice of a network of trading partners. Individuals can form a club-like arrangement for reduction of contract uncertainty. For our purposes, we will define a club or club-like arrangement as any voluntary group deriving mutual benefit from the reduction of contract uncertainty, a public good for members, because: (a) information about propensity to cheat or breach can be obtained cheaper for club members than non-club members; and (b) sanctions in addition to normal market sanctions exist and are imposed on members who violate the rules of the game set by the club, thereby making it more expensive to breach contracts with club members than contracts with non-club members.

In a Knightian sense, it is assumed that clubs reduce both risk and uncertainty in trading with club members.[8] Clubs may and will have many other purposes other than trading. But in the nature of exchange with club members, whether economic or social, one obtains as a by-product valuable trading information about club members (for example, information about the likelihood that any club member will breach a contract). Also since club members have, in general, both economic and social exchange with one another, social as well as economic sanctions can be imposed on club members who breach contracts (for example, club members who break contracts can be removed from the club and prohibited from having either social or economic contact with all club members). On the other hand, similar social sanctions cannot be imposed on nonmembers breaching contracts with members. For example, if one views a family as a club, many more social sanctions are available in dealing with family members than in dealing with non-family members. If one belonged to a club and breached a contract, the victim of the breach could impose economic sanctions (for example, withdraw credit, exclude him in future transactions) on the offending club member and can forbid all club members from having any contact whatsoever with the offender. In this way, clubs increase the costs of breaching contracts with other club members.

Let us set up a simple model that defines in an analytical way the economic advantages that accrue from joining a club. In setting up this model we will investigate the question of the optimal size of a club (from an economic point of view). Let us consider a world where there are $N+1$ individuals of whom $n+1$ belong to a club.[9] For simplicity we will assume that each member engages in one trade per period with each member of the market (both club and non-club)[10] and further, we will assume the existence of one type of breach of contract that if it occurs, imposes a cost of BC on our trader.[11] If our trader enters into exchange with a club member, the probability of breach is Π_1 and, if our trader enters into exchange with a non-club member, the probability of breach is Π_2. Since it is more costly to breach a contract with a club member than with a non-club member, we assume Π_2 is greater than Π_1. Hence expected breach costs in exchange with a club member are $\Pi_1 BC$ and with a non-club member $\Pi_2 BC$. It should be noted that our probabilities of breach can be used to define rigorously the concept of trustworthiness. In our simple model we assume only two levels of trustworthiness; $\Pi_2 - \Pi_1$ being the degree of trustworthiness for club members and $\Pi_2 - \Pi_2$ or zero being the degree of trustworthiness for non-club members. At this stage in our model, we ignore the complications that could arise where each club member has a different degree of trustworthiness. If the probability of breach from a non-club member was still Π_2 but the expected probability of breach for a club member was Π_{1i}, $i = 1, \ldots n$, then we would have $n + 1$ degrees of trustworthiness. In this case, non-club members would have a degree of trustworthiness of zero, and club members would have degrees of trustworthiness of $\Pi_2 - \Pi_{1i}$ for $i = 1, \ldots, n$. Our definition of trustworthiness measures expected comparative probabilities of breach.

Since our trader is assumed to make one trade per period with all N individuals in the market, then equation (6.1) measures total expected breach costs (*TEBC*):

$$TEBC = n\Pi_1 BC + (N - n)\,\Pi_2 BC \tag{6.1}$$

To examine the economic aspects of the club, let us see what will happen as we add more members to the club. As the number of trading partners who join the club increases, total expected breach costs will decrease. See Figure 6.1. For example, point *A* represents the expected breach costs that the trader expects will be imposed on him if only one of the trading partners joins the club. Point *B* represents the breach costs that the trader expects will be imposed on him if two of his trading partners join the club, where $B < A$. When all of his trading partners join the club, expected breach costs are assumed to be reduced to *E*. Consider the addition of one more member to the club.

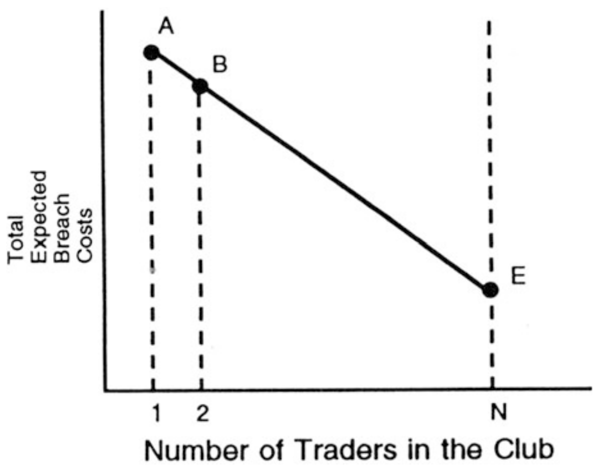

Fig. 6.1 Total expected breach costs and size of club

Now TEBC with $n+1$ members is

$$TEBC' = (n+1)\,\Pi_1{}'BC + (N-n-1)\,\Pi_2 BC \tag{6.2}$$

Therefore the change in *TEBC* is

$$\begin{aligned}\Delta TEBC &= TEBC' - TEBC = [(n+1)\,\Pi_1{}'BC + (N-n-1)\,\Pi_2 BC] \\ &\quad -[n\Pi_1 BC + (N+n)\,\Pi_2 BC] \\ &= (n+1)(\Pi_1{}' - \Pi_1)BC + \Pi_1 BC - \Pi_2 BC \\ &= (n+1)(\Pi_1{}' - \Pi_1)BC - (\Pi_2 - \Pi_1)BC\end{aligned} \tag{6.3}$$

Adding new members involves additional costs as well as additional benefits. The term $(n+1)(\Pi_1{}' - \Pi_1)BC$ represents the marginal costs (*MC*) of adding one more member. For a club to accrue economic benefits to its members it must be able to impose sanctions on members who breach contracts. To impose sanctions it must inform all members when breaches occur. A mechanism is needed, therefore, to ensure that individual club members do not trade with boycotted club members. Clearly the cost of informing club members of breaches and enforcing sanctions is a function of the size of the club.

As more members are added to the club, more time and effort is needed to inform the additional members; hence enforcement costs are expected to rise with the increase in club membership.[12] Although it is certainly true that information costs will increase with club membership, the size of this increase is an empirical question. Cutting in the opposite direction, larger clubs can inflict larger damages on breaching members, which will tend to decrease the likelihood of breach. For purposes of analysis we assume that the first factor outweighs the second, with the result that as n increases, Π_1 increases. For simplicity we assume Π_1 is a linear function of n where

$$\Pi_1 = (\Pi_2 - c - bN) + bn = \Pi_2 - c + b(n-N) \tag{6.4}$$

that is, when $n = \mathrm{N}$, $\Pi_1 = \Pi_2 - c$, where c is the reduction in probability of breach that occurs in going from a world where there are no club members to a world where everybody belongs to the club.[13] With n club members $\Pi_1 = \Pi_2 - c + b(n-N)$; and with $n+1$ club members $\Pi_1{}' = \Pi_2 - c + b(n+1-N)$. Therefore the change in Π_1 due to the addition of one more member (that is, $\Delta\Pi_1$) equals b. The greater are information costs, the greater is b. Now the increase in total expected breach costs due to the addition of one more club member is given in equation (6.5).

$$
\begin{aligned}
MC &= (n+1)(\Pi_1{}' - \Pi_1)BC \\
&= (n+1)\{[\Pi_2 - c + b(n+1) - N] - [\mathit{\Pi}_2 - c + b(n-N)]\}BC \\
&= (n+1)b.BC
\end{aligned} \tag{6.5}
$$

With the addition of one new club member, all $n+1$ club members' costs increase by $b.BC$. Therefore, we have an upward-sloping marginal cost curve, which is depicted in Figure 6.2.

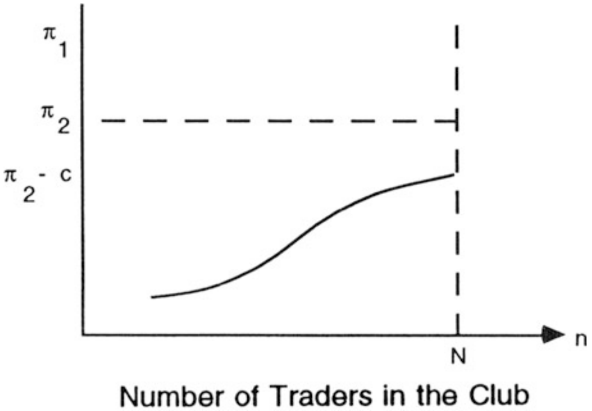

Fig. 6.2 Probability of breach and size of club

The term $(\Pi_2 - \Pi_1)BC$ may be considered the marginal benefit (*MB*) of adding one more member. Adding members to the club clearly reduces expected breach costs. Adding more members to the club brings more of the market under club sanctions to the club members. The marginal benefits of adding one more member to the club are given by equation (6.6):

$$
\begin{aligned}
MB &= (\Pi_2 - \Pi_1)BC = \{\Pi_2 - [\Pi_2 + b(n-N)]\}BC \\
&= -b(n-N)BC \\
&= b(N-n)BC
\end{aligned} \tag{6.6}
$$

The marginal benefit expression in equation (6.6) clearly shows the benefit to be had by adding new club members. New club members are more trustworthy (that is, have lower expected probability of breach) and hence they are lower cost traders. Equation (6.6) also shows that *MB* declines as n increases. Under general conditions, there will be economic limits to the size of a club. Optimum size club is reached where, as depicted geometrically in Figure 6.3, the marginal benefit curve intersects the marginal cost curve at optimal club size, K.

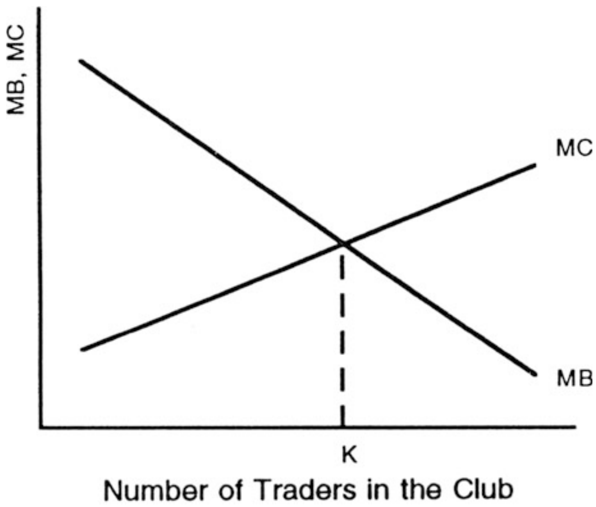

Fig. 6.3 Optimal club size

2.3 Differences in degree of homogeneity and solidarity of club membership in optimal club size

To this point we have assumed that all individuals in the club were homogeneous with respect to contract behavior and with respect to costs of informing other club members about contract breaches. In terms of the model developed in the previous section this means that: (1) any individual brought into the club will have the same expected probability of breach (that is, will have the same common Π_1), and (2) individuals when brought into the club will have identical effects on the costs of informing club members about breaches (that is, any individual brought into the club will increase Π_1 by b) and hence our MC curve will be a straight line. We have thus far ignored real world complications of differences in the degree of homogeneity and degree of solidarity of club members. Taking these complications into account will alter the shape of the *MC* and *MB* curve and hence effect optimal club size.

We shall now take these two complications into account. For some clubs the degree of homogeneity will vary with the proportion of club members who belong to the same clan, ethnic, or religious group. The degree of solidarity may be measured by the proportion of club members who stand in a certain social distance from each other. Thus, a club composed of a group of kinsmen or clansmen, all related by blood ties, exhibits a higher degree of solidarity than a club composed of a group of people from the same ethnic group.

Differences in the degree of homogeneity of club membership are reflected in:

1. *A Shift in the MC Curve*. For example, the higher the degree of homogeneity of club membership, the lower the costs of transmitting information to members regarding a member's breach; hence the *MC* curve corresponding to a more homogeneous club lies everywhere to the right of the MC curve corresponding to a less homogeneous club. This implies that the optimal size club will be larger for a more homogeneous trading club (K_2) than for a less homogeneous club (K_1). See Figure 6.4.

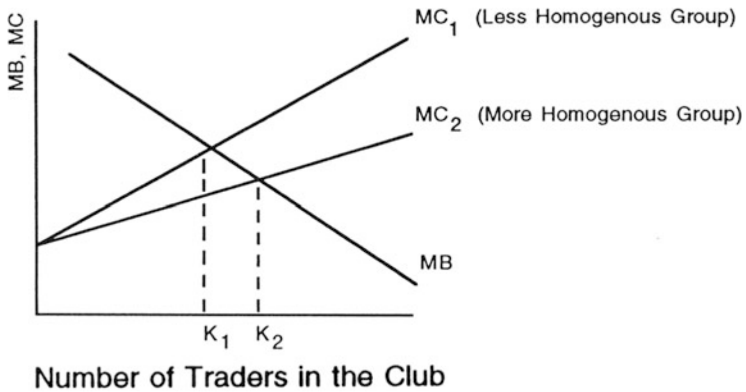

Fig. 6.4 Differences in the degree of homogeneity of club members and optimal club size

2. *A Kink or Discontinuity of the MC Curve*. When trading members included in the club are also drawn from outside the trader's own ethnic group, the difficulties of communication across ethnic and linguistic boundaries may become so serious that enforcement becomes prohibitively costly and there is a kink or discontinuity in the *MC* curve. We have a case where *MC* rises much faster than group size as club members become heterogeneous. Where an *MB* curve intersects an *MC* curve at the kinked portion determines not only the optimal size of the club (K) but also the boundary of the club at the level of the ethnic group. (See Figure 6.5).The impact of the degree of solidarity of club membership, on the other hand, is reflected in:

3. *A Shift of the MB Curve*. We may expect that the greater the degree of solidarity of club membership, the greater the sense of shared values and norms—a sense of belonging to a "moral community"—hence the *MB* curve for a club that exhibits a high degree of solidarity lies everywhere above the *MB* curve for a club that exhibits a lower degree of solidarity. This implies that the optimal size of a club is larger for a club showing greater group solidarity than one showing lower group solidarity. (See Figure 6.6).

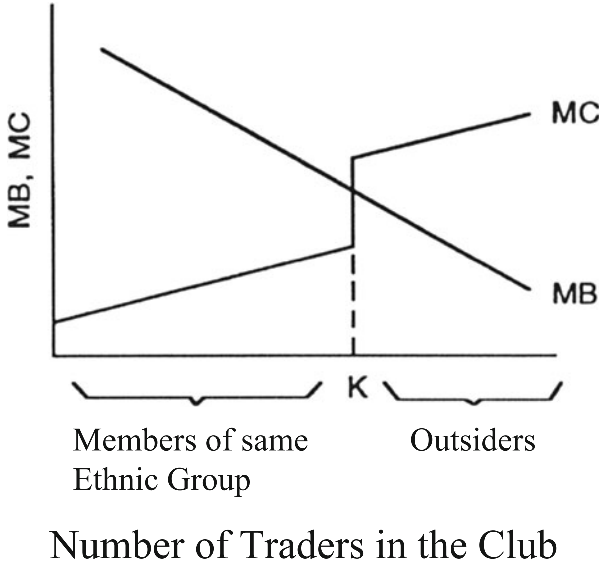

Fig. 6.5 Degree of homogeneity of club members and optimal size of ethnic trading club

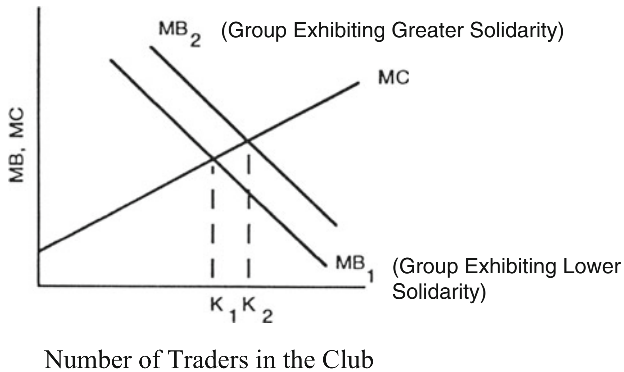

Fig. 6.6 Degree of solidarity of club members and optimal club size

4. *The Existence of a Kink in the MB Curve*. For a heterogeneous group composed of members of one's own ethnic group and outsiders, we may expect that the *MB* curve exhibits a kink at the boundary of the ethnic group, reflecting the discontinuity in the group norms which do not extend beyond the group. Where the MC curve intersects a kinked MB curve, we have not only the optimal size club, but also a club whose boundary is marked off by members of one's own ethnic group (Figure 6.7).

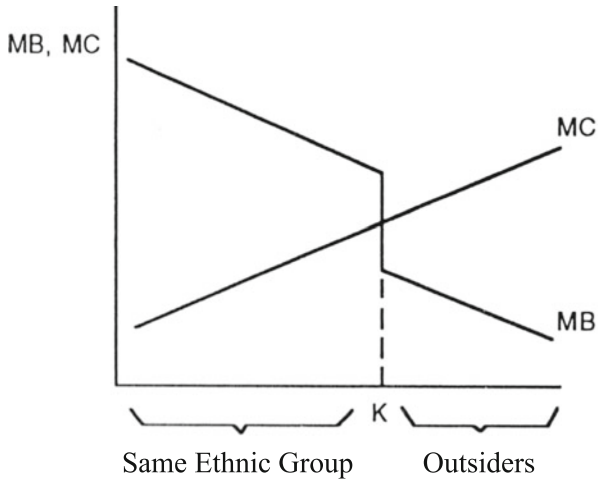

Fig. 6.7 Heterogeneous group and optimal size of ethnic trading club

3 An economic interpretation of symbols, clan names, and religion

In a world of contract uncertainty, we have argued that the identity of the potential trading partner matters. In a world of contract uncertainty, other things being equal, we prefer to trade with fellow club members rather than with non-members. The lower transaction costs are one of the main economic advantages of belonging to a club. In this section we will argue that it is mainly these economic advantages of clubs that explain the continued existence of many club-like arrangements. To be sure, there are costs of belonging to a club. We are assuming that benefits outweigh these costs; otherwise clubs would not be viable. The costs of belonging to a club include: (a) the opportunity costs of keeping contracts with club members when outsiders offer the club member a better contract; (b) the costs of observing club rules (for example, dietary restrictions); and (c) discrimination by outsiders.

So far we have assumed that club members can costlessly identify other club members. The assumption will now be relaxed. We will extend our theory of clubs to include the economics of signaling. In a world where there are positive costs in defining and identifying club members, we will argue that many customs or rituals of various club-like organizations are means to reduce the costs of defining and identifying club members. Various reasons have been advanced by sociologists and anthropologists as to why these institutional arrangements and practices persist. We, however, have given these institutional arrangements and customary practices an additional economic raison d'être as well. Let us consider these various arrangements and practices and see if we can extend the theory developed in the first section to include the economics of signaling to explain their existence.

3.1 Names and clan names

Two important functions are performed by the institution of naming individuals. First, the named individual is now a uniquely identified individual and thus distinguished from all other anonymous individuals. That is, the named individual is identified as a person with specific physical characteristics and a history and biography that extends back in time to his birth. A person's name may therefore serve as a proxy for reputation. In a society with *n* number of named individuals, there are *n* number of persons with distinct reputations, some better than others. Second, each named individual also bears a surname that serves to identify him as a member of a social group, the nuclear family. The nuclear family is the smallest kinship unit in which kinship status is ascribed by birth and in which mutual aid obligations among kinsmen are severest. In this way kinship groups are a prime example of a club-like arrangement. In kinship-based societies like traditional China, the named individual is also embedded in larger kinship units (the extended family, the lineage,[14] and the clan[15]) so that he is a member of a series of ever-widening mutual aid groupings of kinsmen and clansmen. For the larger kinship groups surnames are a means of identifying club members. Since surnames are inherited and transmitted from generation to generation, great care is taken by rich and powerful families to maintain or preserve the reputation of well-known names since reputation is an invaluable intangible asset. Kinsmen and clansmen of well-known families assert kinship/clanship status to gain preferential access to job and trading opportunities provided by wealthy clan members, who in turn prefer their kinsmen/clansmen as cooperating partners because of their greater trustworthiness and reliability. Kinship status, like reputation, therefore is a valuable intangible asset for those possessing such a status. This may explain the following institutional arrangements and practices:

(a) *Named Trading Groups*. These are ubiquitous in the Middle Ages in Europe and in contemporary underdeveloped economies. Excellent examples are the Medici merchant-bankers in fifteenth-century Florence, the Rothchilds in eighteenth and nineteenth-century Europe, the Hokkien-Chinese rubber middleman group in contemporary Singapore and West

Malaysia, dominated by six major clans–the Tan, Lee, Ng, Teh, Lim, and Gan clans– from Fukien province in China. These named trading groups are club-like arrangements for protection of contracts under conditions of uncertainty. The Chinese middleman group, as a club-like arrangement alternative to contract law, emerged in response to conditions of contract uncertainty prevailing in Singapore and West Malaysia, and also in response to a political environment in which the dominant ethnic group in West Malaysia—the Malays—are often hostile to the Chinese (see Rabushka and Shepsle 1972).

(b) *Change of Surname*. Because kinship status is a valuable asset, practices such as change of surname sometimes occur. The following anecdote tells of such change.[16] An immigrant from China, upon arriving in Singapore in the early 1920s, inquired as to which clan in Singapore was the most powerful and wealthiest and, was told the Tan Kah Kee clan (Tan Kah Kee was then the “Rubber King” in Singapore and Malaya). The man thereupon changed his surname to Tan and went to look for a job in Tan Kah Kee’s firm. He was given a job by Tan Kah Kee and eventually rose to become a rubber millionaire himself.[17] If one can easily change one’s name and get away with it (that is, be taken for a clan member), then clans have to look for other methods of identifying their members.

Immigrants to foreign countries often change or shorten their surnames to resemble more closely the common names used in their new country. Generally this is *not* done to claim membership in a clan. The immigrant can be considered to belong to a club, whose members consist of all immigrants from a particular geographical region. Since sometimes club members are discriminated against by non-club members it is sometimes necessary to hide one’s membership in a club from outsiders.[18] Foreigners may change their names so they can no longer be recognized as foreigners; if they do they will find other methods to identify themselves to other club members.

(c) *Ancestor Worship and Genealogy*. In kinship-based societies like traditional China, ancestor worship is an important institution.[19] This institution may be explained by our theory of clubs as a way of economizing on the costs of identifying members of the same descent group, numbering into the hundreds and scattered in different localities, who trace back to a common ancestor. Together with ancestor worship goes the practice of keeping genealogical books. These books include all members of the same clan or lineage and are financed by rich members of the clan. Written Chinese genealogies convey many kinds of information, including biographies, place of residence, and records of members of the lineage who have moved elsewhere to form new lineage settlements.[20] Keeping genealogical records reduces information costs because: (a) it allows for the precise identification of a group of persons from whom members could expect help and favor (persons will know many more kinsmen or clansmen because of standardized genealogies); and (b) it excludes those who would otherwise fraudulently claim kinship or clanship status and hence free-ride the benefits of group membership.[21]

(d) *Creation of Fictive Kinship*. Where two or more unrelated individuals have established relations of mutual trust and would like to maintain their relationship on a longer-term or permanent basis, the individuals may resort to a "legal fiction" via the creation of fictive or artificial ties of kinship on the basis of mutual agreement.[22] Anthropologists have cited many examples of the creation of artificial kinship in primitive societies. For example, in primitive societies, agricultural teams were often composed of kinsmen and fictive kinsmen because kinsmen—real or fictitious—were thought to be reliable people for long-term agricultural cooperation (Gulliver 1971; Leach 1961). Again, in relationships requiring a great deal of trust, such as in secret societies, unrelated individuals seal their relationship by becoming "blood-brothers" through the ritual of mixing the blood of two participants and swallowing the mixture.[23] The classic example of ritual brotherhood is the Freemasonry, an institution that first appeared in seventeenth-century England.[24] Another legal fiction treats adopted children as if they are natural children with all the rights and obligations of kin status conferred upon them by their adopting parents.

These various ways of creating artificial kinship imply that the boundaries of the kinship group are not rigidly fixed by genealogical connections but themselves are endogenous and subject to individual choice.[25] But there is a definite limit to the size of the kinship group. There are limits of kinship morality or "altruism" not extended to everyone in the world.[26] We argued, in Section 2, that there is an optimal size to the club. The optimal size depended on a number of factors. Here we argue that there is an optimal size to kinship clubs and this optimal size depends on economic factors and is not determined exogenously. To a certain extent, who is considered to be your kin is a question of choice.

3.2 Ethnic identity

Since every individual is also a member of an ethnic and linguistic group, another external marking or sign of identity is a person's ethnic identity. In a multi-ethnic society, where assimilation is low, ethnicity serves to classify people into social categories and, from the decision maker's point of view, implies an "insiders-we" and "outsiders-they" distinction. The significance of ethnic identity in the context of multi-ethnic society is that very often the "limits of morality" (Buchanan 1978) end at the boundary of the ethnic group. As anthropologist Fredrik Barth (1969, 15) puts it:

> . . . the ethnic boundary canalizes social life—it entails a frequently quite complex organization of behaviour and social relations. The identification of another person as a fellow member of an ethnic group implies a sharing of criteria for evaluation and judgement. It thus entails the assumption that the two are fundamentally "playing the same game." . . . On the other hand, a dichotomization of others as strangers, as members of another ethnic group, implies a recognition of the limitations on shared understandings, differences in criteria for judgement of value and performance and a restriction of interaction to sectors of assumed common understanding and mutual interest.

Ethnicity is thus a signaling device that transmits nonprice information regarding the potential performance or behavior of the potential partner.[27] Ethnic identity or status is thus an intangible asset for those who are members of the dominant ethnic group. While a person can change his surname, his religion, very often a person cannot change his ethnic status.[28] Because of this and because there are advantages of in-group cooperation, the boundaries of ethnic groups tend to persist over time. This may explain the following phenomena and practices:

(a) *Ethnic Trading Group*s. Numerous examples of ethnic trading groups can be cited.[29] Thus, for example, we find Chinese middlemen groups in Southeast Asia, the Jews in medieval Europe, the Jews dominating the diamond trade in New York (where transactions involving million-dollar deals are concluded with only a handshake, and the Hebrew "*mazel un b'rachah*" ("luck and blessing")), with no cash changing hands, transactions being on credit, and the Mafia engaged in illegal activities in a number of North American cities.

(b) *Occupational Status Defining Ethnic Status*. In Thailand, a high rate of inter-marriage has occurred between the Chinese and the Thai in the past. As a consequence, physical characteristics no longer clearly differentiate a Chinese from a Thai since there are "degrees of Chineseness." Because of this, Szanton (1983) found that in certain cases occupational status defines ethnicity; for example, anyone who engages in trade or commerce (a traditional Chinese occupational role) is defined as a Chinese even though the person may be a Sino-Thai or a Thai.

3.3 Religious identity

There may be club-like economic advantages in belonging to a religious organization. In an economic exchange one can place more trust in members of one's religious club. This phenomenon explains the existence of religious trading groups such as the Jews in medieval Europe and the Arab merchants in Malaya and the Netherlands East Indies during the nineteenth and twentieth centuries.[30] However, not all religious organizations will yield substantial economic advantages to their members. If a religious organization is very large in relation to the potential trading population, then little economic advantage will be received by belonging to it. As a testable implication, we should not expect the dominant religious organization in an area to form the basis of a trading group. If membership in a religious group is very large, the religious group may be far in excess of the optimal size for economic purposes (see Section 2). Too large a group may imply too small an ability to impose sanctions on those who breach contracts. If this is the case, preferential treatment will not be given to fellow co-religionists. Substantial economic advantages will probably accrue to smaller religious groups. And if a religious organization has its members spread throughout the world, economic advantages will accrue to its members both in local and international trade.

It is these economic advantages to smaller religious groups that may explain why no single religious group has dominated the world scene. Small religious groups that have provided economic advantages to its members (as well as seeing to their spiritual needs) have tended to survive through the ages. Because economic advantages accrue to smaller groups, there is no natural monopoly in religion.

Religious organizations have many customs and rituals that are difficult to explain. However, a number of these can be explained by applying the theory of clubs. A few religious groups prohibit the lending of funds at interest to fellow co-religionists. On one interpretation this may be one of the costs of belonging to a club. Consider the Jewish religion, where these costs involved the Talmudic prohibition of lending at interest to fellow Jews ("Unto a foreigner thou mayst lend upon usury, but unto thy brother thou shalt not lend upon usury." (Deuteronomy 23:20)) (see Poliakov [1965] 1977). The costs of observing the Talmudic prohibition, however, were reduced by several devices. One of the most interesting was to lend money at interest to a fellow Jew via the intermediary of a real or fictitious Christian (see Poliakov [1965] 1977). Moreover, the costs imposed by the Talmudic prohibition were outweighed by papal protection of the Jewish money trade in the Middle Ages. The Holy See helped Jews to get around the usury laws in order to lend money at interest to Christians (Poliakov [1965] 1977).

There is another interpretation of the usury rules of religious groups. To look at this other interpretation let us examine the Jewish usury laws again. These laws were interpreted so that they applied mainly to "consumption loans" rather than loans for normal commercial transactions. Jews engaged in normal commercial transactions could lend funds to one another at interest. The usury laws did not impede normal commerce; they were applied when an individual had a bad year with low income and had to borrow in order to maintain a minimal consumption pattern. Such a rule imposed costs on lenders and yielded benefits to borrowers. However, since unfavorable events could strike any member of the club, the usury rule could be interpreted as an insurance scheme enforced by the club.[31] With this interpretation an interest-free loan is not a cost of belonging to the club but an insurance premium paid by a club member. The insurance premium buys an insurance policy that protects club members against declines in their income. When these occur, the club provides its members with interest-free loans. The religious club in this instance provides another service: the enforcement of usury rules. On balance these rules are not costs, but benefits of joining clubs, as they provide insurance unavailable to non-members (except possibly at substantially higher costs).[32]

A number of religious groups impose dietary restrictions on their members. Until the last generation Roman Catholics could not eat meat on Fridays, Muslims still may not eat pork, and Jews have a stringent set of dietary laws known as the *kashruth*. Why do members of these religious organizations restrict their eating behavior when there seem to be no apparent benefits from doing so?[33] We argue that there *are* benefits. Dietary laws give religious members a feeling of shared values. These shared values give members of the religious organizations a sense of a common identity and distinguish them from non-members.[34] It is exactly this difference between members and nonmembers that is needed to facilitate economic exchange under conditions of contract uncertainty. It is interesting to note that Jewish dietary laws were expanded greatly around the fifth century A.D., just as the Jews were being dispersed over the Middle East and Europe. The dietary laws were artificially created to keep Jews, Jews. Dietary laws help identify club members[35] an especially important function if club members are geographically dispersed.[36] Dietary laws discourage conversion by increasing the costs of joining the organization and thus serve as a barrier against those seeking to become members in order to receive the economic benefits. (Conversion, from an economic point of view, is a behavior similar to changing one's name to gain access to a club.) This theory predicts that religious organizations that yield club-like economic advantages to their members will not be missionary organizations seeking converts. Judaism does not seek converts; Protestant sects, on the other hand, do. This theory predicts, in addition, that religious organizations yielding club-like economic advantages will have stringent rules of behavior, like dietary restrictions, whereas the other organizations will not. In this respect, dietary laws serve very much like a signal, as education and ethnicity do in Spence's model. For dietary laws to be a signal like education, the marginal product of following them would have to be less for nonmembers of the religious group than for members. There is some empirical evidence that this is the case with Chinese converts to Islam in West Malaysia. Converts to these small religious groups are generally treated with suspicion. Converts are not trusted to the same extent that bona fide long-standing coreligionists are. Hence, converts adopting dietary laws do not receive the same benefits from following these dietary laws as existing religious members do.

According to Siow (1983), since the "New Economic Policy" was adopted in West Malaysia after the race riots in 1969—a policy that established quotas giving Malays preferential access to job and educational opportunities over non-Malays—there has been a trend toward conversion by Chinese who are economically disadvantaged (the unemployed, laborers, drivers, carpenters, and workers holding menial jobs). The incentive for Chinese to convert to Islam was motivated by short-term monetary benefits provided by PERKIN, an organization formed in 1960 specifically to convert non-Malays to Islam, and long-term benefits of job security for future generations who choose to remain in West Malaysia. The costs to Chinese converts, however, are not zero. Chinese Muslims are met with suspicion by Chinese—even though Chinese Muslims have not been ostracized from their respective clans, dialect associations, or ethnic communities—and by Malays even though Malay officials call the Chinese Muslims "*Saudara, saudara bahru*" ("new brothers"). Furthermore, some Chinese Muslims found it difficult to give up eating pork.

3.4 Insignia and signs: Symbols of group identity

Yet another way of reducing the costs of identifying a potential cooperating partner is to look for insignia—the external markings or symbols of group identity. These include coats-of-arms, blazons, flags, totems, clothing and decorations, and so on. For example, many Jews now wear a *chai* symbol around their necks, which is supposed to bring a long life. The symbol is easily recognized by other Jews; however, to non-Jews, it is meaningless and in no way identifies the wearer. It would seem, because of its technical superiority (unrecognizability by non-club members), that the *chai* has replaced the Star of David as the symbol of Jewish identity.

In Genoa in the Middle Ages, coats-of-arms were flown from every merchant ship in war and in peace. The Medici merchant bankers in fifteenth-century Florence used their famous trademark—a heart surmounted on a cross—for bales of merchandize and for addresses on business letters; for every other aspect of social life they identified themselves to others (apart from revealing their names) by the blazons that characterized their houses and palaces.[37]

In Scotland, clans wore clothing in special colors and patterns, each clan having one or more tartans to distinguish from others. Scottish names, like MacDonald and MacLeod, also identify clans.

Because of the need for secrecy, symbols, insignia, and signs play a very important role in the initiation ritual ceremonies of new members of secret societies. Members learn the symbols and signs of group identity of a secret society; and severe penalties are imposed on those who betray the society's secrets. Chinese secret societies were widespread in Singapore and Malaya in the eighteenth and late nineteenth centuries. Wealthy Chinese merchants were invariably also leaders of Chinese secret societies until the societies were suppressed by the British government in 1870. These leaders, among other things, maintained law and order among members of their own community.[38]

4 Conclusions

In a world with zero transaction costs, clubs or club-like arrangements to define and identify club members and to constrain members' behavior would be redundant. In a world of contract uncertainty, on the other hand, the identity of the potential cooperating partner matters. By forming clubs or club-like arrangements in which members' behavior is constrained, transaction costs can be reduced.

Our model, constructed in Section 2, is a class of models that fall into the economic theory of clubs. We examined the economic benefits of belonging to clubs and abiding by the rules of the game of the club. We argue that the benefits of club membership—lowered transaction costs—explain the continued existence of clubs, whatever their origins.

In section 3, utilizing the theory of clubs together with the economics of signaling, we were able to provide economic rationales for a number of social customs and practices discussed by sociologists and anthropologists but ignored by economists. We explain these customs and practices as ways members economize on defining and identifying club members.

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Endnotes

1. For an economic theory of why Chinese dominate middleman roles in Southeast Asia, see Landa's (1978) Ph.D. dissertation.
2. For a discussion of the role of old boy networks as information networks, see Carr *et al*. (1972).
3. See e.g., Becker (1976b); Posner (1977).
4. See also Geertz (1978), who rationalized the customary practice of "clientalization" (the pairing off of buyers and sellers in recurrent transactions) in bazaars in underdeveloped economies as a response to high information costs associated with uncertainty regarding qualities of goods and the reliability of trading partners.
5. For an extension of Buchanan's theory, which incorporates discrimination in the choice of consumption-sharing partners, see Tollison (1972). For a survey of the economic theory of clubs, see Sandler and Tschirthart (1980).
6. See Cooter and Landa (1984) for a general equilibrium analysis of the model.
7. For the economics of signaling and screening in the context of a job market paradigm, see Spence (1974). See also Akerlof (1976).
8. Knight (1921) made a distinction between risk and uncertainty.
9. We will assume the existence of the club already, for whatever purposes, and any economic advantages that accrue from club membership accrue without any additional pecuniary cost to the club or to its individual members.
10. In this economy we can hypothesize the existence of a standardized commodity and hence define a standard trade. It should be noted that in reality costs of trading with club members will be lower and hence one would expect more trade with club members than non-club members.
11. We assume *BC* is the same in dealing with club or non-club members. In the real world this may not be the case. A number of clubs (for example, various local better business bureaus, various religious groups, and so on) have their own mediation systems for solving disputes. If *BC* includes current costs, then *BC* may in fact be lower for club than non-club members.

12. For an analysis of a different situation involving increased "decision-making costs" as size of group increases, see Buchanan and Tullock (1962, chap. 6).
13. It is also true that as club membership increases, it becomes increasingly more difficult to recognize club members. Hence, as n increases, the perceived value of Π_1, also increases. This formulation assumes the homogeneity of traders. Each trader added to the club adds the same amount to breach costs. As stated in the text, as n increases, there are factors that tend to decrease Π_1, as well as factors that tend to increase Π_1. If these factors operate with different intensities for different values of n, then Π_1, may not be strictly increasing in n. For small n, it is possible that increases in n may result in a fall in Π_1. If this is the case, marginal cost may first fall and then rise. In addition, it should noted that equation (6.4) assumes the homogeneity of traders. Each trader added to the club adds the same amount to breach costs.
14. A lineage organization is composed of the agnatic descendants of a single ancestor together with their unmarried sisters and their wives. The lineage organization is a corporate group, i.e., a group that endures over time in which members share common interests and activities. For a discussion of Chinese lineage, see Freedman (1966).
15. The sharing of a surname is itself a fact of agnatic kinship. A clan is one in which lineages of same surnames are held together genealogically but are not members of a corporate group. For a discussion of Chinese clans, see Freedman (1966).
16. Told to Janet Landa by Hsu Yun-Ts'iao, editor of the *Journal of Southeast Asian Research* (Southeast Asian Research Center, Singapore), October 27, 1969.
17. For a case study of the role of kinship and ethnic networks in facilitating the growth and diversification of the Tan Kah Kee firm, see Landa and Salaff (1980).
18. For an alternative discussion of the motives for concealment of personal information in the marketplace, see Posner (1981).
19. For a discussion of Chinese ancestor worship, see Freedman (1966). Ancestor worship and the keeping of genealogical books were also important in Italy in the Middle Ages, see Heers (1977).
20. For a discussion of the types of information in Chinese genealogies, see Ahern (1976).
21. For the role of genealogical records in excluding outsiders who might fraudulently claim kinship or clanship status, see Freedman (1966). See also Heers (1977). We provide another reason, in addition to Posner's insurance function argument of kinship groups, why certain societies "devote so many of their linguistic, legal, and informational resources to delineating kinship groups much larger than the modem family or, for that matter, the primitive household" (Posner 1980, 12).
22. For a discussion of this topic, see Fuller (1967). The creation of fictive kinship ties itself reveals the importance of real kinship ties. But there is an interesting

asymmetrical aspect of kinship to be noted, that is, it is easier to create kin ties than to get rid of real kinsmen that have become burdensome.

23. For a sociological discussion of secret societies, see Simmel ([1908] 1950). See also MacKenzie ([1967] 1971).
24. For a discussion of Freemasonry, see the chapter by Jones in MacKenzie ([1967] 1971).
25. The sociobiological literature treats kinship in terms of genealogical connections. For a discussion of the sociobiological literature, see Becker (1976a).
26. In the literature on sociobiology, the claim is made that altruistic behavior will vary with kinship distance as a function of similarity of the genetic pool. We, however, emphasize an individualistic-choice calculus that looks at social distance including kinship distance, in terms of reducing transaction costs under conditions of contract uncertainty. Thus, we emphasize the importance of social ties, which may or may not be genetically based. Furthermore, we emphasize the importance of a shared code of conduct, and not shared genes, among members as a basis for mutual trust and mutual aid ("reciprocal altruism" in the sociobiology literature) since shared codes of conduct may exist among individuals who are not genetically linked.
27. We are extending Spence's (1974) concept of ethnicity as a signaling device from a job market context to an exchange economy.
28. It should also be noted that surnames highly correlate with ethnicity. Thus from surnames, one may infer an individual's ethnicity with a high degree of accuracy. While it is possible to change one's surname, it is hard to change one's physical (ethnic) characteristics.
29. A number of sociologists have pointed out the ubiquity of foreign ethnic trading groups. They have developed "outgroup" (or "marginal men," "strangers") arguments as to why foreign ethnic minorities are successful in middleman roles, see Hagan's (1962) discussion of these arguments. Our theory differs from theirs in that we emphasize their ability to form clubs that promote mutual trust among members and hence reduce transaction costs.
30. See Morley (1949). Our theory of the connection between entrepreneurship and religion differs from that of Max Weber (1956) in that we do not invoke the Protestant (Calvinistic) work ethic as a basis for the emergence of entrepreneurship.
31. Following Posner (1980) we may interpret a consumption loan without interest as a "gift" from the lender to the borrower. For a thorough examination of the general phenomenon of gift-giving in primitive economies, see Posner (1980). Posner develops the idea of gift-giving serving as an insurance function in primitive societies, but does not explicitly examine the phenomenon of interest-free consumption loans of Jewish usury laws. For an analysis of the Kula Ring gift-exchange system as a club-like arrangement designed to facilitate barter exchange between different tribal communities living in the region of Massim in Papua New Guinea, see Landa (1983).
32. For a more detailed discussion of these issues, see Carr and Landa (1981).

33. Some people claim Jewish *kashruth* laws serve a cleanliness purpose. A thorough examination of these laws would indicate that this is not the case. Orthodox Jews claim these laws are a matter of faith and are not a matter of cleanliness.
34. Anthropologists have also put forth a functionalist interpretation of the role of dietary restrictions or food taboo as a boundary-maintenance device to help members to achieve group identity and solidarity and to exclude outsiders. See especially Douglas (1966).
35. One of the ways this is achieved is that Jews will buy their food from common locations.
36. As is the case with Jews dispersed throughout the diaspora.
37. For a discussion of the use of insignia by Italian merchants in the Middle Ages, see Heers (1977).
38. For a discussion of Chinese secret societies in Singapore and Malaya, see Blythe (1969).

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Chapter 7
Personal versus Impersonal Trade: The Size of Trading Groups and Contract Law

Robert Cooter and Janet T. Landa

1 Introduction

The economic model of perfect competition depicts exchange as occurring between anonymous partners. Trade is anonymous because buyers and sellers are indifferent as to the identity of their trading partners. This characteristic of competitive exchange, sometimes called Jevons' (1871) "Law of Indifference," is implicit in the idea that commodities are homogeneous and traders care only about price.

In reality, trade often occurs between people who know each other personally. Personal knowledge is important because trade often involves contracts, rather than the simultaneous exchange of goods and money. A contract always involves a promise: a good is given in exchange for a promise to pay, money is given in exchange for a promise to deliver a good, or one promise is exchanged for another. The reliability of a person's promise is important when considering whether to contract with him, especially if contract law is weak or undeveloped.

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In underdeveloped countries, personal trading relations often take the form of ethnically homogeneous trading groups, such as the East Indians in East Africa, the Syrians in West Africa, the Chinese in Southeast Asia, and the Jews in medieval Europe. Landa (1981) developed a theory of ethnically homogeneous Chinese middlemen as a club-like arrangement for the enforcement of contracts in conditions of uncertainty. Carr and Landa (1983) generalized this theory. Central to it is the idea that a trader will discriminate among potential partners in order to economize on the cost of enforcing contracts. Thus private trading groups are a substitute for public laws regulating contracts.

In this paper we develop a theory about the relationship between the size of trading groups and the development of the law of contracts. It is easy to summarize our model and its conclusions. We think of a trading group as a repository of trust which reduces the probability of breach on a contract between insiders. If the group expands, then members gain the advantage of a more extensive internal market. The advantage of a more extensive internal market is that it permits greater diversity of trade within the group. On the other hand, as the group expands, personal relations become attenuated. Personal relations enable the group to rely upon informal means of enforcement of contracts. If the group becomes quite large, formal methods of enforcement, which are more costly than informal methods, will have to be adopted to enforce contracts. In other words, for a given level of expenditure by the group on enforcement, the probability of breach will increase as the group becomes larger. Thus there will be a tradeoff between diversity of trade within the group and security of contracts.

Group members enjoy profits from exchange. By definition, the representative group member enjoys the average level of profits within the group. There is some size of the group which is best from the viewpoint of a representative member, and there is some size which is best from a social viewpoint which takes account of members and non-members. We prove that these sizes are not the same. To be more precise, assuming that charging a discriminatory membership fee is impossible, the size of the group which maximizes profits for the representative member is smaller than the size which maximizes the total profits of members and non-members. This conclusion is similar to the standard result that a non-discriminating monopolist supplies too little of a good.

The actual size which a trading group attains will depend in part upon who controls admission to it. If the person controlling admission maximizes average profits, which would occur if admissions policies were set by the representative member, then the club would be too small. Taking the argument to the opposite extreme, if the group must freely admit everyone who applies, then it will be too large relative to the social optimum.

Free entry results in too large a group because new entrants treat the pool of trust as a free resource. Thus the argument that free entry results in too large a group is analogous to the conclusion that free entry into a public facility results in excessive congestion.

Taken together, the two preceding paragraphs suggest that an economy will be inefficient if trading groups are unrestricted or if they are forced to accept everyone. Fortunately, our analysis also suggests an alternative to the extreme policy options of forcing an exclusive group to accept everyone or doing nothing. We also prove that membership in clubs will decline if contracts with outsiders become more secure. Thus, the monopoly power and influence of exclusive clubs can be attacked indirectly by increasing the effectiveness of contract law.

Having summarized our model, we now develop it formally.

2 The mathematical model

Consider an exchange economy in which trade occurs through contracts and there is a positive probability that any contract will be breached without compensation. For simplicity, assume that all potential trading partners can be classified into two groups: insiders (club members) and outsiders (non-members). We will use Roman letters to denote variables concerning insiders, and Greek letters to denote variables concerning outsiders. The probability of performance on a contract between insiders is denoted p, so the probability of breach is $1-p$. The probability of performance on a contract between an insider and an outsider is denoted π, so the probability of breach is $1-\pi$. For simplicity, the latter probability is assumed to be the same as the probability of breach between two outsiders. The probability of insider breach is assumed to be lower than outsider breach: $p>\pi$.

Performance on a contract between insiders produces value v for each party to it. Performance on a contract between an insider and an outsider, or between two outsiders, produces value γ for each party to it. Without loss of generality, we assume that the payoff from breach of a contract is nil. Thus the expected value of an insider contract is pv and the expected value of an outsider contract is $\pi\gamma$.

Insiders divide their trade between other insiders and outsiders. Let t denote the number of trades that a representative insider conducts with other insiders, and let $1 - t$ denote his trades with outsiders. Thus the expected payoff which a representative insider enjoys from exchange is

$$V = t\rho\gamma \; + \; (1 - t)\pi\gamma$$

The probability p of performance on an insider contract decreases with the number of insiders, $p = p(i)$ where $p' > 0$, since contract enforcement becomes more costly as the club increases in size. The probability p decreases with club size i because informal methods of social control become less effective as personal relations are attenuated. Expenditure on formal methods of contract enforcement are held constant implicitly. However, the average payoff v from performance on an insider contract increases with the number of insiders i, because more insiders permit more variety in the goods exchanged. For the same reason, the average payoff v decreases when a larger proportion of total trades t are conducted among insiders:

$$v = v(i,\; t) \quad \text{where} \;\; v_1 > 0 \text{ and } \; v_2 < 0$$

Substitution of terms into the equation for V gives the expected payoff which a representative insider enjoys from the trade:

$$V = tp(i)\,v(i,t) + (1 - t)\pi\gamma \tag{7.1}$$

The monopoly club chooses i and t to maximize V.

The total value of all exchanges in the economy is the sum of payoffs to all insiders and outsiders I:

$$W = iV + (I - i)\pi\gamma \tag{7.2}$$

The socially efficient club membership is the value of i which maximizes W.

Let $i^*(t)$ indicate the values of i which maximize W relative to t. Under the usual continuity and convexity assumptions, this function can be found by solving the first order condition

$$0 \geq \frac{\partial W}{\partial i} = (V - \pi\gamma) + i\frac{\partial V}{\partial i} \tag{7.3}$$

The analytically interesting case concerns a situation in which club membership is not a disadvantage: $V \geq \pi\gamma$. This assumption and Eq. 7.3 imply that $0 \geq \frac{\partial V(i,t)}{\partial i}$ for all t, evaluated at $i = i^*(t)$.

It is helpful to graphically represent the relationship between W and V. Define $i_m\,(t)$ to be the values of i which maximize V relative to t. This function can be found by solving $0 \geq \frac{\partial V(i,t)}{\partial i}$.

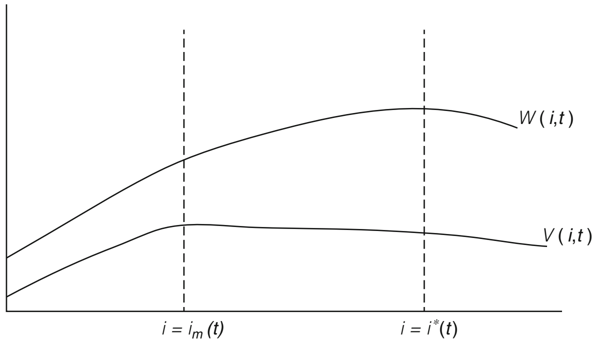

Fig. 7.1 Characteristics of the function V and W

In the preceding paragraph we showed that $0 \geq \frac{\partial V(i,t)}{\partial i}$ at $i = i^*(t)$ and at $i = i^*(t)$,with a strict equality for internal maxima. This fact and the convexity assumptions imply that the functions have the characteristics depicted in Figure 7.1. This graph is essential in the arguments which follow.

We will discuss conditions under which private bargaining will result in the socially efficient club membership. Then we prove that free entry and monopoly control will not ordinarily result in efficient membership. These proofs make the usual convexity and continuity assumptions, i.e., controls can be approximated by continuous variables, first-and second-order derivatives exist, and the second-order conditions for optima are satisfied.

2.1 Perfect bargaining

It is possible to imagine different rules for admission to the club. One possibility is that non-members have the right to admission, in which case we say that there is free entry. Another possibility is that the original members control admission of new members, in which case we say that there is monopoly.

If the number of members is inefficiently small, then the total value of trades can be increased by admitting additional members. There is a tradition in economics of assuming that gains from trade will be exhausted if bargaining is costless (Coase 1960). This tradition leads to the conclusion that costless bargaining between members and non-members will lead to an efficient number of members, regardless of whether the background rule is free entry or monopoly. This proposition corresponds to the familiar Coase Theorem, which asserts that efficiency will be achieved, regardless of the rule of liability, providing that the parties affected by a legal right can bargain costlessly.

For example, suppose that the original club member can set an initiation fee which new members must pay. Non-members would be willing to join so long as the initiation fee did not exceed the value of membership. These assumptions correspond to a perfectly discriminating monopolist, who will achieve the efficient club size, as we now show.

The value which a non-member places upon admission to the club equals the difference in payoffs between insiders and outsiders, or V-$\pi\gamma$. Think of the original member as collecting the admission fee V-$\pi\gamma$ from all i members, except himself. Thus, the controlling member enjoys the payoff from membership V, plus the initiation fees (V-$\pi\gamma$), paid by i - 1 people:

$$\begin{aligned}\text{discriminating monopolist's payoff } &= V + (i-1)\,(V - \pi\gamma)\\ &= i(V - \pi\gamma) + \pi\gamma\end{aligned}$$

The total value of trade is given by Eq. 7.2, which can be written

$$W = i(V - \pi\gamma) + I\pi\gamma$$

Thus the total value of trade and the discriminating monopolist's payoff differ with respect to the terms $\pi\gamma$ and $I\pi\gamma$. These terms are constant with respect to i and t, so the difference between the equations does not affect the maximizing values of i and t. Thus the discriminating monopolist chooses the club size which maximizes the social value of trade.

The discriminating monopolist bargains with each individual to arrive at the initiation fee V-$\pi\gamma$. The impediments to such bargaining include the cost of enforcing contracts, which motivates this paper. We are interested primarily in the situation where members and non-members cannot bargain together in order to achieve an efficient club size, so we now turn to examine free entry and monopoly without bargaining.

2.2 Monopoly

Suppose that the original members of the club control entry, but there is no discriminatory initiation fee. Power and authority might be distributed in various ways among club members. A useful focal point for analysis is to assume that power is distributed so that the policy towards applicants to the club benefits the representative member. For example, this result would occur under a democratic organization in which profits are equally distributed among members, and existing members control the number of new members. This is just one illustration of why the club which controls its own admissions might maximize profits per member. It is easy to prove that under this assumption the monopoly club size, i_m, is too small relative to the social optimum, i.e., an increase in members would increase social value W.

This proposition follows immediately from the interpretation of Figure 7.1. The monopoly membership is set at the value of $i = i_m(t)$, where $\frac{\partial V}{\partial i} = 0$ At this point it is apparent that $\frac{\partial W}{\partial i} > 0$ so that increasing members would increase social value W. The restriction on membership under monopoly is to be expected since the club does not take account of the difference between insider and outsider payoffs $(V - \pi\gamma)$ when deciding whether to admit an additional member. Instead, the club decides to admit a new member if and only if his membership will increase the payoff V to insiders.

2.3 Free entry

Suppose that anyone who wishes to join the club must be admitted on the same terms as existing members. We are contemplating a situation in which membership is, in effect, a property right of non-members, rather than a right of members as in the monopoly case. Under this assumption it is easy to prove that club membership will be too large, i.e., a decrease in the number of members would increase social value W. The reason why club membership is too large under free entry is that trust is treated as a free resource, so it is spread too thinly.

Under free entry, the payoff to insiders and outsiders is the same in equilibrium: $V(i,\ t) = \pi\gamma$. Let $i_f(t)$ be the values of i which satisfy this equation. The derivative of W with respect to i is given by the equation

$$\frac{\partial W(i,t)}{\partial i} = V - \pi\gamma + i\frac{\partial V}{\partial i}$$

If $i = i_f(t)$, then

$$\frac{\partial W(i,t)}{\partial t} = i\frac{\partial V}{\partial i}$$

i.e., the derivative of W and V has the same sign. From Figure 7.1, it is clear that either $i_f(t) < i_m(t)$ or else $i_f(t) > i^*(t)$.

It is easy to see that $i_f(t) < i_m(t)$ implies an unstable free entry equilibrium. To see why, assume that $V = \pi\gamma$ and $i_f(t) < i_m(t)$. In this zone $\frac{\partial V}{\partial i} > 0,$ as depicted in Figure 7.1, so if an additional person joined the club, the equality would be changed to the inequality $V > \pi\gamma$. But now everyone would want to join the club. Thus stability in the free entry equilibrium rules out the situation where $i_f(t) < i_m(t)$.

The remaining alternative is $i_f(t) > i^*(t)$, which is what we sought to prove. Thus the only stable free entry equilibrium (and all equilibria are stable under the convexity assumptions) is one in which membership is too large relative to the efficient level $i^*(t)$.

2.4 Contract law

We have shown that club size is too large under free entry and too small under non-discriminating monopoly. Next we show that, under certain assumptions, club size falls when there is an improvement in the law of contract regulating exchange between non-members, regardless of the rule governing admission.

Suppose that the club is a non-discriminatory monopoly. An additional member causes the average value of performance on an insider contract to increase ($V_2 > 0$). The average value of performance on an insider contract increases because an additional insider increases the variety of goods attainable within the club. However, an increase in i causes insider breach to increase ($p' < 0$). These two influences exactly offset each other in monopoly equilibrium, so V does not change if there is a small increase in i. However, an increase in the expected value of an outsider contract ($\pi\gamma$) will cause a decrease in insider trades t. As a consequence, the need for a large club to supply a diversity of goods will be diminished and the monopoly club size will fall.

It is straightforward to prove this mathematically. The first-order conditions for a maximum by the monopoly club can be written

$$\begin{aligned} 0 &= V_1(i,\ t) \\ 0 &= V_2(i,\ t) \end{aligned}$$

Fully differentiate and invert to obtain:

$$\begin{bmatrix} \mathrm{d}i \\ \mathrm{d}t \end{bmatrix} = \frac{1}{\Delta}\begin{bmatrix} V_{22} & -V_{21} \\ -V_{12} & V_{11} \end{bmatrix}\begin{bmatrix} 0 \\ \mathrm{d}(\pi\gamma) \end{bmatrix}$$

where Δ is the determinant. Solve in order to obtain:

$$\frac{\mathrm{d}t}{\mathrm{d}(\pi\gamma)} = \frac{1}{\Delta} V_1$$

$$< 0 \text{ by second-order condition}$$

$$\frac{\mathrm{d}i}{\mathrm{d}(\pi\gamma)} = \frac{-1}{\Delta} V_{21}$$

$$= \left[\frac{-1}{\Delta}\right] \left\{ \frac{p'v + pv_1}{0\,\mathrm{by}\,0 = V_1} + \frac{tp'v_2}{+} + \frac{tpv_{21}}{?} \right\}$$

The first equation states that an increase in the expected value of outsider contracts $\pi\gamma$ causes insider trades t to diminish. The second equation states that an increase in the expected value of outsider contracts $\pi\gamma$ causes the monopoly club to decrease in size, assuming V_{21} is positive or small.

3 Concluding remarks

We have shown that the socially efficient trading group is smaller than the free entry trading group and larger than the monopoly trading group which maximizes benefits to its representative member. These propositions may explain in part the behavior of trading groups and the reaction of governments to them. Successful trading groups in underdeveloped countries monopolize trade by erecting barriers to entry into the businesses which they control. These entry barriers may take the form of membership criteria such as ethnic identity, dietary restrictions, and religious rituals. These practices prevent entry by outsiders or raise its cost, and also lower the cost of identifying members and enforcing contracts among insiders. Part of the hostility of outsiders towards trading groups may be explained by the losses created by monopoly restrictions on entry. This hostility sometimes provokes harsh measures to destroy the monopoly power or expel the "foreign" middlemen, e.g., the Chinese in Indonesia in the 1960s and the East Indians in Uganda in the 1970s.

According to the model in this paper, trading groups perform the useful function of facilitating contracts under conditions of uncertainty. Destroying the groups will inhibit trade. An alternative policy is to try to reduce the exclusiveness of groups. For example, the government of Singapore since the 1970s has encouraged the five major Chinese ethnic groups to use English and Mandarin Chinese in their dealings with each other in order to create a homogeneous society and facilitate foreign trade. This paper suggests still another approach to the problem, specifically developing and strengthening contract law. Improvements in contract law reduce the equilibrium size of trading groups by facilitating exchange among strangers. In brief, competitive conditions can be created by developing a legal structure in which anonymous exchange is not so risky.

Our analysis was carried out with a number of mathematical restrictions, e.g., the total number of trades and traders was fixed, and the only differentiation among traders was between insiders and outsiders. Relaxing these restrictions probably would not involve a fundamental change in the mathematics or conclusions. A more radical generalization would make the number of trading groups endogenous, not just their size.

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Chapter 8
Cognitive and Classificatory Foundations of Trust and Informal Institutions: A New and Expanded Theory of Ethnic Trading Networks

Take Belfast. Two strangers meet and a guessing game starts immediately. The first thing you think is, “Is this person a Catholic or a Protestant?” . . . It’s a kind of self preservation technique. If it fails, and if your luck is really out, you could end up being killed.

—Review of MacLaverty (1995) by Philip Marchand (1995)

Thinking depends upon institutions.... Classifications, logical operations, and guiding metaphors are given to the individual by society.

—Mary Douglas (1986, p. 10)

In the beginning, however, there were no words. Language seems to have appeared in evolution only after humans and species before them had become adept at generating and categorizing actions and at creating and categorizing mental representations of objects, events, and relations.

—Antonio Damasio and Hanna Damasio (1992, p. 89)

1 Introduction

All rational action is preceded by cognitive processes in the individual’s mind in which classification plays a fundamental role. The opening quote in this chapter dramatically reveals the cognitive and classificatory foundations of human mental processes as they interact with living things.

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Consider the hero in Bernard MacLaverty's (1995) title story in his collection of stories entitled *Walking the Dog: And Other Stories*. The hero is kidnapped by gunmen in Northern Ireland; the gunmen identified themselves to him as members of the IRA, but the hero knew that they could really be Loyalists passing as IRA members in order to trap potential Catholics. He therefore tries to identify his kidnappers. Similarly, his kidnappers wanted to know his religious identity as well: Is he a Catholic or a Protestant? To identify him and put him in the correct category, they asked him a series of questions: What is his surname? If his surname is MacLaverty then any Belfast native will instantly know that he is a Catholic. Does he have a tattoo on his arm? How does he pronounce the letter *h* (since Protestants pronounce it as "aitch" and Catholics as "haitch").

Despite the importance of classification in human society, rational choice approaches underlying the New Institutional Economics (NIE) and the "New Institutionalism" (NI) have ignored the cognitive and classificatory foundations of social institutions. In this chapter, I develop a new approach to institutions, with special reference to informal institutions (e.g. codes of conduct) embedded in ethnically homogeneous middleman groups/networks (EHMGs) that promote mutual trust and reciprocity among trading partners. Codes of ethics embedded in EHMGs coordinate the activities of various interdependent traders linked in complex networks of exchange. This new approach to informal institutions combines my NIE approach to EHMG (Landa 1981, reprinted in Landa 1994, chapter 5) with anthropologist Mary Douglas's (1986) cognitive and classificatory approach to institutions. The result is a new NIE-cognitive and classificatory approach to trust and informal institutions, an approach which also falls into the new sub-discipline of bioeconomics (the integration of economics with biology).

The chapter is organized as follows. Section 2 will review some of the definitions of the concept of institutions by scholars of NIE and NI, and will describe in some detail anthropologist Mary Douglas's (1986) concept of institutions. Section 3 will revisit and re-examine my NIE theory of the EHMG (Landa 1981) and place it explicitly on cognitive and classificatory foundations. Section 4 will discuss some wider theoretical implications of working with an NIE-cognitive theory of trust and informal institutions. Section 5 will discuss some wider implications of our theory for understanding the performance of economies in different contexts.

2 Some definitions of social institutions

The study of institutions is at the heart of NIE and of NI: "Institutions matter" because they economize on transaction costs by reducing uncertainty.[1] But what exactly is a "social institution"? James Buchanan (1975, p. 6) sees institutions—Adam Smith's "laws and institutions"—simply as rules. But what are institutions-as-rules? Political scientist Elinor Ostrom (1986, p. 5) provides one definition:

> Rules ... refer to prescriptions commonly known and used by a set of participants to order repetitive, interdependent relationships. Prescriptions refer to which actions (or states of the world) are *required, prohibited, or permitted*. Rules are the result of implicit or explicit efforts by a set of individuals to achieve order and predictability within defined situations by (1) creating positions (e.g. member, convenor, agent, etc.); (2) stating how participants enter or leave positions; (3) stating which actions participants are required, permitted, or forbidden to take; and (4) stating which outcome participants are required, permitted, or forbidden to affect.

To illustrate this definition of institutions-as-rules, consider the formal institution of contract law. A breaching party is legally permitted to breach a contract for a fungible good provided that the defendant pays monetary damages to the plaintiff if the plaintiff sues the defendant in court. Thus parties to a contract are subject to a legal constraint enforced by the courts. The existence of contract law reduces contract uncertainty by constraining a trader's breach of contract and hence helping to coordinate the activities of interdependent actors (Landa 1976, reprinted in Landa 1994, chapter 2). Economist Douglas North (1990, pp. 3–4) provides another definition of social institutions:

> Institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction. ... Institutional constraints include both what individuals are prohibited from doing and, sometimes, under what conditions some individuals are permitted to undertake certain activities.

North's definition of institutions includes both formal institutions such as written rules as well as informal institutions such as conventions and codes of conduct. A convention, according to philosopher David Lewis (1969, p. 42), is a regularity in behavior of members of a population when they are in a recurrent situation in which everyone conforms to the convention, and expects everyone else to conform, and prefers to conform to the convention on condition that the others also conform. Lewis (1969, p. 44) provided an example of a convention: In the United States (and Canada) drivers drive in the right lane on roads; in Britain the left lane is used. Convention thus may be considered to be equivalent to tradition or custom. Susan Crawford and Elinor Ostrom (1995) classified definitions of institutions by a group of rational choice scholars into three categories: (a) institutions-as-rules; (b) institutions-as-shared norms; and (c) institutions as “shared strategies.”

Unlike the analysis of institutions by rational choice economists, political scientists, and sociologists cited by Crawford and Ostrom (1995), anthropologist Mary Douglas (1986, p. 8) has a very different approach to the analysis of institutions. She criticizes the rational choice approach to institutions for relying too heavily on individualist foundations, and as a result having great difficulties with the idea of group solidarity. According to Douglas (1986, p. 1):

> Writing about cooperation and solidarity means writing at the same time about rejection and mistrust. Solidarity involve individuals being ready to suffer on behalf of the larger group and their expecting other individual members to do as much for them.

To bridge the gap between the individual and society, Douglas (1986, p. 19)—drawing on the sociological theory of Max Weber and Emile Durkheim, as well as the work of Ludwik Fleck, Ian Hacking and Nelson Goodman in the philosophy of science—proposes to develop:

> . . . a double stranded view of social behavior. One strand is cognitive: the individual demand for order and coherence and control of uncertainty. The other strand is transactional: the individual utility maximizing activity described in a cost-benefit calculus.

This she would do by supplementing the “unsociological” weakness of rational choice approaches to institutional analysis with a cognitive and classificatory theory of institutions that bridges the concept of the individual and society. Institutions promoting cooperation and social solidarity need to be grounded by a cognitive device in order for individuals to be certain about each other’s strategies, thus generating the necessary trust in other individuals’ behavior (Douglas 1986, p. 55). For human discourse and cooperation to be possible, individuals have to agree on basic categories of thought. And that, according to Douglas (1986, pp. 55, 91), is provided by institutions which “define sameness,” “confer identity,” and “do the classifying.” In what ways do “institutions do the classifying” for us? Douglas (p. 91) argues that:

> Our social interaction consists very much in telling one another what right thinking is and passing blame on wrong thinking. This is, indeed, how we build the institutions, squeezing each other’s ideas into a common shape so that we can proof rightness by sheer numbers of independent assent.

Classification of different kinds of people begins with the distinction between Ego and other individuals (Douglas 1986, p. 62). Classification also guide people's choice of "their allies, and opponents and the pattern of their future relations" (p. 63). For Douglas, classification is a fundamental cognitive process based on institutions that define standard expectations of his society. Institutions do the classifying for individuals by providing "labels": "People have always been labeling each other, with the same consequence—labels stick" (p. 100); "persons realize their own identities and classify each other through community affiliation" (p. 102). Douglas (p. 103) illustrates the importance of social identities in conveying information about a person, by quoting from the work of anthropologist Lawrence Rosen (1984):

> Thus where an American may wish first to place another by asking what he *does* (i.e. what occupation he practices) because such information conveys a host of implications for economic, social and political attitudes, in Morocco, the central question is "where are your origins," since it is this information which, initially, conveys a degree of predictability about the sort of ties that are possible with such a man.

The importance of knowing a person's identity in predicting behavior has also been emphasized by anthropologist Elizabeth Colson (1974, p. 25):

> [I]f you know a person's clan, you have a good chance of being able to find out an appropriate kinship term to signal the etiquette to be used between the two of you and to define the moral imperative that ought to govern your relationships.

More recently, Douglas (1992, pp. 244–5) has restated her theory of the cognitive and classificatory foundations of institutions by linking the cognitive nature of "collective beliefs" with institutions-as-rules:

> Collective beliefs are embodied in rules of behaviour .... A version of the world depends on the rules, and is guaranteed by the social system in which mutual claims are honoured. Categories are right if they fit well with the relevant rules and claims, and wrong if they do not.

3 Cognitive and classificatory foundations of trust, informal institutions, and ethnic trading networks

Until recently, I was unaware that my theory of the EHMG (Landa 1981) was built on cognitive and classificatory foundations. My theory of the EHMG is a theory of how traders protect themselves from breach of contract in economies in which the legal framework for enforcing contracts is not well-developed. Under conditions of contract uncertainty, a rational trader will have the incentive to reduce uncertainty, hence reducing transaction costs of enforcing contracts by particularizing exchange relations on the basis of kinship or ethnicity. A Chinese middleman in Southeast Asia, for example, uses an informal institution, the Confucian code of ethics, embedded in the EHMG, to reduce contract uncertainty. Under conditions of contract uncertainty, Ego (e.g. a Hokkien-Chinese trader) must identify his potential trading partner because to enforce contracts Ego must rely on the Confucian code of ethics, shared with his trading partners, rather than on formal contract law. Ego will arm himself with a subjective "calculus of relations" (Fortes 1969) which establishes a system of classifying all traders in a market into seven categories corresponding to different "grades" of traders in descending order of trustworthiness: (1) kinsmen from the nuclear family; (2) distant kinsmen from extended family and lineage; (3) clansmen; (4) fellow villagers; (5) people speaking the same dialect from the same province in China, for example, fellow-Hokkien from Fukien province in China; (6) Chinese speaking a different dialect; and (7) non-Chinese.

It may be inferred from Ego's subjective discriminatory system of ranking of traders that Ego uses four basic structural principles to classify all traders into seven categories of traders: kinship, clanship, territory, and ethnicity; the general classificatory principle being based on the degree of social distance between Ego and his trading partners. But this general classificatory principle based on social distance by itself does not naturally mark off the boundaries separating different grades of traders into *seven* categories. What then is the principle of classification of traders into *seven* groupings/grades of traders? For Chinese merchants in Southeast Asia, the principle of classification is based on the informal institution of *Confucian ethics* (of reciprocity). Confucian ethics, in overseas Chinese society, prescribes differences in the patterns of mutual aid obligations between people with *varying degrees of social distance within a well-defined social structure*—near kinsmen (e.g. family members), distant kinsmen in extended family and lineage, clansmen, fellow villagers, and people speaking the same dialect. Kinship relations within the family, in which social distance is at a minimum, are strong ties that involve the severest degree of constraint in dealings among kinsmen. Thus near kinsmen are the most trustworthy people with whom to trade. On account of the differences in institutional constraints, each of the five categories of members occupies a special place within the overall social structure of a specific Chinese ethnic community (e.g. Hokkien Chinese community). This implies that different behavioral patterns can be predicted for each of the five categories of traders: close kinsmen will be predicted to be the most reliable traders, while Hokkien-Chinese will be predicted to be the least reliable traders. This, then, forms the cognitive basis for Ego's classification of all traders within the Hokkien community into *five* different categories/grades of traders. The *limits* of Confucian ethics form the basis for Ego's classification of all traders into two major categories: the insiders (category 1 to 6) and outsiders (category 7). Thus Ego's discriminatory system of classification of all trading partners into *seven* categories reflects the *content* and the *limits* of Confucian code of ethics.

Having established his subjective classification system for ranking traders into seven grades of trustworthiness, it remains for Ego to *identify* a potential trading partner in order to place him in the correct category. To do so efficiently, Ego looks for highly visible ethnic or biological markers, such as facial features, in order to identify correctly a potential trader's ethnicity/race. Ego can also acquire information directly from his potential partner at low cost in order to slot him into one of the categories simply by asking his name, where he comes from, and the dialect/language he speaks. By this process of identification of all potential traders, and sorting them into their respective categories, Ego can *predict* the reliability of a trading partner in honoring his contracts with a high degree of accuracy. Ego thus economizes on the costs of directly acquiring information of the reputation of the traders that he actually chooses to become his trading partners.

Trading partners linked by kinship or ethnic ties in an EHMG have an incentive to honor contracts not only because of the existence of the Confucian code of ethics, but also because economic sanctions are imposed upon the trading partner who violates the ethics of the group (see also Carr and Landa 1983, reprinted in Landa 1994, chapter 6). The economic sanctions imposed by the victim of breach and other traders in the ethnic trading network on the breaching party include: (a) withdrawal of credit so that the offending party has to deal on a cash basis; (b) exclusion from future dealings; and (c) expulsion from the group via bankruptcy proceedings. The Confucian code of ethics, enforced by members of the EHMG, functions to deter trading partners from breach of contract and hence may be regarded as the functional equivalent of modern contract law.

In light of my recent research into the bioeconomics of folk and scientific classification (Ghiselin and Landa 1995), and into the sociology of traditional Chinese social structure, I wish to make some comments about my 1981 analysis of ethnic trading networks. First, while Ego's classification of different categories of traders in terms of trustworthiness is "socially constructed,"[2] the social construction of social categories of members with shared identities—members in each category sharing the same social identity—itself rest on *biological* foundations in the kin relations embedded in the family, extended family, and the lineage. Second, while it is true that humans use institutions to help them classify and label themselves and other humans, nonhumans (e.g. animals) also have the cognitive ability to classify nonhuman kinds into different categories (example, conspecifics, mother, offspring, predator, prey, etc.), and this ability is fundamental to the very survival of nonhuman species (Landa 1998a; Ghiselin and Landa 1995).[3] Third, I recently came across the work of Chinese sociologist Fei Xiaotong (1992, translated by Hamilton and Zheng) who describes the basic characteristic of Chinese traditional society in terms of the concept of *"chaxugeju"* ("differential mode of association"): each individual is at the center of a series of widening concentric circles or networks of overlapping kin and social relationships. Chinese social structure, unlike Western social structure which is individualistic in nature, consists of a careful ranking of people who are classified according to distinct categories of social relationships. Confucian ethics facilitate social categorization. To explain the emergence of ethnic trading networks under conditions of contract uncertainty, it is necessary to combine the NIE/NI "institutions-as-rules" transaction costs approach with Mary Douglas's "institutions-as-classification" cognitive approach.

4 Some theoretical implications of a cognitive theory of trust and informal institutions

4.1 Classification matters: Introducing "*Homo classificus*"

One of the limitations of rational choice theory that underlies the economics of institutions is that it abstracts from the fundamental cognitive, mental processes that occur in the mind. The theory implicitly assumes that all the mental processes involved in arriving at a rational choice have already been performed in the human brain; subjective mental processes are thus ignored. Rational choice theory of institutions is thus an objective and not a subjective theory dealing with mental models, cognitive processes and the like. By ignoring how the mind economizes on information costs by classifying information, rational choice theory loses sight of some important aspects of economizing behavior that takes place in the brain of rational economic agents. This is especially true if economists are doing the economics of trust and informal institutions.[4] The analysis of trust involves not only a person's actual rational choice of trading partners, along benefit-cost lines, but also an analysis of the person's mental process of classifying who is trustworthy and who is not, and making finer discriminations of categories of trading partners in terms of the degree of trustworthiness. A NIE approach to the analysis of trust/commercial morality embedded in ethnic trading networks must therefore rest on cognitive and classificatory foundations. "Classification matters" because of its cognitive role in economizing on information costs. A fuller analysis of the behavior of *Homo economicus* (Economic man) must therefore be supplemented by his cognitive counterpart, whom I shall call, "*Homo classificus*."[5]

Nowhere is the role of *Homo classificus* more important than *Homo sapiens*' use of language for communication with others. The origin of language, according to Antonio Damasio and Hanna Damasio (1992, p. 89)—neurologists renowned for their research on the neurology of vision, memory, and language—has to do with the way the mind efficiently categorizes the world:[6]

> Language arose and persisted because it serves as a supremely efficient means of communications, especially for abstract concepts.... But language also performs what Patricia S. Churchland of the University of California at San Diego aptly calls "cognitive compression." It helps to categorize the world and to reduce the complexity of conceptual structures to a manageable scale.... The cognitive economies of language ... make it possible for people to establish even more complex concepts and to use them to think at levels that would otherwise be impossible. In the beginning, however, there were no words. Language seems to have appeared in evolution only after humans and species before them had become adept at generating and categorizing actions and at creating and categorizing mental representations of objects, events and relations.... Language exists both as an artifact in the external world ... and as the embodiment in the brain of those symbols and the principles that determine their combination.

And institutions, communicated and transmitted to others via language, facilitate human beings to categorize things, events, and human relations, and thus economize on the limitations of human memory.

4.2 Classificatory rationality

Herbert Simon (1957) rejected the maximizing postulate of economic man and substituted instead the concept of satisficing as the relevant behavioral concept. This is based upon his concept that man's rationality is "bounded." As a consequence, models of man based upon the assumption of "bounded rationality" take into account the individual's limited mental computational abilities. My cognitive theory of trust and informal institutions embedded in the EHMG sees rationality of *Homo classificus* in terms of the concept of what I call "classificatory rationality": i.e., the rational person classifies and categorizes because of the cognitive limitations of the human agent's brain/memory. My concept of "classificatory rationality" is consistent with Simon's bounded rationality concept, but provides some details of how cognitive limitation of the brain is circumvented.

4.3 North's cognitive science approach to institutions

Nobel Laureate in Economics Douglas North, in a co-authored paper with Arthur Denzau (Denzau and North 1994) on institutions, has taken a new route—a cognitive science approach to the analysis of the role of ideologies and institutions. According to the authors (1994, p. 4), "mental models are the internal representations that individual cognitive systems create to interpret the environment; the institutions are the external (to the mind) mechanisms individuals create to structure and order the environment." The individual categorizes and classifies in order to learn and interpret the environment. Unfortunately, by treating institutions as external to the mind of the economic agent, Denzau and North fail to build an important bridge between the individual's mental processes and the institutions of the group in which he is embedded. Only by explicitly treating institutions-as-rules and institutions-as-classification, as set out in this chapter, can the bridge be built between the individual and his group, and the institutional environment in which the individual is embedded.

It is at this point in the development of an NIE-cognitive theory of trust and informal institutions that the frontiers in law-and-economics of informal institutions, forming a part of the NIE, cross over into the cognitive sciences covering such disciplines as neuroscience, cognitive psychology, cognitive anthropology (as exemplified by the work of Mary Douglas), and bioeconomics.[7]

But Denzau and North (1994, p. 27) are certainly right in pointing to the importance of developing a cognitive science approach to institutions for understanding the performance of different economies:

> [O]nce we open up the black box of "rationality," we encounter the complex and still very incomplete world of cognitive science. This essay is a preliminary exploration of some of the implications of the way in which humans attempt to order and structure their environment and communicate with each other. Does the argument have relevance for social science theory? Certainly it does. Ideas matter and the way by which ideas evolve and are

communicated is the key to developing useful theory which will expand our understanding of the performance of societies both at a moment of time and over time.

In this chapter, I have looked at informal institutions from the point of view of a NIE-cognitive theory of trust and informal institutions. Such an approach to the analysis of trust and informal institutions has great relevance for social science theory. Understanding the cognitive and classificatory processes of choice of trading partners under conditions of uncertainty provide us with useful theoretical insights for explaining the successful performance of certain economies, such as the East Asian economies, China's economy in transition, and the Mafia-dominated underground economy of Russia in transition to a market economy.

5 Wider implications

Important insights are yielded by a cognitive theory of trust and informal institutions directed to understanding the performance of different economies. The theory uses the NIE-cognitive theory of trust and informal institutions.

5.1 The "East Asian Miracle"

According to Root and Campos (1995), the rapid and sustained economic growth in East Asia after the Second World War was due to the ability of regime leaders in these economies to provide the "institutional foundations" necessary for high economic performance. Political institutions fostered business confidence in leaders' ability to make commitments for long-term growth. Their analysis is, however, incomplete because the writers fail to take account of the cognitive and cultural foundations of Confucian ideology in which entrepreneurs in many of the high-performance East Asian economies are embedded. Chinese firms in East Asian economies are predominantly family firms, and Asian regional and international trading networks are predominately organized as kin and ethnic-based exchange networks (Landa 1978, 1981; Hamilton 1996). Landa (1978) argued, using a Property Rights-Public Choice approach (part of NIE), that these ethnic networks are self-governing economic organizations that function to mobilize capital and information, and to enforce contracts in an environment characterized by underdeveloped infrastructure. It is this ability of Chinese middleman-entrepreneurs in Southeast Asia to perform "gap-filling" and "input-completing" (Leibenstein 1968) functions that gave them a differential transaction cost advantage over the indigenous population to appropriate middleman roles in the first place. Landa thus rejects the traditional Marxian exploitation thesis of Chinese middleman success in Southeast Asia. The very success of Chinese middleman-entrepreneurs in Southeast Asia historically had generated a great deal of ethnic/racial conflict between Malays and Chinese in Southeast Asia, especially in the late 1960s. Pointing only to the state's economic role in the development of these high-performance economies, therefore, greatly underestimates the economic significance of cultural and cognitive embeddedness of entrepreneurs in Confucian ethics/ideology, i.e., the capacity of entrepreneurs for creating self-governing ethnic communities in providing for themselves the ethnic "club-like" infrastructure for entrepreneurship in less-developed economies, hence contributing to the "East Asian Miracle."

5.2 Entrepreneurship in the informal sectors of economies in transition

Beginning in 1978, China's leaders embarked on a series of economic reforms designed to transform China's socialist economy into a more market-oriented economy. The major economic reform took place in rural China with the introduction of the Household Responsibility System (HRS) in 1979. As part of China's program of economic reforms, leaders of the Communist Party recognized that the success of the HRS depends on the existence of legal institutions for the protection of property rights arising from contracts. Thus almost contemporaneous with the introduction of the HRS, the domestic contract law was established in 1982. Under the HRS, individual household farms replaced the commune system. Peasants, after fulfilling government quotas, were allowed to sell their surplus agricultural products in markets where prices were higher and to appropriate profits for themselves; under the HRS, peasants were transformed into peasant-entrepreneurs. The HRS greatly increased the volume of trade and facilitated the growth of markets. The growth of markets led to the emergence of a class of specialized profit-seeking traders engaged in long-distance trade. The Chinese leaders also legalized their activities by allowing them to transport goods over long distances and sell their goods in newly freed-up wholesale markets. Since 1983, the private merchants have helped to generate a national network of wholesale markets. The emergence of a class of profit-seeking private merchants and transport operators also saw the "resurgence of cultural and social ties" (Watson 1988, p. 2) linking merchants together. These cultural and social ties linking merchants together is a manifestation of the same phenomenon which occurred in its most developed form as the Chinese EHMG in Southeast Asia, discussed earlier. These cultural and social ties between merchants supplemented mediation, arbitration and the role of formal contract law in enforcing contracts and contributed greatly to China's success during the transition period (Landa 1998b). China's relative success in transition to a market economy is in great contrast to the experience of Russia and Eastern Europe in transition where private profit-making entrepreneurship flourished predominately in the underground economy dominated by Mafia-type "black and informal marketeers" and "speculators" who use trust as well as extra-legal mechanisms for enforcing contracts (Brenner 1990).[8] Brenner (1990) sees the underground economy as a fertile source for the emergence of legitimate entrepreneurship once that sector of the economy is legalized and a new contract law adopted. But, instead,

> . . . legalizing much that was illegal, and letting the black market's customary law to serve as the seed of the new system, one of the first laws of the *perestroika* was the May 1986 law against "non-labor" (Brenner 1990, p. 3).

Outside Russia's underground economy there is little entrepreneurship, not only because of the absence of a well-developed contract law, but also because all the institutions that foster bonds of trust and social solidarity were systematically destroyed during Russia's transition to a market economy (Brenner 1990). Like Russia in transition, powerful informal and Mafia-like networks, which had been entrenched in Communist Poland and Eastern Europe, continued to be a source of private illegal entrepreneurship in Poland and Eastern Europe in transition to market economies. Under communism, informal barter networks, based on kinship, friendship, ethnic, and patronage ties generate mutual trust and mutual obligations. These informal networks, substituting for missing social structures, such as family, Church, religious orders or private societies, had been effectively destroyed in the name of Communist ideology (Los 1992b, pp. 360–1). In addition to the informal barter networks, entrepreneurship also flourished in the illegal organized crime economy where stolen goods are sold through Mafia networks. In these Mafia networks, personal ties among participants ensure mutual assistance and enforcement of contracts through swift and cruel punishment (Los 1992a, pp. 117, 121).

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Endnotes

1. For the various sub-disciplines that make up transaction cost economics or "New Institutional Economics," see Williamson (1985, pp. 1–14, and Chapter 1), Eggertsson (1990, chapter 1), and Landa (1994, chapter 1). The NI is broader than NIE, and includes the work of economists, political scientists, and rational choice sociologists.
2. I am using the concept "social construction" in the sense of sociologists Peter Berger and Thomas Luckmann (1966), where reality has a subjective and an objective dimension. Berger (pp. 135–6) provides an explanation with an example: "In primary socialization, then, the individual's first world is constructed. Its peculiar quality of firmness is to be accounted for, at least in part, by the inevitability of the individual's relationship to his very significant others." See also John Searles's (1995) view of the "construction of social reality" which also consists of an objective and a subjective/cognitive component.
3. It must be emphasized here, however, that animals do not depend on institutions for their ability to make social classifications. As Frank Salter pointed out to me (personal communication, December 1996), "social classification is pre-human and certainly pre-institutional."
4. For a discussion of the evolution of my work on the economics of trust and informal institutions, see Landa (1996).
5. Wulf Schiefenhövel suggested to me at the Reimers Foundation Conference, 25 September 1996, that *Homo classificans* is a better terminology than the one I am proposing. According to Faisal Bari (e-mail correspondence, 19 October 1996) "To term humans as *Homo classificus* is perfect and support for it would come not only from sociology and anthropology, but you would get wonderful arguments from philosophy as well as evolutionary biology. The debate between British empiricism especially David Hume and Kantian idealism was surely centred around that. And I think there is general agreement that Kant was right against Hume when he said that categories are indispensible for humans. In fact he went further and said that no thinking is possible without that, and our world is thus and so because our thinking being in certain categories."
6. I thank my brother, neurologist Dr. Tai Chao, for giving me the citation to the Damasio and Damosio (1992) article.
7. For a brief survey of the new sub-discipline of bioeconomics, see Landa (1994, 1, pp. 18–20). Bioeconomics has its own journal, *Journal of Bioeconomics;* the inaugural issue was published on 2 July 1999. For an editorial on the nature of bioeconomics as a discipline, and the aims and scope of the Journal, see Landa and Ghiselin (1999).

8. For a discussion of entrepreneurship operating in the informal sectors of less developed economies, see Landa (1988).

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Chapter 9
The Role of Culture and Institutions in Promoting Middleman-Entrepreneurship in Less-Developed Economies

1 Introduction

In this chapter I will focus specifically on the relationship between culture and ethnic middleman entrepreneurship in less-developed countries (LDCs). Ethnically homogeneous middleman groups (EHMGs) have played significant roles in cross cultural trade throughout history.[1] Some of these EHMGs, such as the Jews in medieval Europe, have persisted over long periods of time; others, in present-day LDCs—Chinese in Southeast Asia, the Indians in East and Central Africa, the Lebanese in West Africa—have relatively shorter histories. What accounts for the success and persistence of these EHMGs?[2] Does culture play a role?

Economists have paid little attention to this area, relegating the study of culture and of ethnic middleman entrepreneurship to sister disciplines of sociology, anthropology, and marketing theory. In recent years, however, there has appeared a small but growing body of economic literature on the determinants of ethnic group differences in labor markets and in entrepreneurial roles. William Darity and Rhonda Williams (1985), for example, have criticized contemporary economic theory (Neo-classical and Austrian theory) for attempting to bury the idea that market discrimination explains racial wage differentials or differences in general pecuniary accomplishments

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across ethnic groups under competitive conditions. Referring specifically to the Austrian view of competition associated with the work of Israel Kirzner (1973), Darity and Williams (p. 256) argued that according to that view, discriminatory wage differentials could not be maintained because a "latent reservoir of alert entrepreneurs presumably would seize the profit opportunities generated by the discriminatory wage, drive discriminatory employers from the market, and erode the wage differentials." Darity and Williams (1985, p. 258) also criticized what they call the "new" cultural variant of human capital theory—associated especially with the work of Thomas Sowell (1978, 1981,1983) and of Barry Chiswick (1983)—which proposes cultural explanations for differences in economic achievements across distinct racial and ethnic groups:

> If one accepts the position that cultural difference are significant determinants of ethnic and racial inequality, then one must explain why cultural differences salient for success are persistent. This persistence is impossible to maintain if one believes the market system is imbued with an Austrian process of competition. Sowell,[3] for one, seems to have in mind exactly such a view of competition.

Darity and Williams further argued that the inadequacies of the cultural explanations are compounded by their inadequacies in explaining the experiences of specific ethnic groups. In searching for an adequate theory of ethnic success, they suggested the notion of Marxist competition, which they believe can be reconciled with the existence of market discrimination as a persistent source of difference in racial and ethnic group achievements:

> The evolutionary nature of Marxist competition simply means that competition gives rise to monopolies. . . .Marxist capitalist winners consolidate and concentrate; they can exclude losers and consolidate their positions for long stretches of time. Austrian competition's winning entrepreneur cannot, in contrast, *permanently* maintain barriers to preserve his position.[4] According to the Austrian view, barriers will eventually be torn down by newer contestants. We extend Marxist competition to labor powers. Workers also concentrate and consolidate, particularly by ethnicity or race. . . .Specific ethnic and racial groups could gain control and dominance of particular occupational or labor powers. . . . Pursuit of this line of inquiry necessitates investigation of the concrete economic and historical conditions confronted by specific ethnic and racial groups (Darity and Williams, pp. 259–260).

In this chapter, I shall argue that both the Austrian and Marxist notions of competition are inadequate to explain the emergence and persistence of certain EHMGs in LDCs, such as the Chinese in Southeast Asia, the Indians in East and Central Africa, the Lebanese in West Africa, and the Jews in medieval Europe and elsewhere. I shall argue that culture which facilities mutual aid among members of the ethnic group in the provision of local public goods for the ethnic group facilities "group competition," enabling the ethnic group to out-compete other ethnic groups to appropriate and maintain middleman roles.

My alternative transaction cost-cultural theory incorporates the concepts of "institutions" and "transaction costs" from transaction cost economics, which is part of the New Institutional Economics; "culture," the "ethnic group," ethnic groups as "cultural-bearing" and "cultural-transmission" units from anthropology literature; "cultural norms as social capital" from sociology; "N-entrepreneurship" (entrepreneurial gap-filling functions) from entrepreneurial literature; and the concept of "group competition" from evolutionary biology. It is an empirically-grounded theory and is based on examining the empirical realities of the social structures and cultural values of specific ethnic trading groups and the historical-institutional contexts in which these groups are embedded.

Section 2 will discuss the link between economists' concept of the "economic man" and relate it to anthropologists' concepts of "culture" and the "ethnic group." Section 3 will discuss the relation of culture to economists concept of institutions-as-rules, and the role of institutions in economizing on transaction costs. Section 4 will discuss the role of entrepreneurship in performing gap-filling functions in imperfect markets/less-developed economies. Section 5 will discuss how entrepreneurs, in performing gap-filling functions, have the incentive to create personalistic trading networks (EHMGs), with rules/cultural norms embedded in these networks in order to efficiently perform their middleman functions. Section 6 will discuss the role of cultural norms embedded in these EHMGs as social capital, and how EHMGs in their role as "cultural bearing" units contribute to the persistence of the EHMGs. Section 7 will discuss how EHMGs as "cultural transmission" units further contribute to the persistence of these EHMGs via their role in private provision of local public goods. Section 8 will discuss Jack Hirshleifer's (1982) concept of "group competition"—in contrast to Austrian as well as Marxist notions of competition—and show that the concept of group competition is more useful in understanding how a middleman ethnic group out-competes another ethnic group in appropriating and maintaining middleman-entrepreneurial role for themselves. Section 9 provides some concluding comments.

2 Economic man, culture, and the ethnic group

The concept of the isolated, individual rational "economic man" (*Homo economicus*) is at the heart of the methodology of economics. The economic man carefully weighs benefits and costs before arriving at a rational choice.[6] Before man can make rational choices, however, he must be socialized or enculturated. The role of culture or socializing forces in influencing an individual's rational choice has been generally ignored by economists, with the notable exception of Friedrich Hayek (1988). Hayek is keenly aware of the relationship between the "thinking man" and the transmission of tradition and culture largely through the family (Lavoie 1991, p. 46–47). Nobel Laureate Herbert Simon (1989, p. 13) also emphasized the importance of rational man as a "socially dependent creature":

> Human beings are not the independent Leibnitzian monads conjured up by libertarian theory. Society is not something imposed on them; it provides the matrix in which they survive and mature and act on the environment. The society, including but not limited to the family, provides not only nutrient, shelter, and safety during childhood and youth, but also knowledge and skills that are needed for expert, hence fit, adult performance. Society has enormous power, enduring through a person's lifetime, to enhance or reduce fitness.

Cultural anthropologists, on the other hand, have always insisted on the importance of culture in influencing an individual's behavior. Clifford Geertz (1973, p. 49), for example, argues that men without culture are "unworkable monstrosities":

> …with few useful instincts, fewer recognizable sentiments, and no intellect: mental basket cases….To supply the additional information necessary to be able to act, we were forced, in turn, to rely more heavily on cultural resources—the accumulated fund of significant symbols. Such symbols are thus not mere expressions, instrumentalities, or correlates of our biological, psychological, and social existence; they are prerequisites of it. Without men, no culture, certainly; but equally, and more significantly, without culture, no men.
>
> We are, in sum, incomplete or unfinished animals who complete ourselves through culture—and not through culture in general but through highly particular forms of it: Dobuan and Javanese, Hopi and Italian, upper-class and lower-class, academic and commercial.

The link between man and specific forms of culture is further clarified by anthropologist Fredrik Barth (1969, p. 9) via the concept of "ethnic units" or "ethnic groups":

> Practically all anthropological reasoning rests on the premise that cultural variation is discontinuous: that there are aggregates of people who essentially

> share a common culture, and interconnected differences that distinguish each such discrete culture from all others. Since culture is nothing but a way to describe human behavior, it would follow that there are discrete groups of people, i.e., ethnic units, to correspond to each culture.

But what precisely is an ethnic unit? What is the cultural content of an ethnic group?

An ethnic group, according to anthropologist Anya Royce (1982, p. 24) can be defined in terms of the following six characteristics:

1. The group shares common origins, such as national origins, or common descent;
2. Group members share fundamental cultural values;
3. The group relates to other ethnic groups in a broader system of social relations;
4. Ethnic groups are larger than kin or locality groups and transcend face-to-face interaction;
5. Different meanings for ethnic categories pertain both in different social settings and for different individuals;
6. Ethnic categories are emblematic, having names and group identity.

The first characteristic points to the ethnic group as a biological or racial group, with members of the same group identified by distinguishable, objective physical characteristics.

Among the characteristics listed above, anthropologists have traditionally given central importance to the second characteristic—the connection between ethnic groups and culture. So important is this feature that anthropologist Fredrik Barth (1969, p. 13) calls an ethnic group a "cultural-bearing unit." He divides the cultural contents of ethnic groups into two kinds: the overt signals or symbols of identity—what anthropologists term "cultural diacritica"—such as language, religion, rituals, dress style, food preferences—that people look for and exhibit to show identity; and the underlying values, ethics, or standards of morality shared by group members. Of particular importance to Barth (p. 15) is the concept of the ethnic *boundary*:

> . . .the ethnic boundary canalizes social life—it entails a frequently quite complex organization of behavior and social relations. The identification of another person as a fellow member of an ethnic group implies a sharing of criteria for evaluation and judgment. It thus entails the assumption that the two are fundamentally "playing the same game." . . . On the other hand, a dichotomization of others as strangers, as members of another ethnic group, implies a recognition of limitations or shared understandings, differences in criteria for judgment of value and performance, and a restriction of interaction to sectors of assumed common understanding and mutual interest.

Barth's emphasis on the dependence of the self on the values and ethics of one's own ethnic group is spelled out in greater detail by biologist Lewis Thomas (1978). Speaking of the individual, "myself," Thomas says:

> The original root was *se* or *seu*, simply the pronouns of the third person, and most of the descendant words, except "self" itself, were constructed to allude to other, somehow connected people; "sibs" and "gossips," relatives and close acquaintances, came from *seu*. *Se* was also used to indicate something outside or apart, hence words like "separate," "secret" or "segregate." From an extended root *swedh* it moved into Greek as *ethnos*, meaning people of one's own sort, and *ethos*, meaning the customs of such people. "Ethics" means the behavior of people like one's self, one's own ethics.

There is, thus, a clear link between the self, the ethnic group, and the ethics of the group; the self is inescapably socialized or enculturated. The self, embedded in an ethnic group, belongs to a "moral community" of people like one's self; the self is "culture-bound" (Selznick and Jaeger 1964).

The third characteristic points to the existence of smaller groups within the wider ethnic group. Anthropologist Marshall Sahlins (1965), for example, sees the individual, Ego, as embedded in ever-widening concentric circles of groupings: the family, the lineage, the village, and finally the tribal/ethnic group. Ego is seen as interacting with individuals in ever-widening social spheres in which kinship/social distance increase as Ego moves out from the center to the boundary of the ethnic group. As social distance increases, mutual aid and reciprocity between Ego and his cooperating partner decreases. Across the ethnic/tribal boundary, Ego expects "negative reciprocity" (Gouldner 1960) from interaction with outsiders. Sahlins's model of kinship/social distance and reciprocity describes the phenomenon of nepotism and ethnocentrism in social or economic transactions: A person will always favor close kin over more distant kin, and will favor fellow ethnics over outsiders. Pierre Van den Berghe (1981) goes even further to include the sociobiologists' emphasis of kin selection and reciprocal altruism in the nonhuman world as promoting inclusive fitness of the individual. He regards ethnicity as "kin selection" and the ethnic group ("ethny") as representing the outer limits of that:

> .... inbred group of near or distant kinsmen whom one knows as intimates and whom therefore one can trust. One intuitively expects fellow ethnics to behave at least somewhat benevolently toward one because of kin selection, reinforced by reciprocity. The shared genes predispose toward beneficence; the daily interdependence reinforces that kin selection. Fellow ethnics are, in the deepest sense, "our people" (p. 25).

Ethnocentrism, the identification of "us, the insiders whom we trust" and the discrimination against "them, the outsiders, whom we distrust" is an inherent feature of all ethnic groups. Not all ethnic groups are equally ethnocentric, however; some are more ethnocentric than others because they are more effective at enforcing the values and norms of the group.

The fourth characteristic emphasizes the fact that ethnic identity emerges only in the context of interethnic contact situations. Barth (1969, p. 10), in particular, emphasizes the point that "ethnic distinctions do not depend on an absence of social interaction and acceptance, but are quite to the contrary often the very foundations on which embracing social systems are built."

The fifth characteristic emphasizes situational use of ethnicity, which according to Royce (p. 26) , implies that identities can be manipulated to suit situations:

> (1) individuals can choose, within certain constraints, between a variety of identities; (2) individuals will maximize the options available to them and will use ethnic identity if they perceive an advantage in so doing; (3) that individuals have to contend, in this process, with other individuals engaged in the same process whose interests and perceptions may be quite different. In other words, the use of ethnic identity is fluid and flexible.

The sixth characteristic focuses on the fact that ethnic groups have names that serve as powerful symbols of identity. In fact, the ethnic group constitutes the outer boundaries in which discrimination and identification of "us" and "them" are based. To the six characteristics defining an ethnic group, we should add a seventh, namely that ethnic groups are "cultural transmission units" in that the cultural traits of ethnic groups are treated as a group inheritance that is transmitted most often, but not exclusively, through family upbringing. Here the link is once again between ethnic groups and culture, but in this case the concept of culture is defined as "the transmission from one generation to the next, via teaching and imitation, of knowledge, values, and other factors that influence behavior" (Boyd and Richerson 1985, p. 2). See section 7. The various characteristics of an ethnic group will be important in the development of our theory of the emergence and persistence of EHMGs and ethnic trading boundaries.

3 Institutions-as-rules and transaction costs

An essential feature of an ethnic group, as already pointed out, is that members share the same culture and play by the same rules. This fact is important for understanding the concept of rules-as-institutions. What precisely are rules? Rules, according to political scientist Elinor Ostrom (1986, p. 5):

> refer to prescriptions commonly known and used by a set of participants to order repetitive, interdependent relationships. Prescriptions refer to which actions (or states of the world) are *required, prohibited, or permitted.* Rules are the result of implicit or explicit efforts by a set of individuals to achieve order and predictability within defined situations by: (1) creating positions (e.g. members, convener, agent, etc.); (2) stating how participants enter or leave positions; (3) stating which actions participants in these positions are required, permitted or forbidden to take; and (4) stating which outcome participants are required, permitted, or forbidden to affect.

In short, all rules contain prescriptions that require, forbid, or permit some actions or outcome and these rules are monitored and enforced. All ethnic groups have such rules. But it must be emphasized that some ethnic groups are more efficient in enforcing in-group norms than are other ethnic groups. The ethnic groups that have emerged to dominate middleman roles, such as the Chinese in Southeast Asia, the Indians in East and Central Africa, the Jews in Jerba and in Antwerp, all have strict codes that are strongly enforced (Landa 1988).

The study of institutions-as-rules (Ostrom 1986; North 1990, p. 4) is at the heart of transaction cost economics, which is part of the New Institutional Economics.[7] Institutions emerge in order to economize on transaction costs. Transaction costs economics began with the work of Ronald Coase (1937) with his ground-breaking paper, "Nature of the firm," which introduced the concept of transactions costs into economics: costs of the search for prices and trading partners, and costs of contract negotiation.

Oliver Williamson (1985) extended Coase's theory of the firm and has identified three alternative modes of economic organization of developed capitalist economies for coordinating the actions of interdependent firms: the market, the vertically integrated firm, and relational contracting (on-going long-term contractual relations). Central to Williamson's work is the behavioral assumption that "some individuals are opportunistic some of the time and that differential trustworthiness is rarely, transparent ex-ante. As a consequence, ex-ante screening efforts are made and ex-post safeguards are created" (Williamson 1985, p. 64). Opportunism is defined as "self-seeking with guile," of which breach of contract is an example. Williamson argues that vertical integration and long-term relational contracts can be viewed as governance structures, alternative to market contracting, to protect parties from opportunism, thereby economizing on the costs of contract enforcement.

Kenneth Arrow (1970) has identified yet another way society constrains opportunistic behavior: codes of behavior and ethics that establish trust between two parties who share the same code. The existence of trust economizes on transaction costs. Without trust, transaction costs may be so high as to lead markets to go out of existence.

In LDCs, the existence of mutual trust among trading partners is manifested in the clublike economic organization of the ethnically homogeneous middleman entrepreneurial groups which emerge to economize on the costs of enforcing contracts. See section 5.

4 Entrepreneurship, imperfect markets, and gap-filling functions

Entrepreneurship is often considered a fourth factor of production or input, along with land, labor, and capital. There is, however, no general agreement of the defining characteristics or functions of an entrepreneur. For example, Frank Knight ([1925] 1965) emphasized the uncertainty-bearing function of entrepreneurs; Joseph Schumpeter ([1934] 1961) emphasized the innovation function; Israel Kirzner (1973) emphasized the arbitrageur-entrepreneur function as one of possessing the subjective capacity to perceive and seize opportunities from arbitrage arising from the existence of price differentials. Because of the lack of consensus regarding the definition of an entrepreneur, the concept of entrepreneurship remains elusive and has been compared to the mythical creature known as the “heffalump” (Kilby 1971).

It is clear, however, that the concept of the entrepreneur as defined by Knight, Schumpeter, and Kirzner is applicable to *developed* Western capitalist economies. Since LDCs differ significantly from developed Western capitalist economies, it may be expected that the entrepreneurial role in LDCs will also differ. William Glade (1967) has provided a useful general framework for analyzing the emergence and growth of entrepreneurship in LDCs. A theory of entrepreneurial formation, he says, must examine the role of opportunity structure, the exogenously determined structural or environmental factors such as technological change, population shifts, shifts in demand, which determine the demand side of entrepreneurship; and the conditions for opportunity appropriation. Given an objective structure of opportunity, what are the factors determining who will perceive and appropriate the opportunities for themselves? Glade suggests that the ability to exploit new opportunities will depend on all key inputs and not just the conventional categories such as land, labor, and capital. Information networks, political connections, “transaction security arrangements,” and capital-mobilizing mechanisms may also be key inputs critical to the emergence of entrepreneurship.

Harvey Leibenstein's (1968) theory of "N-entrepreneurship" provides another view of the importance of nonconventional inputs for the emergence of entrepreneurs in LDCs. He defines N-entrepreneurship as:

> …the activities necessary to operate or carry on an enterprise where not all the markets are well established or clearly defined and/or in which the relevant parts of the production function are not completely known. In both cases, the entrepreneur coordinates activities that involve different markets; he is an intermarket operator. But in the case of N-entrepreneurship not all markets exist or operate perfectly and the entrepreneur, if he is to be successful, must fill in for the market deficiencies. … As we have defined the entrepreneur he is an individual or group of individuals with four major characteristics: he connects different markets, he is capable of making up for market deficiencies (gap-filling), he is an "input-completer," and he creates or expands time-binding input-transforming entities (i.e. firms).

The greater prevalence of incomplete and imperfect markets gives rise to the significance of N-entrepreneurship, which includes the capacity to reduce risks and uncertainties associated with imperfect markets. Nathaniel Leff (1979, pp. 48–49) suggests that, given the greater risks and uncertainties in LDCs:

> …entrepreneurship in LDCs is likely to involve more than psychological capacity or perceiving new economic opportunities and entering them with an aggressive investment policy. The special conditions affecting risk and uncertainty, and the need to open new channels for factor mobilization and product supply are likely to impose additional requirements.

Leff pointed to the role of the "Group" type of industrial organization, a large-scale firm somewhat similar to the Japanese *zaibatsu* and the American conglomerate, that "invests and produces in several product lines that involve vertical integration or other economic and technological complementarities. Much of the private and domestically owned advanced sector in the LDCs is in fact organized in the 'Group' pattern of industrial organization" (Leff, p. 52). The "Group" pattern of organization overcomes many of the market imperfections in LDCs by mobilizing capital and information and by reducing uncertainty surrounding investment and production decisions.

5 Personalistic trading networks (EHMGs) as efficient economic organizations: A transaction cost approach

In this section, I focus on the middleman N-entrepreneurial "gap-filling" role of coping with the problem of *contract uncertainty* in LDC's where the legal framework for contract enforcement is not well-developed.

Specifically, I focus on the middleman-entrepreneur's capacity for creating personalistic exchange networks (EHMGs) for economizing on costs of enforcing contracts, a problem ignored in entrepreneurial theory as well as in development economics. The EHMGs are unlike Leff's Group form of organization in that they do not involve vertical integration between firms, but are *decentralized trading networks* among independent marketing firms linked by particularistic ties.

I have, in chapter 5, presented my theory of the emergence/origins of the EHMG (Landa 1981) and also generalized and extended my theory of the EHMG in chapter 6 (Carr and Landa 1983), and chapter 7 (Cooter and Landa 1984). What follows is a brief summary of my theory of the origins of the EHMG. Under conditions of contract uncertainty in LDCs, traders must cope with the problem of opportunism arising from breach of contract. Traders, operating at the individual microlevel, are aware that they are not isolated individuals but are embedded in larger macro-units or social structures—the family, the clan, the ethnic group—with rules to constrain members' behavior. Thus, the rational "embedded economic man," will not indiscriminately enter into impersonal exchange relations randomly with anonymous traders, but will choose to enter into exchange relations with those whom he can trust, who are usually members of family, clan, fellow villagers and members of his own ethnic group. Given an interdependent marketing network, the structural effects of many individual middlemen's rational choices of trustworthy traders is the emergence of an EHMG/particularistic trading network with norms of behavior constraining middleman behavior, embedded in the EHMG. The EHMG emerges from an Austrian-Hayekian "spontaneous" process in that no one organized the emergence of the EHMG. Since the EHMG is itself part of a larger ethnic group with its tradition and cultural norms already in existence, the EHMG is seen as an emergent macro-phenomena in a highly complex, multi-tiered system.

The emergence of the EHMG economizes on transaction costs of protecting contracts, hence EHMGs may be considered club-like economic organizations, alternative to Williamson's (1985) three modes of economic organization, found in highly developed Western capitalist economies for coping with opportunism. The particularistic kinship/ethnic trading networks are the dominant form of economic organization found in non-Western LDCs. As such, particularistic trading networks may be considered a fourth kind of economic organization in which relational contracting takes place between traders linked by particularistic ties of mutual trust. Alternatively, the EHMG may be considered to be an *intermediate* form of economic organization, lying between Oliver Williamson's

(1975) economic organizations of markets (contracts) and hierarchies (the vertically integrated firm). They are an efficient form of economic organization that emerged for the protection of contracts, given the conditions of contract uncertainty and the historical-institutional context in which these ethnic middlemen-entrepreneurs operate.

6 Cultural norms as social capital, and EHMGs as "cultural-bearing units": Symbols of individual and group identity, and "passing"

Once an EHMG has emerged, what factors account for the persistence of ethnic trading boundaries? I shall argue that the role of the EHMGs as "cultural-bearing units" is one of the important factors contributing to the persistence of the EHMG.

Every trader who belongs to the same ethnic group benefits from belonging to the group because of the existence of shared ethics or cultural norms that function to reduce transaction costs of protecting contracts. Because of this fact, cultural norms embedded in an ethnic group may be considered to be local public goods/assets (Buchanan 1975, chaps. 3,7) or "social capital" (Coleman 1987). Since cultural norms of behavior are specific to specific ethnic groups, these norms may also be considered as *ethnic-specific assets*. The importance of ethnic-specific assets is that the identity of individuals matters under conditions of contract uncertainty because traders prefer to transact with insiders rather than outsiders. It is in this context that symbols of individual and group identity—such as names, clan names, dietary rules, language, and religion—play an important signaling function in transmitting nonprice information on the identity of potential partners (Carr and Landa 1983). This also explains the rationale of ethnic signaling, in which Chinese and Jewish merchants, for example, engage in "situational ethnicity," that is, the strategic use of an ethnic identity to fit particular situations (Royce 1982, p. 202). Chinese traders tend to emphasize Chinese identity when interacting with Chinese creditors (Sanzton 1983). Similarly, Jews in Jerba, Tunisia (Udovitch and Valensi 1984), and the Jews involved in the diamond trade in Antwerp (Gurwith 1968) constantly use clothing, physiognomic indicators, and other symbols of identity to facilitate interaction with each other. The importance of group cultural norms in lowering transaction costs of members of the group also explains the kind of identity manipulation that sociologists and anthropologists call "passing"—masquerading as someone else to improve status. Observe the following phenomena:

(a) *Changing surname*. An individual who wishes to pass into another clan can change his surname to gain access to trading networks dominated by other clans. Some of the Indians in Central and East Africa bearing the surname of Koli tried to masquerade as the Patels, who successfully dominated middleman roles (Dotson and Dotson 1968). Changing names, however, may not be an effective strategy if the trading community has numerous interlocking voluntary associations and dense informational networks that can easily uncover the real identity of those who try to pass via a change of surname. This form of passing or identity switching is rarely used by the Chinese in Southeast Asia, for example, since the Chinese communities are highly organized. This might also explain why some Kolis are able to pass as Patels because voluntary organizations are not so important in the Indian trading communities in East and Central Africa.

(b) *Religious conversion*. In order to pass as a member of another religious group, an individual may resort to conversion; however, there are costs to this tactic. For a Malay to convert to a Chinese way of life, for instance, he not only has to invest in speaking the Chinese language, but he also has to eat pork, and both involve high psychological-adjustment costs.

(c) *Assimilation*. Because ethnicity involves immutable physical characteristics, it is very costly for a person from a different ethnic group to switch ethnic identities. Within certain limits, a person may alter physical features by plastic surgery, hair straightening or frizzing, or wearing contact lenses to change eye color (Royce 1982, p. 189). In the long run, the strategy of assimilation through intermarriage allows the children of mixed marriages a greater chance to attain better status through switching ethnic identities. "Switching an identity is sometimes a two-generation process" (Royce 1982, p. 208). Because the costs of ethnic identity switching are so prohibitive, both in the short and long run, ethnicity imposes an effective barrier for those attempting to pass as insiders.

A major reason accounting for the persistence of ethnic trading boundaries, then, is the role of the EHMGs as "cultural-bearing units": not only do insiders use individual and group symbols of identity to facilitate economic interaction among themselves, but symbols of group identity also function to exclude outsiders from participation in the "morality community" of homogeneous middleman networks. These cultural barriers to entry create differential costs of passing for outsiders, with ethnicity as the most effective barrier. The EHMGs as "cultural-transmission units" further contribute to the persistence of ethnic trading boundaries.

7 EHMGs as "cultural-transmission units": Family learning and the private provision of public goods

Another important consequence of the existence of group specific norms, viewed as ethnic-specific capital assets, is that the capital-asset feature of cultural norms necessitates its maintenance and its transmission to future generations. Since group-specific norms are local public goods, there is the familiar free-rider problem associated with the private voluntary provision of public goods. Unless there are selective rewards, no individual will have the incentive to voluntarily contribute to the provision of public goods (Olson 1965). Chinese and Jewish merchant communities have, however, overcome the traditional free-rider problem by providing such incentives; for example, wealthy Chinese merchants frequently donate large sums of money to establish schools, scholarships, hospitals, or graveyards for members of their own community (Willmot 1967; Barton 1983). This is not pure altruism, but it does contain elements of mutual aid and reciprocity as well as self-interest. Successful merchants often are themselves the beneficiaries of mutual aid that enabled them to be successful in the first place. The large donations may represent a return gift for some of the benefits received from members of the same community. The voluntary charitable contributions may also represent pure self-interest in that the contributions further enhance personal reputations and prestige of the doners within the community. It is through the learning of cultural values at school and at home that group values are preserved and transmitted to the members of the next generation. Ethnic groups are efficient, low-cost "cultural-transmission units."

In further developing a theory of the EHMG with respect to transmission of cultural values through the family, I draw on the insightful work of Robert Boyd and Peter Richerson (1980), anthropologist and biologist respectively. The authors argue that conventional sociobiological theory cannot explain the great diversity of human behavior among ethnic groups—even though genetic differences between such groups are relatively trivial—or the fact that much of human social behavior is culturally acquired. What is needed, they argue, is an extension of conventional sociobiological theory to include cultural transmission of behavior. Their model, which includes both genetic and cultural transmission of behavior, is called a "dual inheritance theory" of genes and culture. In this theory, the concept of culture is crucial and is defined as:

> …quite broadly as the transmission of the determinants of behavior from individual to individual, and thus from generation to generation, by social learning, imitation or some other similar process. From our point of view, the

> essence of culture is that it constitutes a second, supplementary system of inheritance (Boyd and Richerson 1980, pp. 101–102).

The relative success in cultural transmission—defined as the inheritance of determinants of behavior—depends on parents teaching their children and relatives, and individuals learning from or imitating the behavior of others, such as teachers, priests, or “big men.” It is social learning that causes the communication of cultural traits directly from individual to individual, so that culture is a “population-level phenomenon” (Boyd and Richerson 1985, p. 6). Cultural inheritance is important in the evolution of human behavior because of the costs of learning. If individuals have to discover the optimal local adaptive behavior by trial-and-error methods, and such methods involve significant costs, selection will provide short-cuts to learning. Cultural inheritance is adaptive precisely because it is such a shortcut. Individuals, embedded in a cultural population, can learn to adapt to local conditions with a much smaller investment in learning compared to what is required in an acultural population (Boyd and Richerson 1985, pp. 14–15). Social learning can occur as a result of “direct bias,” that is, trial-and-error learning, which can be costly. Where “decision-making costs are likely to be especially high for many common choices that have low ‘trialability’—whom to marry, what occupation to choose, what major capital investments to make, whether to convert to another religion, and so forth” (Boyd and Richerson 1985, p. 285), adoption of the following two rule-of-thumb methods for acquiring culture can be efficient: “frequency-dependent bias,” copying or imitating the everyday behavior of others (“In Rome, do as the Romans do”); and “indirect bias,” imitating those who appear to be notably successful in a particular habitat. These methods for acquiring culture can substitute for costly trial-and-error learning. Crucial to Boyd and Richerson’s theory is the idea that the individual is responsive to learning and to imitation, an idea not unlike Hayek’s emphasis of the crucial role of tradition being transmitted to the individual via family and community.

The idea that an individual is responsive to learning and to imitation can be captured in Herbert Simon’s concept of “docility.” Discussing markets and organization, Simon (1989, p. 13) defines the trait as follows:

> To be docile is to be tractable, manageable and above all teachable. ... Docile people are disposed to accept instruction and instructions from the social environment they depend on. They tend to adapt their behavior to norms and pressures of the society. From an evolutionary standpoint, having a considerable “measure of docility is not altruism but enlightened selfishness.”

Boyd and Richerson's theory can be used to develop the concept of the EHMG as a cultural-transmission unit, via family learning, that helps the EHMG to persist over time. Present members of the EHMG share the same cultural values, including rules of the game, but they will all eventually die and be replaced by new members. What is the process by which new members acquire the culture of the older generation of middlemen? Since many of the family firms of the deceased middlemen will be passed on to sons, social learning of the culture of the middleman group takes place through docility and "frequency-dependent bias"—sons copying the behavior of their fathers—without the need for costly trial-and-error learning. The next generation can also copy those middleman-entrepreneurs who are especially successful and have emerged to assume roles as leaders and philanthropists in their own ethnic community. Since the enculturation process of social learning also goes on in the wider ethnic community of which the EHMG is a subgroup, new members of the ethnic group will also inherit the cultural values of the group. The rules of the game and other cultural values governing members of the present generation of middlemen, then, will be transmitted via social learning from one generation to the next. Since these cultural rules of the game are local public goods, they are maintained and preserved over time at low cost. Because of this, ethnocentrism of members of the EHMG is reinforced; those who are already in the middleman group will continue to prefer to choose new trading partners from the younger generation of the same ethnic group. The cultural boundaries of middleman trading networks thus persist over time and cannot be eroded by "Austrian competition." The phenomenon of the EHMG is a manifestation of successful "group competition" of one ethnic group against other ethnic groups for middleman-entrepreneur roles. To this, we now turn.

8 Group competition, group loyalty, and group identification

The EHMG, as pointed out earlier, is an efficient institutional arrangement for the protection of contracts in LDCs. The concept of efficiency, as economist Jack Hirshleifer (1982, p. 50) has pointed out, should be defined relative to the boundaries of the group:

> On all levels of life organisms have found it profitable to come together in patterns of cooperative association. But such cooperation is always secondary and contingent, in at least two respects: (1) in-group cooperation is only a means for more effectively and ruthlessly competing against outsiders, and (2) even within the group there will not be perfect parallelism of interests,

> hence cooperation must generally be supported by sanctions. ... Efficiency, in this interpretation, is meaningful only as a measure of group strength or advantage relative to competing groups in the struggle for life and resources. ... A totally universalistic measure of efficiency is pointless; we must draw the line somewhere, at the boundary of "us" and "them."

Herbert Simon (1989) has also made a similar argument. He argues that if a group (a family, a company, a city, a nation, or the local baseball team) that is in competition with other groups has a culture that contributes greatly to the fitness of the group, it could survive at the expense of other groups if individual members are docile and accept the contents of their culture. Simon emphasizes the importance of organizational/group identification and loyalty, ignored in the New Institutional Economics, which overcomes opportunistic behavior.

Viewed from an evolutionary perspective, Hirshleifer's concept of group competition, ignored in conventional economics literature, is crucial to our explanation of the success and persistence of the EHMG. The very success of the foreign, ethnically homogeneous trading group in LDCs in appropriating middleman roles for themselves attests to the usefulness of the concept of group competition. In the ruthless competitive interethnic struggle for profit opportunities, in-group members with efficient social structures for the enforcement of cultural norms of behavior have a group competitive advantage over other groups in appropriating and maintaining middleman-entrepreneurial roles for themselves.

9 Some concluding comments

Many EHMGs in LDCs, including the Chinese in Southeast Asia, the Indians in East and Central Africa, the Lebanese in West Africa, have persisted for relatively long periods of time. What accounts for their emergence and persistence? Central to my theory of their emergence is the notion that in LDCs where the legal infrastructure is not well developed for the enforcement of contracts, middlemen-entrepreneurs must take on the additional "gap-filling" function of coping with the problem of contract uncertainty. Ethnic groups with efficient social structures for the enforcement of cultural norms of behavior that facilitate mutual aid and in-group cooperation will be able to create personalistic exchange networks which economize on transaction costs of enforcement of contracts, and hence, outcompete other ethnic groups to appropriate middleman-entrepreneur roles for themselves. EHMGs/ethnic trading networks are thus an *efficient* form of economic organization in LDCs, functioning as alternatives to formal contract law and the vertically integrated firm.

To maintain middleman-entrepreneur roles, it is essential for these EHMGs to function as "cultural-bearing units." Members use symbols of individual and group identity to facilitate interaction among members of the group; the group's symbols of identity make it costly for outsiders to enter these ethnic trading networks. In addition, EHMGs function as "cultural-transmission units" because wealthy members of the EHMG provide certain local public goods, including education, to fellow members; and because group cultural values are transmitted to future generations of the ethnic group via school and family teaching.

The Austrian theory of competition and entrepreneurship, as developed by Israel Kirzner (1973), cannot explain the phenomenon of EHMGs. If subjective perception of profit opportunities is essential for the emergence of entrepreneurship, then one would expect entrepreneurs to be *randomly* distributed among the general population, which is clearly not the case with the EHMGs. Although it is undoubtedly true that the subjective ability to perceive price differentials is essential for Kirzner's entrepreneurs to reap profits from arbitrage, it is unsatisfactory to leave the entire arbitrage theory of profit depending solely on the subjective capacity of different economic agents in the market to perceive and seize profit opportunities.

In order for the arbitrageur-entrepreneur to appropriate profits, contracts of buying and reselling must be enforced. Kirzner's theory of competition and entrepreneurship implicitly assumes the presence of markets with well-developed legal infrastructure for the enforcement of contracts, hence zero transaction costs of contract enforcement. Given these assumptions, Kirzner's entrepreneurs' profit expectations always materialize because breach of contract is ruled out in his theory.[8] Kirznerian entrepreneurs do not face the transaction costs of contract uncertainty, hence the need to particularize exchange relations by the formation of EHMG. Kirzner's theory of entrepreneurship and his Austrian view of competition are thus incomplete for an understanding of the emergence of EHMGs. Darity and Williams's (1985) notion of Marxist competition is also inadequate in explaining why certain ethnic groups emerge to dominate specific occupational roles, since they have not explained how Marxist competition led certain ethnic groups to dominate specific occupational roles in the first place.

My transaction cost-cultural approach to a theory of EHMGs, on the other hand, can explain why certain ethnic groups emerge to dominate middleman roles and why these EHMGs persist over time. Furthermore, my theory can be reconciled with Darity and Williams's notion of the existence of market discrimination as a persistent source of differences in ethnic group achievement.

My theory of ethnic middleman success differs from Sowell's cultural theory of ethnic success in two ways. First, I incorporate the importance of transaction costs for explaining the institution of social norms embedded in the EHMGs in promoting mutual trust, hence economizing on contract-enforcement costs in LDCs where the legal framework is not well developed. Second, whereas evolutionary concepts of in-group cooperation and group competition are also central concepts in my theory of the success and persistence of EHMGs, Sowell (1983, p. 139) does not have such concepts in mind. Referring to the Chinese in Southeast Asia, for example, he speaks of the "Chinese aptitude for arduous and painstaking work" as an example of the cultural advantages that enable Chinese to be successful in Southeast Asia.

My theory is also consistent with sociologist Edna Bonacich's (1973) theory of ethnic middleman success. Bonacich explains the success of minority middleman groups by referring to their ethnocentrism, attachment to their homeland, their status as sojourners and the effects of sojourning on their attitudes toward thrift, their ability to accumulate liquid capital, and a high degree of internal solidarity. "Communal solidarity plays an important role in the economic position of the middleman group. Family, regional, dialect, and ultimately ethnic ties are used as preferential economic treatment. The 'primordial tie' of blood provides a basis of trust, and is reinforced by multi-purpose formal and informal associations." The difference between Bonacich's theory and my theory of success of minority middleman groups is that I use a transaction cost economics framework, while incorporating concepts of trust between people related by blood such as kinsmen, people from the same region, and people speaking the same dialect.

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Endnotes

1. For a fascinating study of numerous trading groups throughout human history that have engaged in cross-cultural trade, see Philip D. Curtin (1984).
2. For a theory of why Chinese are successful as middlemen-entrepreneurs in Southeast Asia, see Landa (1978). For a generalized theory of middleman success (the Chinese in Southeast Asia, Indians in East and Central Africa,

Lebanese in West Africa, Jews in medieval Europe and elsewhere), see Carr and Landa (1983); and Landa (1988)
3. Sowell (1981).
4. Kirzner (1973).
5. For an in-depth study of the social structures and cultural values of the Chinese in Southeast Asia, based on my fieldwork in Malaysia and Singapore in 1969, see Landa (1981); see also Landa (1988).
6. An individual is said to engage in rational choice when his preference structure is complete (in that in comparing any two commodities he is able to prefer one to the other, or he is indifferent), transitive, and convex.
7. Coase (1937) in his famous paper, "The nature of the firm," argues that the institution of the firm emerges in a specialized exchange economy in order to economize on certain kinds of transaction costs, chief of which are contract-negotiation costs. If the price mechanism is used, input owners would be required to enter into a number of contracts with other factors with whom they cooperate. By organizing a firm, however, the costs of contract negotiations are reduced because, in place of several contracts, *one* employer-employee contract is substituted. The essence of the contract is that the employees agree to obey the directions and orders of the entrepreneur-coordinator within certain limits; and within these limits, the entrepreneur-coordinator directs and coordinates economic activities within the firm. To Coase, then, the distinguishing characteristic of the firm is the supersession of the price mechanism because of the transaction costs of using the latter. The body of transaction cost economics most familiar to sociologists is Oliver Williamson's (1985) work on markets, hierarchies, and relational contracting, which extends the work of Coase's theory of the firm, and explicitly combines the disciplines of law, economics, and organization.
8. For a theory of how contract law deters breach of contract, and hence protects a trader's profit expectations, see Landa (1987).

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Chapter 10
The Co-evolution of Markets, Entrepreneurship, Laws, and Institutions in China's Economy in Transition: A New Institutional Economics Perspective

1 Introduction

Since embarking on an ambitious program of economic reforms in 1978, the People's Republic of China (China) has enjoyed a degree of success in making the transition from a centrally planned economy to a market-oriented economy.[1] China has enjoyed rapid economic growth at the average rate of 9.5 percent during 1980–1990, and double-digit growth from 1993–1995.[2] China's experience during the transitional period stands in sharp contrast to the reform experience of Eastern Europe. What factors account for the difference?

Some writers, in accounting for China's experience, have singled out the role of local governments in supporting market-oriented reforms, or the role of China's gradual and partial approach to reforms, in contrast to the rapid ("big bang") approach of Eastern Europe. For example, Christine Wong (1992) singled out the role of local governments in pushing reforms and in supporting pro-reform forces as being a critical factor which helps to explain the success of the gradualist strategy of reform in China. She contrasts China's experience with the experience of Eastern Europe where "repeated attempts since the 1960s at gradualist reform were defeated by recentralizing forces when confronted with growing macroeconomic imbalance and allocative tension" (Wong 1992, p. 2).

In this chapter, I wish to focus on an important factor accounting for China's success which is ignored in studies on China's economy in transition. I will argue that the critical factor—indeed, the single most important

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factor—accounting for China's success is the creation of formal laws and informal institutions for the protection of property rights and the enforcement of contracts. These, in turn, promote the emergence of markets and entrepreneurship. China's new leaders, in embarking on a program of economic reforms aimed at promoting the emergence of markets and entrepreneurship, also undertook fundamental legal reforms by introducing contract law and the rule of law. In addition, informal institutional arrangements, such as Confucian ethics embedded in particularistic or personalistic (*guanxi*) trading networks for the protection of contracts, were created by newly emergent merchants operating in an environment in which the legal infrastructure for the enforcement of contracts was underdeveloped. In focusing on the fundamental roles of contract law, the rule of law, and Confucian ethics in facilitating the development of markets and entrepreneurship, I draw on New Institutional Economics (NIE) to provide the theoretical framework for analyzing China's experience during the transitional period.

This chapter is divided into 5 sections. In Section 2, I discuss aspects of the Household Responsibility System (HRS) and the emergence of markets, entrepreneurship, and personalistic *(guanxi)* trading networks. In Section 3, I discuss aspects of China's legal and constitutional reforms with emphasis on China's domestic contract law and the rule of law. To illustrate China's contract law and the rule of law in practice, I first present four case studies of court resolution of rural contract disputes, followed by a discussion of the problems which severely limit the effectiveness of Chinese courts to enforce contracts. In Section 4, I present my theory of the coevolution of markets, entrepreneurship, laws, and institutions in China's economy in transition, using a NIE theoretical framework. I begin by presenting aspects of NIE because of my belief in the transferability of this important new interdisciplinary field of knowledge to scholars doing research on Socialist economies in transition to market economies. I then use the NIE framework to analyze the role of law in reducing envy-induced breach of contract thereby protecting property rights of peasant entrepreneurs. The framework is extended to the analysis of the role of Confucian ethics in providing informal social norms for protecting contracts of merchant-entrepreneurs connected in *guanxi* exchange networks. I argue that the emergence of social connections among the middlemen is in response to the environment of contract uncertainty in which merchants operated. I also examine the emergence of rent-seeking activities and profit-seeking entrepreneurship by former cadres who lost status. I offer an explanation, in addition to those discussed by Christine Wong, of why cadres and party leaders at the level of local governments tend to be pro-market in ideology and have actively supported China's pro-market reforms. In Section 5, I provide some concluding comments.

2 HRS and the emergence of markets, entrepreneurship, and *guanxi* trading networks

2.1 Household responsibility system

Beginning in 1978, China's leaders embarked on a series of economic reforms designed to transform China's economy into a more market-oriented economy and to promote and expand China's foreign trade. The major economic reform took place in rural China with the introduction of the HRS in 1979.[3] This system introduced a considerable element of privatization and decollectivization of the people's commune system by reintroducing household farming. Large communal farms were converted into smaller units in which households or small groups sign a contract with production teams to farm given plots of land. After fulfilling state quotas, any surplus belonged to the contracting parties, who were then allowed to keep or sell the surplus in the private markets where prices were higher, and to appropriate the residual profits for themselves.

With the introduction of the HRS, the hierarchical command system—or the subordinate relationship of the commune members to the leadership in day-to-day farming operations—was superseded by a contractual one. Groups, households, or individuals are able to enter into legally-binding contracts with commune members in a relationship which included the legal notions of economic rights and obligations. The basic means of production such as land, farm machinery, and implements are owned by commune members. The team distributes the land according to each household's population, labor force, or both. All heads of households in a village sign a general land contract which gives them the right to farm the contracted land in exchange for a contractual obligation to sell a specified volume of grain (or other products) to the state at prices fixed by the state, to pay agricultural taxes, and to pay certain fees to the collective. Any production exceeding the contractual obligations belongs to the contracting households who can sell the surplus in markets where the prices are higher. By paying a contractual fee, a household wishing to become a specialized contracting household may bid for the right to use the collectively-owned land to undertake specialized activities; the highest bidder will become a specialized contracting household. Specialized contracts signed by heads of specialized households differ from general land contracts in that the only obligation of specialized households is to pay to the collective the contractual fee in cash.[4] Thus, specialized households have rights to all their output. The contractual fee in no way reflects scarcity-rent, but is in fact a "tax" that is typically set at a level at which the team can cover its administrative, welfare, and other expenses (Cheung, 1989, p. 22). Communal land allocated to contracting households for cultivation "belongs" to the contracting household only for the duration of the contract; hence the contracted land cannot be sold. Contractual rights and obligations, including the length of the contract, are spelled out by the contracting parties. In the early days of the HRS, contracting households signed short-term contracts with a duration of three to four years. Later, starting in 1984, some households signed long-term contracts ranging from 15 to 30 years.

Contracting households undertake production and management of an activity. They keep separate accounts and are responsible for the losses and gains derived from undertaking the activity; hence the term "household *responsibility* system." Before the Communist Party came into power in 1949, the independent Chinese family farm had been the traditional organizational form in rural China. Therefore, China's new leaders, through instituting the HRS, have reinstated the Chinese farm household as the unit of production.

2.2 Emergence of markets, entrepreneurship, and "*guanxi*" trading networks

Under the HRS, contracting households have the right to make many decisions on the spot, whereas previously decisions were made exclusively by production team leaders. This decentralization of decision-making in the HRS constitutes an important rural reform. The most important feature of rural reform is that contracting households holding general land contracts for the cultivation of crops or staples are given the right, after fulfilling government production quotas, to appropriate profits as private property. Members of contracting households holding general land contracts are thus transformed into *profit-seeking peasant-entrepreneurs*. As the HRS spreads, "specialized households" also emerge to take advantage of opportunities for profit-making. These specialized households, emerging out of China's rural households, engage in sideline activities, specialize in activities that are more profitable than growing crops or staples, for example, firing bricks and tiles, raising livestock, or growing fruits or vegetables.

The HRS was first adopted in remote mountainous areas and in the poorer regions of provinces such as Anhui and Gansu. By 1983, more than 90 percent of farm families in China had adopted the HRS (Hartford 1985). Between 1978 and 1982, sales of farm and sideline products increased by 99 percent; the volume of trade in the rural market increased by 130 percent; and the number of rural markets increased nearly 25 percent (Zweig *et al.* 1987, p. 322). The domestic contract law (ECL) which came into effect on July 1, 1982, was designed to protect property rights of contracting households by enforcing contracts. County governments printed and distributed standardized form contracts to all households that signed general land contracts with their teams. In Zhejiang Province, for example, there had been a 2.55 times increase from 1978 to 1983 in the volume of trade between rural market towns and cities and a 70 percent increase in the number of rural markets (Nee 1989, p. 196).

The specialization and division of labor in production, which contributed to the growth in the number of rural markets, in turn, led to the emergence of a class of specialized profit-seeking traders engaged in long-distance trade. As early as 1981, long distance trading by private traders was legal, but long distance traders were not permitted to use trucks, boats, and other means of large-scale transportation. With the proclamation of Document 1, 1983, the agricultural marketing system was reformed, giving private merchants the right to transport goods by trucks or tractors over long distances and to sell them in newly unfettered wholesale markets. Since 1983, private merchants—specializing in transport and marketing activities—have helped to generate a national network of wholesale markets.[5] The profits of private merchants have come from playing the role of intermediaries, connecting producers with consumers via their activity of buying commodities at a lower price in one market and reselling the same commodities at a higher price in another market. The emergence of free wholesale markets and intermediary-entrepreneurs has meant a shift away from the government-controlled distribution system. Although the marketing of most agricultural products by private traders was permitted in the early and mid-1950s and in the early 1960s, the private traders and private marketing networks were suppressed during the decade of the Cultural Revolution (1966–1976); the state took over the marketing of crops—such as grains, edible vegetable oils, and cotton—that make up 90 percent of China’s cultivated area (Sicular, 1985 pp. 84–85). The emergence of a class of profit-seeking private merchants and transport operators also saw the “resurgence of cultural and social ties” (Watson 1988, p. 2) linking merchants together. These personal connections with overseas Chinese firms also fuelled the dramatic growth of

China's township and village enterprises (TVEs) which in turn have been an important part of rural development in China. The TVEs are often considered an alternative path of development through the growth of individual or private enterprises.

With the introduction of the HRS, contracting households, especially specialized households, began to grow wealthy. As the income disparity between commune members and specialized contracting households became highly visible, fellow commune members and cadres became envious. Envy manifested itself in various ways, including stealing or destruction of private property belonging to specialized households or in cadres arbitrarily abrogating contracts. Four case studies are presented (see section 3.3 below) to illustrate the envy-induced breach of contract by cadres. Of course, envy of the success of others leading to violence or breach of contract is not unique to China; envy is also widespread in Eastern Europe and the former Soviet Union (Brenner 1991). Entrepreneurial intermediaries frequently earned profits many times greater than would have been the case if they had specialized in agricultural production, making their success the cause of envy and jealousy (Nee 1989, p. 181). Their vulnerability to hostility is heightened by the traditional Chinese cultural bias against merchants. As Nee (1989, p. 182) noted: "These entrepreneurs were frequently characterized as immoral for profiting from others' efforts without producing anything themselves." Wang Gungwu (1991, p. 183) explains the root of this cultural bias:

> It is well known that Confucian social and political philosophy placed the merchant at the bottom of a four-tier social structure, beneath the literati, the peasant and the artisan. This was endorsed and reinforced in the laws made by the Qin-Han bureaucracy two thousand years ago. And merchants have remained officially, and in the eyes of most Chinese people, in lowly social position until modern times.

3 Aspects of China's legal and constitutional reforms

3.1 China's domestic contract law and notarial regulations

As part of China's program of reforms, Chinese leaders recognized that the success of the HRS depended on the existence of legal institutions for the protection of property rights arising from contracts. Thus, almost contemporaneously with the introduction of the HRS in the People's Republic of China in 1979, domestic contract law—Economic Contract Law of the

People's Republic of China (ECL)—was adopted by the National People's Congress on 31 December 1981, coming into effect on 1 July 1982.[6]

In establishing the ECL, Chinese leaders are using an institution central to modern Western capitalist economies to provide the legal framework for protecting property rights so as to facilitate China's modernization process. In adopting the Western institution of contract law, Chinese leaders had to modify the ECL to take account of China's state plans and also Chinese cultural and legal traditions (Zweig *et al*. 1987, p. 325).

As a consequence, several features of Chinese contract law and contractual practices differ significantly from their Western counterparts. Various scholars have described aspects of China's contract law and contractual practices (Hsiao 1965, Lubman 1983, Mu 1983, G. Wang 1986, R. Macneil 1986, Zweig *et al*. 1987). From the literature, and especially from two invaluable studies, one by Roderick Macneil (1986) and another by Zweig, *et al*. (1987), at least two broad areas of China's contract law and contractual practices, that differ sharply from their Western counterparts, can be identified.

First, in the area of remedies for breach of contract:

(a) specific performance, rather than money damages, is the preferred remedy for breach (Gao 1987, p. 328);
(b) Chinese contract law protects the restitution and reliance interests rather than the expectation interest (R. Macneil 1986, p. 342, p. 349); and
(c) there is a prevalent contractual norm of loss-splitting between the defendant and the plaintiff (R. Macneil 1986, p. 342).

Second, in the area of dispute resolution methods, Chinese disputants prefer using out-of court settlements such as mediation or arbitration. They especially prefer the use of mediation and abhor going to court. The court is used only as a last resort when all out-of-court methods of settlement have failed. Even then, the court will try to reach a mediated settlement before imposing its decision upon the parties (Zweig *et al*. 1987, p. 357). As part of its basic legal reforms, in 1982 China introduced the Notarial Regulations *(Provisional Regulations of the People's Republic of China on Notarization)* making it necessary for a contract to be notarized in order to be legally binding. The Chinese notariate, which did not exist in the traditional Chinese legal system, now plays a crucial role in China's legal system, performing a wide variety of functions which in the West are normally performed by lawyers and judges.[7] Chinese notaries, unlike their western counterparts, are bureaucrats. The various functions performed by Chinese notaries include:

(a) notarization of economic contracts submitted by contracting parties on a voluntary basis;
(b) certification of the authenticity of signatures and seal impressions of contracting parties;
(c) verification that the contract complies with the ECL and that the terms of the contract are clearly spelled out, including liability for breach of contract;
(d) issuing summary writs of execution concerning uncontested claims to recover debts or property; and
(e) drafting notarial and other legal documents.

These functions help create greater confidence that contracts will be honored by contracting parties. The institution of the notariate in China, therefore, plays a crucial gap-filling function in supplementing China's underdeveloped and incomplete system of economic contract law.

3.2 China's constitution and the rule of law

The "rule of law" is not part of the Confucian cultural heritage of the Chinese people: traditionally, China has been a country governed by the rule of man.[8] With the introduction of economic reforms, however, leaders of the Communist Party have recognized that if they are to promote the security of property rights in the HRS, then in addition to contract law, the rule of law is also necessary to prevent bureaucrats from arbitrarily and unilaterally abrogating contracts. In the early days of the HRS, many reported cases of breach of contract were induced by envious rural cadres who tore up contracts. Faced with the arbitrary power of bureaucrats in tearing up contracts, it was essential that Chinese Communist leaders, who had created "one of the most bureaucratized social systems known to man," (Whyte 1989, p. 252) establish a constitutional setting in which all individuals were treated equally under a rule of law protecting individual rights. This required placing constitutional limits on the power of bureaucrats to unilaterally abrogate contracts which violate the property rights of contracting households. In Article 32 of China's 1982 Constitution, the section on "Rights and Duties of Citizens" states that "[a]ll citizens of the People's Republic of China are equal before the law."[9] With the promulgation of the ECL in China, the courts by enforcing property rights of contracting households, are assuming a new role in limiting the discretion of local administrators and party cadres to act arbitrarily. To the extent that contract law and the rule of law both contribute to the control of bureaucratic behavior in unilaterally abrogating contracts, they have had an important impact on the success of the HRS which in turn has facilitated the emergence of markets and entrepreneurship. To show evidence of the role of contract law and the rule of law in protecting property rights of contracting households, I present four case studies of court resolution of specialized household responsibility contract disputes, and then look at various problems that in general limit the effectiveness of Chinese courts in protecting property rights and enforcing contracts.

3.3 China's contract law and the rule of law in practice

Breach of contract induced by envy on the part of fellow commune members or cadres was a major source of breach of contract in the early years of the HRS. With the introduction of ECL in 1982, courts throughout China began hearing household responsibility contract disputes.[10] Several writers have reported a number of rural disputes in the post ECL-period which were caused by cadres arbitrarily abrogating contracts. I present four case studies of court resolution of specialized household responsibility contract disputes, and then look at various problems that in general limit the effectiveness of Chinese courts in protecting property rights and enforcing contracts.

3.3.1 Liucun Brigade Orchard Case (1983)[11]

In 1983, the suburban People's court of Qinhuangdao City tried the case of a contract in which some cadres in the Liucun Brigade of the Huangtukan Commune had unilaterally torn up the contract. The Liucun Brigade of the Huangtukan Commune in the suburbs of Qinhuangduo had an orchard of 83 *mu*.[12] Before 1982, this orchard was run by the brigade. As a result of bad management, it incurred losses. For example, in 1981, the total income of the orchard was only 350 *yuan,* while the expenditure was over 1,000 *yuan*. At the end of that year, at the request of the commune members, the brigade put forward a scheme to contract out their orchard to team members: "contract amount of 1,000 *yuan* a year, increasing by 200 *yuan* per year, sole responsibility for profits and losses and definitely no change for five years." The commune members were allowed to tender as they wished. Sun, Ma, and four other commune members raised the contract amount for one year from 1,000 *yuan* to 2,122 *yuan* and, since no one else wanted to take it, they signed a contract with the brigade. From then on, the six commune members devoted themselves to the orchard, working from dawn to dusk every day, and painstakingly looked after the fruit trees so that the appearance of the orchard changed greatly and the fruit yield of the orchard increased from the previous year's three to four thousand catties to over 50,000 catties. The total income last year was over 13,000 *yuan* and after deducting costs and the amount handed over to the brigade, each member's net income was over 1,200 *yuan*.

After the orchard's bumper harvest, the party branch secretary of the brigade, Hou, and a few cadres and commune members became infuriated. They tried all sorts of ways to find an excuse to propose that the present orchard contract should be improved and a new contract signed. They also announced to all the commune members, through loudspeakers, that the commune members should get ready to contract for the trees again. Firmly believing that the party's policies and the laws of the state would not change again, Sun, Ma, and the other four commune members refused to allow the contract to be abrogated. They carried on going to the orchard as usual to cut branches, but were obstructed and harassed by Hou, Sun, and other commune members, who also destroyed over thirty trees. The six contracting parties repeatedly asked the leaders of the commune for support and went to see the Suburban Rural Working Department four times but the problem could not be solved. They next went to the Qinhuangdao City Legal Advice Office in January 1983 and asked for a lawyer. The lawyer went to Liucun to mediate but without success. So he drew an indictment on their behalf and told them to bring an action in the Suburban law court. The presiding judge and the clerk of the court went to Liucun Brigade to investigate the case. They repeatedly made clear to the cadres and commune members the Party's economic policies in the countryside and the Law of Economic Contracts. On 7 March 1983 the court made the ruling: the contract signed by the contracting parties with the brigade, undertaking the running of the orchard for five years, was completely valid and was protected by the law. Both parties had to observe it strictly and ensure the fulfilment of the contract. Except in special circumstances, such as a major natural disaster necessitating a revision of the contract by both parties, neither party could abrogate or alter the contract on their own authority. They also declared that Hou and Sun, both Communist Party members, had disregarded party discipline and the law of the country; they had wantonly destroyed the collective trees and encroached upon the legitimate interests of contracting parties. However, since they had admitted their fault and had a fairly good attitude and intended to change their ways, they were only to be fined.

3.3.2 The Tangerine Orchard Case (1983)[13]

In March 1982, team cadres and members of a commune had decided to contract out their tangerine orchard to team members in order to increase the output of tangerines. Without getting the consent of team members, the team head, Guo, together with the tangerine technician, Ni, signed a three-year contract for the orchard. Their contract, however, was approved by the vice-chairman of the brigade management committee. Under Guo and Ni's management, the gross output of tangerines increased to over 5500 kilograms from the previous year's yield of about 200 kilograms. Guo and Ni each earned a net income of over 800 *yuan*. Their prosperity caused some team members to be envious. In April 1984, the team members annulled Guo and Li's contract on the pretext that they had not given their consent and that Guo and Li had used the power of office to obtain the contract. They then divided the tangerine trees among all the households. Several attempts at out-of-court mediation failed to resolve the dispute between Guo and Li and the team members. Guo and Li brought the dispute to the people's court. The court noted the reason for the suit: envy destroys the agreement and the aggrieved party brings suit.[14] But because efforts at a court-mediated settlement failed, the court decided to conduct a public hearing on 17 July 1983 in order to "educate the masses and propagandize the law" (Zweig *et al.* 1987, p. 346). After failing once again to arrive at an agreement between the parties through mediation, the court ruled to protect the contractual rights of Guo and Li by upholding the original contract. But the court also ruled that since Guo and Li had failed to discharge all their contractual obligations during the contracting period, they were responsible for bearing the costs for remedying the situation. The costs of the court trial, 25 *yuan,* were apportioned between the two: the team would have to pay 15 *yuan* and the two contracting households would have to pay 10 *yuan*.

The court later found out that in one particular entire county, there were 15 commune and brigade farms and 45 team farms, of which seven farms had intended to abrogate the contracts. However, they refrained from doing so after court ruled to protect the rights of contracting households in the tangerine orchard case.

3.3.3 The Apple Orchard Case (1984)[15]

In August 1981, Wang, a member of an apple orchard team, was the highest bidder for the production team's apple orchard. He signed a three-year contract with the team to produce apples. Under the terms of the contract, Wang agreed to bear all expenses, including payment of a yearly contractual fee of 500 *yuan* at the end of September to the team. Wang would keep all the net profits. With help from his two brothers and a hired technician, Wang greatly increased the orchard's output. In 1982 and 1983, he paid the contractual fee to the team on time and made a profit of 1,000 *yuan*. Some members of the commune, including the team head, became envious of Wang's prosperity and plotted to have Wang's contract annulled. At a meeting of team members held in January 1984, the team head demanded that Wang should pre-pay the 1984 contract fee of 1500 *yuan* or have his contract annulled. When Wang refused, the team annulled his contract and a new contract was awarded to four households who were required to pay the higher contractual fee. Wang brought the dispute between himself and the team to the people's court in June 1984. The court emphasized the important task of the courts in protecting the rights of households against the arbitrary power of cadres in unilaterally abrogating contracts and urged the team to uphold Wang's contractual rights:

> The reason why some rural communes and brigades are abrogating contracts, aside from prejudice, is that commune and brigade cadres' sense of legality is weak. They are accustomed to handling matters through administrative commands and treat signed contracts as merely another purely administrative method to be handled arbitrarily. Not only are the legal rights and interests of contracting households infringed upon and their production enthusiasm seriously dampened, but the thorough implementation of Party [policy] is also adversely affected. Given the present situation, preserving the legality of rural contracts and conscientiously safeguarding the legal rights and interests of contracting households has become a major task of the People's Court.[16]

As a result of mediation by the court, the parties arrived at an agreement in which the original contract with Wang was upheld, and the newly-signed contract with the four specialized households was annulled.

3.3.4 The Brick Kiln Case (1984)[17]

In October 1982, members of a brigade and production team ("A") signed a three-year contract with Luo and five other members ("B") for a brick kiln for a yearly contractual fee of 11,000 *yuan* to be paid in installments. As part of the contract, A guaranteed the supply of the kiln's land for production, electricity, water, and roads. B was responsible for buying additional kiln equipment and giving the equipment free to the team at the end of the contracting period. To make the contract legally binding, the parties signed and affixed seals and had the contract notarized in the county notary's office. After the contract went into effect, B invested 25,000 *yuan* on kiln equipment, made repairs to the kiln and the roads, and bought additional equipment and began production. After a year, production greatly increased. This aroused the envy of some members of the brigade committee including the team head who then demanded that B pay a yearly increase in the contractual fee of 10,000 *yuan*. When B refused, the team head sent someone to shut off the kiln's electrical supply, and the land used by the kiln was divided among the commune members as responsibility fields, forcing the kiln to stop production. As a consequence, B suffered heavy losses. The township government tried several times to resolve the dispute through mediation but failed. The dispute ended up at the people's court on 13 February, 1984. Unable to reach a mediated settlement, the court decided to form an economic tribunal and to conduct a public hearing of the case. On March 1984, the panel made its ruling based on articles 6, 32, and 35 of China's Economic contract law[18]:

(a) the original contract between A and B was legally binding and would be upheld;
(b) the defendant pay to the plaintiff 500 *yuan* as penalty for breach of contract and 1000 *yuan* in compensatory damages; and the team head was to reimburse the kiln 100 *yuan;*
(c) the divided land to be returned to the plaintiffs for the kiln's use; and
(d) the courts costs of 550 *yuan* to be paid by the defendants.[19]

After the court made its ruling, the masses in the audience reacted with relief. Some said: "the village cadres talk but it doesn't mean anything, and they tear contracts to shreds. They bully everybody and specialized households; they should be fined a bit more."[20] Specialized households in the audience reacted by saying: "In the past, we feared that the policies would change. This year's CC [Central Committee] Document No. 1 has reassured us. Today the people's court has also backed up our households." [21]

These four selected cases of court resolution of specialized household responsibility contract disputes in the post-ECL period are among the leading cases that the Chinese authorities wish to publicize as the correct method for the court's handling of cases where local cadres unilaterally tear up a contract. Three of the four selected cases are among the leading cases cited in Zweig *et al* (1987) in which Chinese courts made them available to Chinese legal specialists and to the press. As such, leading cases often serve as indicators of how similar disputes are to be resolved in the future, even though China's system is a code-based or civil law system. In this context, the brick kiln case stands out among the widely publicized contract dispute cases in that, in a radical departure from the usual practice of courts protecting the plaintiff's restitution or reliance interests, the court protected the plaintiff's expectation interests by awarding compensatory damages. Furthermore, the court did not invoke the norm of loss-splitting between the two parties. For these two reasons, I consider the brick kiln case to be a landmark case.[22] Although the four chosen cases demonstrate that Chinese courts emphasize the importance of contract law and the rule of law in protecting property rights of peasant households and upheld peasants' property rights, we know from the studies by Zweig *et al.* (1987), Roderick Macneil (1986) and Lester Ross (1989) that the majority of rural contract disputes were settled through mediation by mediation committees.

During my four months of fieldwork in China, September-December 1993, when I conducted interviews with village leaders, heads of peasant households in villages, and government officials in various Rural Working Departments in Jiangsu, Shandong, and Guangdong provinces, I, too, found that the majority of rural contract disputes were settled by mediation, and not by the courts. However, mediators are guided by ECL in arriving at mediated settlements. The preference for mediation over court resolution of contract disputes in the HRS not only reflects the traditional Chinese preference for mediated settlements, but may also reflect many of the problems associated with court enforcement of contracts.

Donald Clarke (1991), in his study of the role of law in promoting China's economic reforms, has identified a number of problems which make the Chinese courts a weak instrument for carrying out China's economic reforms:

(a) poorly educated judges, many of whom were demobilized army officers (pp. 21–22);
(b) corrupt judges who may not want to render a judgment (p. 58);
(c) judges of local courts, because of their dependency on local governments for sources of funding as well as their own appointment, may thus be pressured to dispose of court cases according to the wishes of local party leaders: "A recalcitrant court could find its clerical help transferred elsewhere, its automobile unrepaired, its electricity supply frequently interrupted, and its budget cut" (p. 64);
(d) the difficulty for judges in rendering judgment against a defendant who is well-connected and who is a higher-ranking official than the judge himself (p. 65). Thus, even though theoretically China's bureaucrats operate under the rule of law, in practice they still function under the age-old rule of man.
(e) the parochialism of party leaders who often oppose court judgments requiring the defendant to pay compensation to the plaintiff from another jurisdiction since, as the primary claimants on the income from local enterprises, party leaders do not like to see resources flowing

out of their own jurisdiction. Thus contracts across jurisdictions are difficult to enforce (p. 69). Similarly, Pitman Potter's (1983) study of Chinese contract law also pointed out many difficulties with the actual operation of China's ECL.

4 The co-evolution of markets, entrepreneurship, laws and institutions in China's economy in transition: A new institutional economics perspective

4.1 The new institutional economics perspective

In referring to the transferability of Western knowledge for scholarship on China, political scientist David Easton (1990, pp. 650–51) lamented that a major crisis exists in modern knowledge:

> It is what I have called the "Humpty Dumpty" problem. To understand the world, it has seemed necessary to analyze it by breaking it into many pieces—the disciplines and their own divisions—in much the way that Humpty Dumpty, now the egg of knowledge, fell off the wall. But to act in the world, to try to address the issues for the understanding of which highly specialized knowledge was presumably sought, we need somehow to reassemble all the pieces. Here is the rub. Try as we may, we have been no more able than all the king's horses and all of the king's men of the children's parable, to put our knowledge together again for coping with the problems of the world.

According to Easton (p. 659) ". . .there is no general theory about the best way to integrate major areas of knowledge in the social sciences, let alone the humanities." Even if there is as yet no general theory, I suggest that the cross-over of economics into law, politics, and history has spawned the New Institutional Economics (NIE), which allow us to reassemble some of the specialized knowledge which can be used to analyze the complexities of China's economy in transition.

The study of social institutions is at the heart of the NIE. Social institutions can be thought of simply as the "rules of the game" which in turn prescribe a specific set of participants in a particular situation. The situation will be such that actions are required, prohibited, or permitted so that the participants can achieve predictability and hence achieve the co-ordination of plans and expectations (Ostrom 1986, p. 5). NIE includes several sub-disciplines within economics such as:

(1) Property rights theory or law-and-economics;
(2) Public choice theory;
(3) Austrian theory of institutions and entrepreneurship;

(4) The transaction costs/governance approach associated with the work of Ronald Coase (1937) and Oliver Williamson (1985); and
(5) The New Economic History associated with the work of Douglass North (1990).[23]

4.1.1 Property rights theory (Chicago School of Law and Economics)

The notion of transaction costs is a key concept underlying property rights theory. Transaction costs, unlike costs of production, are defined as those costs that are incurred in the process of exchange such as the costs of searching for prices and/or trading partners, the costs of negotiation and enforcement of contracts, and the costs of breach. The role of institutions is to economize on transaction costs.

It was Ronald Coase's (1937) seminal paper, "The Nature of the Firm," that established transaction cost economics, hence laying the foundations of NIE.[24] The important contribution of this paper is the explicit introduction of the concept of transaction costs into economic analysis. Coase argues that the institution of the firm emerges in a specialized exchange economy in order to economize on certain kinds of transaction costs, especially contract-negotiation costs. If the price mechanism is used, input owners would be required to enter into a number of contracts with other factors with whom they co-operate. By organizing a firm, the costs of contract negotiations are reduced. This is because in place of several separate contracts, one employer-employee contract is substituted. The essence of the employer-employee contract is that the employees agree to obey the direction or order of the entrepreneur within certain limits, and within these limits, the entrepreneur-coordinator directs and coordinates economic activities within the firm. To Coase, then, the distinguishing characteristic of the firm as an institution is the supersession of the price mechanism because of the transaction costs of using the latter.

Coase's (1960) paper, "The Problem of Social Cost," extends the analysis of the institution of the firm to the analysis of legal rules, hence laying the foundations of property rights theory also known as the Chicago School of law-and-economics. Coase argues that, in a world with zero transaction costs, parties involved in an externality relationship will have an incentive to negotiate/bargain among themselves and exchange rights so as to internalize the externality; there is no role for government in a world of zero transaction costs. A negative externality is defined as the social costs which one individual through his actions (example, polluting a river) impose on another individual without the latter's consent. But the real contribution of the paper is Coase's emphasis that in the real world with positive transactions costs, institutions including the state have important roles to play, including the initial definition of property rights, in economizing on transaction costs. Harold Demsetz (1967) has used the transaction costs argument to explain the emergence of private property rights out of common property.[25] Richard Posner (1986) explained the role of contract law in economizing on transaction costs of private protection of contracts.[26] My article "A theory of the ethnically homogeneous middleman Group" (Landa 1981) has gone beyond the NIE by developing a theory of the EHMG/ethnic trading network as a low-cost club-like institutional arrangement, an alternative to contract law and to the vertically integrated firm, for protection of contracts in an environment characterized by contract uncertainty.[27]

4.1.2 *Property rights-public choice theory: Virginia school of law-and-economics*

James Buchanan and Gordon Tullock (1962), founders of public choice theory (the economics of politics), carried the Chicago law-and-economics approach to institutions one step further by incorporating public choice theory. They extended the analysis of institutions to the study of their origins or their *emergence* via a *public choice/contractarian* process, hence creating the property rights-public choice approach (Virginia School of Law-and-Economics). In the property rights-public choice approach, laws/legal norms of the state thus conceptually emerge *endogenously* via a *public choice* or *contractarian* process. Buchanan (1975), in particular, assigns an important role to the "protective state" for the protection of property rights and contracts in a market economy.[28]

Mancur Olson's (1965) seminal contribution to the public choice literature is to point out that size of the group is a major determinant of the likelihood of voluntary collective action in providing for the public good. Thus, if the size of the group is large, a public good will not likely be forthcoming unless "selective incentives" are offered to provide incentives to members not to free-ride on the benefits but to contribute to the provision of the public good.

An important component of public choice theory is Gordon Tullock's (1967) "rent-seeking" theory. Tullock describes behavior, that Ann Krueger (1974) subsequently calls "rent-seeking," in terms of the socially wasteful expenditures invested by rent-seekers in trying to obtain monopoly rents. For example, a government is in the process of granting an airline a monopoly over the routes between two or more cities. If there is more than one airline in the country, then these airlines will engage in rent-seeking behavior by investing resources in the hope of being the one that is successful in obtaining the monopoly. Such socially wasteful expenditures may be in the form of bribes given to government officials by lobbyists employed by airlines. Unlike productive profit-seeking entrepreneurship which promotes economic development, rent-seeking activities are unproductive activities involve transaction costs.[29] Government granting of scarce permits and licenses also generate rent-seeking behavior. Tullock (1993) has extended the theory of rent-seeking to the behavior of persons within bureaucracies. The basic idea is that a person who wishes to be promoted will do nothing if by doing something, such as telling his boss that his boss's policy is counterproductive, it will hurt his chances of being promoted; in this case doing nothing is also considered to be "rent-seeking."

4.1.3 Austrian theory of institutions and entrepreneurship

In contrast to the public choice approach to the emergence of social institutions, the Austrian approach associated with the work of Ludwig von Mises, Friedrich Hayek, Karl Menger, and others provided a "spontaneous order" (Hayek 1948) explanation of the emergence of social institutions. In this spontaneous order approach, institutions evolve as a result of market processes and other forms of spontaneous individual action. In other words, institutions emerge in an invisible-hand manner without any conscious will directed toward their creation by the individuals concerned. Of the contributors to the Austrian school, Israel Kirzner (1973) especially emphasized the central role of the entrepreneur, ignored in mainstream neo-classical theories of exchange, in achieving equilibrium in which expectations of interacting individuals are fulfilled. The Kirznerian entrepreneur seeks out opportunities for profit-making arising from the existence of price differentials for the same good in different markets: he buys goods at a lower price in one market and resells them at a higher price in another market. It is the ability of the entrepreneur to *subjectively* perceive and exploit opportunities for arbitrage, based on information not available to everyone else in the economy, that generates the entrepreneur's profits.

4.1.4 Transaction costs/governance approach to institutions

Williamson's (1985) transaction costs/governance approach explicitly combines the disciplines of law, economics, and organization. Unlike the Chicago or the Virginia schools, which de-emphasize the importance of opportunistic behavior such as breach of contract, Williamson (p. 61) emphasizes the importance of *ex post* monitoring of contracts, that is, how contracts are to be protected from "opportunism" *(i.e.,* "self-seeking with guile"). He argues that vertical integration and long-term relational contracts, can be viewed as alternative governance structures to protect parties from opportunism, especially under conditions of asset specificity. In addition, unlike the Chicago and Virginia schools of law-and-economics scholars who follow the Hobbesian "legalist centralist" tradition—which emphasizes the importance of the state in achieving social order via its role in protecting property rights and enforcing contracts—Williamson's approach emphasizes the importance of different forms of "private ordering" of which vertical integration and relational contracting are prime examples.

4.1.5 The new economic history

Douglass North (1990) has rewritten traditional economic history by incorporating transaction cost approach to economic history. Hence the work associated with North has been called the "New Economic History." North argues that traditional economic history has been preoccupied with the development of technology or the development of markets and has neglected the analysis of transaction cost considerations for the emergence of the structure of property rights that facilitate exchange and the development of markets. Using the transaction costs approach to economic history, North showed that different kinds of transaction costs associated with exchange have dramatically changed the history of modern western world.

4.2 Peasant-entrepreneurship and the role of law in reducing envy-induced breach of contract

Since the success of the HRS is dependent on the ability of contracting households/peasant entrepreneurs to appropriate residual income, it is essential that the state protect property rights of contracting households by enforcing contracts. Especially important is the role of the courts in reducing the risks of breach induced by envious opportunistic cadres who have arbitrarily abrogated contracts. This is because no contracting household is willing to sign long-term contracts with commune members and undertake non-trivial investments in specific assets if they face contract uncertainties arising from the arbitrary and opportunistic behavior of their fellow commune members and cadres. This is because the significance of specific assets makes them difficult to deploy elsewhere so that peasant-entrepreneurs' profit expectations depend upon the continuation of the contractual relationship (Williamson 1985, pp. 61–62). Asset specificity increases the coercive power of commune members/cadres vis-à-vis the contracting household; therefore, safeguards are important in constraining the behavior of opportunistic commune members/cadres who by unilaterally abrogating a contract are able to expropriate peasant-entrepreneurs' profit expectations and to transfer rents to themselves or to members of another coalition. Safeguards against opportunistic behavior, however, do exist in China. If the parties to a dispute mutually agree to resolve the contract dispute out-of-court through mediation or arbitration, the disputants will generally agree to the protection of the restitution or reliance interest, subject to the cultural norm of contractual loss-splitting. Thus, although out-of-court mediation and arbitration methods are cheaper to use, court-adjudicated settlements, though more expensive, provide the major advantage of protecting the plaintiff's profit expectations. Thus the success of the HRS critically depends upon the existence of efficient formal courts—courts of last resort—to which aggrieved parties can bring the dispute for a ruling which will strictly uphold the plaintiff's expectation interest. The longer the terms of the contract, the larger the anticipated profits, the more important the role of contract law and the rule of law will be in contributing to the success of the HRS. The number of potential rural contract disputes brought to the courts is predicted to increase as the stakes in the residual income (profits) rise. As Zweig *et al.* (1987, p. 334) observed:

> Moreover, the higher stakes of rural economic activities under the reforms inevitably increase the potential for local conflicts, and the number of contract disputes has risen significantly. In Jiangpu, there were only eight such cases in 1983, twenty four in 1984, and sixty-one in 1985. By May 1986, there were already thirty-four cases, and court officials suggested that the number would increase dramatically at the end of the year.

The 1984 brick kiln case (Case 4), which I consider to be a landmark case, may have contributed to the dramatic increase in the number of disputes brought to the courts. This is because, as noted earlier, the 1984 court-imposed ruling departs radically from the traditional Chinese contractual practice; the court protected the plaintiff's profit expectations by awarding compensatory damages. Because this case was tried publicly with many contracting households present in the audience, it is very likely that word got around to contracting households elsewhere that the courts would protect plaintiffs' rights against the unilateral and arbitrary abrogation of contracts by envious commune members and cadres. This may help to explain the dramatic increase in the number of breach of contract dispute cases brought to the people's courts. It also shows that peasant-entrepreneurs acted rationally in making use of the courts—an institutional arrangement which traditionally they have been reluctant to use to protect property rights—when they perceive that the courts are more effective in protecting property rights compared to mediation or arbitration. To the extent that contract law, rule of law, the Chinese notariate, and mediation, all contribute to the protection of property rights of peasants, they also contribute to the development of markets and peasant entrepreneurship.

4.3 Markets and merchants: Contract uncertainty, Confucian ethics, and the emergence of personalistic ("*guanxi*") trading networks

In order to facilitate the growth of merchant-entrepreneurship, it is essential that China's ECL protects the merchant's expectation interest because the rationale of Kirznerian Chinese merchant-entrepreneurship is the making of profits by arbitrage: buying goods at a lower price in one market and reselling the goods at a higher price in another market. As long as current Chinese contractual practices emphasize the protection of the restitution and reliance interest subject to the contractual norm of loss-splitting, traders operate under conditions of contract uncertainty and must make private provisions for the protection of contracts.

In a paper that went beyond the NIE paradigm to incorporate concepts from sociology and anthropology, I developed a theory of the "ethnically homogeneous middleman group" (EHMG), with specific reference to Chinese merchants in Southeast Asia, as a club-like institutional alternative to Western contract law and the vertically integrated firm for the enforcement of contracts (Landa 1981). Chinese merchants in Southeast Asia, operating under conditions of contract uncertainty where the legal framework is not well developed, have created the EHMG/particularistic trading networks based on kinship/ethnic ties for the protection of contracts. This is because *Confucian ethics* prescribes mutual aid/reciprocity among persons linked by social or cultural ties such as kinship or ethnicity.[30] In an interconnected marketing channel, rational traders choosing trading partners on the basis of kinship or ethnicity result in the emergence of the macro-phenomenon of the EHMG, with Confucian ethics embedded in the EHMG. Social sanctions are imposed on any trader who violates the Confucian ethics by a breach of contract. Confucian ethics, by constraining traders from breach, promotes mutual trust among traders, which in turn reduce the transaction costs of protecting contracts. The EHMG is thus a low cost club-like economic organization which emerged to economize on the transaction costs of enforcing contracts under conditions of contract uncertainty. *Seen in this light, my theory of the EHMG/guanxi trading networks, as Chinese economic organization, rest on Coasean foundations.*[31]

Williamson (1985), extending Coase's theory of the firm, has emphasized the importance of types of economic arrangements, such as the vertically integrated firm and relational contracting, as substitutes for contract law in Western capitalist economies. In non-western economies characterized by contract uncertainty, the EHMG is a non-Western/Chinese form of economic organization which emerges as an *alternative* to Western style legally binding contract, the vertically integrated firm, and relational contracting for the co-ordination of activities of interdependent intermediaries. It is a *non-western* hybrid form of economic organization in that it is neither market, hierarchy, nor relational contracting, but combines elements of all three. The contract between trading partners is the market element, the particularistic relations between the contracting partners represent the quasi-hierarchical element, and the on-going relations between trading partners represent the relational contracting element.

Before the establishment of the PRC, particularistic trading networks have always been the traditional Chinese way of organizing exchange relationships (Willmott 1972).[32] I suggest that the "resurgence of cultural and social ties" (Watson 1988, p. 2)—or what the Chinese call *guanxi* ties—linking merchants together in present-day China is in response to an environment characterized by contract uncertainty. Contract uncertainty arises from the fact that Chinese contract law places little weight on protecting the plaintiff's profit expectations and from the various contract enforcement problems noted earlier. I predict that as markets increase in size and in number, the phenomenon of particularistic trading networks will become more widespread as traders have the incentive to invest in the creation of *guanxi* ties as a form of social capital which will increase merchants' money capital by economizing on the transaction costs of contract enforcement. This prediction is supported by the recent resurgence in the popularity of Confucianism in China (Easton 1990). Confucianism, as noted earlier, emphasizes the importance of the norm of mutual aid embedded in particularistic relations, especially kinship relations. Chinese economic relations historically have always taken the form of "relational contracting" in the sense suggested by Ian Macneil (1974) not only because of the recurring nature of transactions emphasized by Macneil, but also in the sense suggested by Karl Polanyi (1957) that economic relationships are embedded in kinship/particularistic relationships as well. From a comparative analysis of institutions, Confucian ethics, embedded in merchant *guanxi* exchange networks, may be viewed as an informal institutional arrangement which function as a substitute for the incompleteness of Chinese contract law.

While a particularistic trading network, viewed as Chinese economic organization, is able to cope with the problems of contract-uncertainty, its efficiency depends upon the environment in which it operates. Membership in a particularistic trading network or "club" must be small relative to the whole population in order for club members to be able to monitor each others' behavior efficiently. As the size of a trading "club" expands, the mutual trust among "club" members will become attenuated as more unrelated traders become "club" members (Carr and Landa 1983, Cooter and Landa 1984). Thus, as markets expand in size and in number and as the number of intermediaries increases, traders will find it increasingly more efficient to resort to a nation-wide contract law for the enforcement of contracts. For this to occur, however, the Chinese ECL must evolve into a contract law that will fully protect the plaintiff's expectation interest.[33] If the 1984 brick kiln case turns out to be a landmark case in Chinese contract law by setting a precedent that the courts will protect the plaintiff's expectation interest, then the future augurs well for the long-run emergence of impersonal private trading networks. In the meantime, it is predictable that particularistic trading networks, a traditional private ordering type of Chinese economic organization, will continue to play an important "gap-filling" function until such time as Chinese contract doctrine and practice become "westernized" *i.e.,* when the expectation interest of the plaintiff is fully protected.[34]

4.4 Local cadres support for reforms: Opportunities for rent-seeking and profit-seeking entrepreneurship

Rural cadres play pivotal broker roles in the personalistic or *guanxi* ties between intermediaries located in rural and city markets. As Nee (1989, p. 172) noted:

> [L]ocal cadres, defined as village, commune, and county officials often act as brokers or middlemen in market exchanges, especially those involving economic transactions between private entrepreneur and state agencies.... Entrepreneurs themselves are local individuals who must mobilize social networks to gain access to capital, labor, raw materials, technology and markets. These networks frequently are controlled by gatekeepers in the state structure. Peasant entrepreneurs sometimes seek favorable access to capital, raw material, and markets by bribing local cadres to gain access to scarce resources controlled by the state.

The reason many brigade and team cadres were able to emerge in pivotal "gatekeeper" roles is due to the fact that they had the "interpersonal ties established [while] in office, which [gave] them preferred access to resources and marketing outlets." See Zweig (1986, p. 172). This gatekeeper role is especially important to those cadres that have lost status as China is transformed into a more market oriented economy. We can predict that the cadres, including those that have lost status, will use their gatekeeper roles and connections to engage in rent-seeking activities or value-added profit-seeking entrepreneurship by emerging as merchants. Both routes were taken by some party cadres in "Chen" Village in Guangdong Province. By 1982, the HRS had resulted in "Chen" Village's fields becoming private holdings so that the production teams had become redundant. Party cadres like Qingfa had lost much power and status, according to Chan et al. (1984, p. 277):

> But Qingfa still had a certain measure of power over the peasants. He controlled access to permits of all sorts; and local prosecutory powers were still effectively in his hands. Qingfa let it be known that villagers could curry his favor by plying him with gifts.

In the above context, plying Qingfa with gifts is clearly a euphemism: Qingfa is encouraging villagers to engage in classic rent-seeking activity. Furthermore, Longyong, another party cadre who also lost status, was able to use his *guanxi* ties to facilitate his emergence as a merchant:

> [he] now only concerned himself with his own family and sought to enrich himself as best he could, by hook or by crook. He had leased the grain processing plant and hired two laborers to run it for him, and he spent much of his time away from the village buying cattle in poor districts and reselling them at a high profit in richer districts. To do so was still illegal, but Longyong used the official contacts he had developed as a cadre to smooth his way (Chan et al. 1984, p. 278).

Not only Qingfa and Longyong but cadres at all levels from the county leadership down were taking advantage of their strategic positions located in "*guanxi* networks" to enrich themselves either in rent-seeking or middleman-entrepreneurial activities. The situation, of course, is not unique to "Chen" Village but is widespread in China's economy as it undergoes marketization. Thus, for example, in a field study of entrepreneurship in China's township and village enterprises (TVEs), Yang Mu and Tang Zhimin (1994) found that the directors of eight TVEs had "backgrounds as cadres or local party secretaries, being a grassroots planner managing a production brigade or a production team. These directors had used their good '*guanxi*' relations with state owned enterprise officials for entrepreneurial activities."

This has two important implications. First, this means that, quite apart from the exogenous factor of the decentralization of powers that gave local government bureaucrats a stake in the reforms, there is the *endogenous factor:* once markets emerge and expand, rent-seeking and profit-seeking rural cadres will be among those who reap benefits from marketization through their gatekeeper roles and their access to a wide network of *guanxi* ties. Second, it also implies that those bureaucrats seeking promotion within the bureaucracy will also rent-seek within the bureaucracy by supporting or at least not opposing reforms put forth by their superiors. These two factors provide additional reasons, to those discussed by Christine Wong (1992), as to why local government officials are staunch supporters in pushing reforms forward and in supporting pro-reform forces.

5 Some concluding comments

This paper attempts to assess the role of China's laws and institutions on the emergence of markets and entrepreneurship during the transitional period, focusing especially on the role of contract law, the rule of law, and Confucian ethics. The economic framework I use in this paper is the NIE approach. Using the NIE framework for analyzing aspects of China in transition to a more market-oriented economy yields important insights into the role of formal and informal institutions play in the emergence of markets and entrepreneurship during China's transitional period.

My conclusions are as follows: as long as China's contract doctrine and contractual practices fall short of the full protection of the plaintiff's expectation interest, and as long as courts are weak in protecting property rights, contracting households will always face the hazards of expropriation of profits by envious rent-seeking fellow commune members and cadres. The effect will be to attenuate the incentive of contracting households to enter into long-term contracts with commune members or to undertake significant investment in specific assets. Alternative institutions to the courts, such as mediation and arbitration committees and the Chinese notariate, will thus play an important "gap-filling" role in protecting the property rights of peasants during China's transitional period. Similarly, as long as Chinese courts fall short of the full protection of merchants' profit expectations, we can predict the full-blown emergence of particularistic/*guanxi* trading networks—a traditional "private ordering" form of Chinese economic organization—for economizing on the costs of protecting contracts. These self-governing particularistic networks of exchange, too, play an important "gap- filling" function, substituting for a more fully-developed contract law, both in terms of doctrinal development and in terms of more effective enforcement of contracts. In the longer-run, as a more developed contract law evolves in China in which profit expectations of plaintiffs are protected, the particularistic marketing networks will be replaced by impersonal trading networks based on contracts. Finally, as long as markets increase in size and number, providing opportunities for rent-seekers and profit-seeking entrepreneurs to accumulate wealth, local cadres will continue to be the staunchest supporters of market reforms and of pro-reform forces within the bureaucracy, and hence facilitate China's transition into a market economy.

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Endnotes

1. The economic reforms since 1978 were undertaken to promote the "Four Modernizations," *i.e.,* to improve industry, agriculture, defense, science, and technology. For a discussion of China's economic reforms between 1977–1986, see Perkins (1988). The market-oriented reforms were derailed in the fall of 1989, but by early 1992 the reforms were back on track. For a discussion and an explanation for the growing political resistance to economic reforms by China's party leaders, who, in the fall of 1988, adopted an austerity program, see Tinari and Lam (1991).
2. GDP percent per annum growth rate was 9.5% between 1980–1990; 1993 was 13.4%; 1994 was 11.8%; and 1995 was 10.2%. Figures from World Development Report 1995 and earlier years as cited in Table I, John Wong (1992). For other statistics on aspects of China's achievements since 1978, see Chen *et al*. (1992).

3. There are many different forms of HRS. See discussions by Hartford (1985), Wang *et al*. (1985), Luo (1985), Zweig (1985). For a concise discussion of the commune system, see Perkins (1988). For discussion and studies of the process of de-collectivization, see Parish (1985), Zweig (1985).
4. Specialized households have been defined by the state as those households in which family members spend at least 60 percent of their time in specialized commodity production and sell at least 80 percent of their products on the market. See Nee (1989, p. 181).
5. For a discussion of the reform of the agricultural system and the emergence of free markets and private merchants, see Watson (1988).
6. For a translation of China's Economic Contract Law, see "Economic Contract Law" (1982) *China L. Reporter* 61. For discussions of various aspects of China's contract law as it relates to China's reforms, see Potter (1983). China also established a foreign contract law to regulate the contractual relations between Chinese and foreign enterprises. For various aspects of China's foreign contract law, see Tai (ed. & translated, 1988). With the introduction of the ECL, the primary role of law as an instrument for serving class struggle thus changed dramatically into one that is aimed at promoting economic development. For a discussion of the pragmatic nature of law in China since 1949, see Yu (1989).
7. My discussion of the Chinese notariate is based on Chen (1986).
8. I am using the term "rule of law" as "the use of law to restrain the exercise of executive power" as defined by Alford (1990). For a discussion of China's emerging rule of law, see Lubman (1983). For a discussion of constitutionalism and constitutional choice in Public Choice theory, see Buchanan (1987). For a general discussion of the importance—for China's economic reforms—of constitutional protection of individual rights and property rights, and safeguarding these rights against political opportunism, see Dorn (1989).
9. Since 1949, China had promulgated four constitutions: in 1954, 1975, 1978, and 1982, with further amendments made in 1988. For a discussion of China's changing constitutions since 1949, see Yu (1989).
10. For studies of court resolution of household responsibility contract disputes, see Zweig *et al*. (1987), Chang (1989), Ross (1989). It is important to note that extremely few general land contract disputes are brought before the courts, in contrast to specialized contract disputes. This is because, as Chang (1989) has noted, low prices of grain limited the size of profits, thereby reducing the feelings of envy which had given rise to envy-induced breach of contract. In contrast, prices for specialized agricultural products such as fruit and fish increased sharply after prices were deregulated, while contract fees have been set at modest levels; thus specialized contracts offer the potential for reaping large profits, thus generating envy-induced breach of contracts by local cadres. See Chang (1989, p. 100).
11. This case appeared in the Chinese newspaper *Zhongguo Fazhi Bao,* April 1, 1983. I wish to thank William Tai of the *China Trade Translation Company*

for making available to me the English translation of the case. See Tai (translated, 1983). Contract dispute cases printed in the Chinese newspapers are selected and disseminated for pedagogical value as statements of an ideal, and thus do not necessarily represent actual Chinese contractual practices. Thanks to Professor Pitman Potter for pointing this out to me. Personal communication P. Potter and J. T. Landa (5 November 1991).

12. One *mu* equals 0.1647 acre.
13. The case is based on Zweig *et al*. (1987, pp. 342–47).
14. *Ibid*. p. 343.
15. This is based on the case in Zweig *et al*. (1987, pp. 340–42).
16. *Ibid.,* p. 342.
17. This is based on the case in Zweig *et al*. (1987, pp. 351–53).
18. Article 6 of the ECL says that a contract once drawn up is legally binding. No party can unilaterally terminate, or alter the contractual terms. Failure to perform results in a breach of contract. Article 32 of the ECL says that a party in breach may be subject to administrative penalty or criminal penalty. Article 35 of the ECL says that in case of breach, the payment of damages is not a substitute if the party who is not in breach requires specific performance. See "Economic Contract Law", *supra* note 6.
19. Although the court ruled in favor of the plaintiffs, at the time "Law, Contract, and Economic Modernization" was written, the authors did not know how the case was finally resolved, *i.e*. whether the defendant accepted the ruling. See Zweig *et al*. (1987)
20. *Ibid*. at p. 352.
21. *Ibid*. at pp. 352–353
22. Professor James Feinerman also agreed that the brick kiln case can be considered to be a "landmark" case. Personal communication J. Feinerman and J. T. Landa (7 Oct. 1991).
23. The literature that forms the New Institutional Economics (NIE) is vast, comprising various sub-fields in economics. For an overview, see Landa (1994, chap. 1) For a survey of the vast array of topics covered in NIE, see Eggertsson (1990).
24. Coase's (1937) article has been reprinted in Williamson (1991).
25. See also Landa (1976).
26. Posner (1986) has been spearheading the law-and-economics movement by writing the first widely used textbook on law and economics.
27. For more discussion on Landa's (1981) theory, see Section 4.3.
28. Misunderstandings about the nature of public choice theory are still common, particularly by scholars outside economics. Frequently, they think that public choice theory consist of specific models of rent-seeking by interest groups, or other kinds of self-interested behavior by voters or bureaucrats. Many of these scholars also overlook the emphasis of public choice theory on the fundamental role played by government as "protective state" in providing for the fundamental "rules of the game" of a market economy in protecting property rights and contracts. Public choice theory is an approach to the

economics of politics, and involve a great variety of theories about the self-interested behavior of people in their roles as voters, politicians, bureaucrats, etc. For a textbook surveying a vast range of topics in public choice theory, see D. C. Mueller (1989).

29. For a discussion of the distinction between rent-seeking activities and profit-seeking entrepreneurship, see Buchanan (1980).
30. For the Confucian concept of reciprocity ("pao") see Yang (1957).
31. For an extension of Landa's theory of the EHMG, see Carr and Landa (1983). For a discussion of Landa's theory of the EHMG in terms of the notion of an "informal sector," see Landa (1988). For a survey of the evolution of my theory of EHMG since my 1981 paper, see Landa (1996).
32. As Willmott (1972, p. 5) puts it "one might say that economic transactions occur along particularistic lines in all pre-industrial societies, but the Chinese develop particularistic links between those involved in economic transactions."
33. Contract law in Western economies protect the plaintiff's expectation interest, subject to the foreseeability and mitigation doctrines. For a discussion of this, see Posner (1986, pp. 114–15). See also Landa (1987).
34. Expectation damages generally are greater than reliance damages or restitution. Thus, a contract law that protects the plaintiff's expectation interest also plays a deterrent function. See Landa and Grofman (1981).

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Chapter 11
The Socio-Economic Functions of Kinship and Ethnic Ties in the Establishment and Growth of the Tan Kah Kee Family Firm in Singapore: A Transaction Costs Approach

Janet T. Landa and Janet W. Salaff

1 Introduction

Social scientists concerned with economic development have long contended that kinship ties and loyalty to members of one's ethnic group impede entrepreneurship. According to this view, the use of personalistic or particularistic ties to recruit managers and workers blocks ethnic and kin-based firms from growth. Such firms are doomed to remain inefficient, small in size, and ill-equipped to seize new opportunities for expansion. (See United Nations 1951, 1955; Wolf 1955; Ogburn and Nimkoff 1958; Nimkoff 1960; and Levy 1966).

In recent years, however, cross-cultural studies of entrepreneurship reveal that under certain conditions kinship and ethnic networks can contribute to the growth of the firm. Social scientists, particularly sociologists and anthropolists, working in different institutional settings, have drawn attention

I dedicate this chapter to the memory of my friend and co-author sociologist Janet Salaff, Department of Sociology, University of Toronto, who passed away unexpectedly November 10, 2010. This chapter by Landa & Salaff (1986) is a slightly revised version of Landa and Salaff's (1980) paper. We presented our 1980 joint paper at the Structural Analysis Workshop Series, Sociology Department, University of Toronto, 8 February, 1980. See also Acknowledgements.

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to the wide spectrum of interest groups and social networks that structure economic transactions. These interest groups include family, church, sect, school, and social club. Small face-to-face "primary groups," such as the family, a group of individuals related by blood, marriage, or adoption, often turn their ascriptive or particularistic relationships towards instrumental goals. The contribution of these ascriptive ties to economic enterprises have, however, been best documented for small "family firms." (See Despres 1958; Bennett and Despres 1960; Baltzell 1962; Khalaf and Shwayri 1966; Benedict 1968; Singer 1968; Nafziger 1969; Owens 1971; Light 1972; and Bonacich and Modell 1980). But sociologists and anthropologists have yet to describe the ways in which kinship and ethnic networks can aid the growth of a firm from a small family firm to a large-scale diversified enterprise.

In recent years economists, engaging in "economic imperialism" into sociology and anthropology (Landa 1978, 1981, 1983; Ben-Porath 1980; and Pollak 1985), have turned their attention to the economic implications of family/kinship or ethnic ties for organization of economic activities. A key concept which underlies their analysis of kinship/ethnic networks is the notion that in a world where transaction costs are not zero, kinship/ethnic ties based on mutual trust reduce the costs of monitoring the behavior of cooperating partners such as members of a household production team or members of a trading group. Thus, in addition to the well-known "markets" and "hierarchies" transaction costs paradigm of Ronald Coase (1937) and Oliver Williamson (1971, 1975, 1985) which ignores kinship and ethnic networks, Landa, Ben-Porath, and Pollak focused on personalistic networks as an alternative institutional arrangement or governance structure for organizing economic activities.[1]

Recently, a few sociologists have begun engaging in "sociological imperialism" into economics by analyzing markets as concrete social structures (White 1981) and "markets as social structures" from a transaction costs approach (Baker 1984).

This chapter contributes to cross-cultural studies of entrepreneurship and family firms in two ways. First, we shall provide a *socio-economic* theory of the role of kinship and ethnic networks in promoting entrepreneurship, using a transaction costs approach. We shall emphasize the transaction costs implications of trust embedded in personalistic networks for the functioning and growth of a firm. Second, using our transaction costs approach, we shall examine in detail the socio-economic functions of kinship and ethnic networks in the functioning of a Chinese family firm—the Tan Kee firm—and the processes by which the firm employed family, kinsmen, and fellow-Hokkens in managerial positions, in response to new opportunities for profit-making, to grow into a large diversified multi-million dollar enterprise during the first three decades of this century.

The rest of the chapter is organized as follows: Section 2 provides a socio-economic theory of particularistic networks in promoting entrepreneurship. Section 3 applies the theoretical framework to interpret the business career of Tan Kah Kee through four main phases of the growth of the Tan Kah Kee family firm. Section 4 provides a summary and concluding remarks.

2 The socio-economic functions of kinship and ethnic networks in promoting entrepreneurship: A transaction costs approach

Early 20th century Southeast Asia was characterized by a poorly developed infrastructure. To provide the infrastructure necessary for their activities, entrepreneurs often drew on particularistic social networks. Fieldwork in Kuching, Sawarak, by Tien Ju Kang (1953) in the immediate post World War II period, revealed that the collection and distribution of smallholders' rubber was dominated by several interrelated Hokkien Chinese families. Landa's fieldwork of the marketing network for smallholders' rubber in Singapore and West Malaysia in 1969 also found that the network was dominated by a Hokkien-Chinese middleman group with a tightly knit kinship structure consisting of six clans (Landa 1978, ch. 2). Landa's study showed that rubber dealers drew upon kinship and ethnic networks and various mutual aid organizations embedded in the Hokkien community to facilitate their trading roles. On the basis of her empirical findings, Landa (1978, ch. 4; 1981) developed an economic theory of particularistic trading networks, as they manifest themselves in the "ethnically homogeneous middleman group."

The ethnically homogeneous middleman group is an informal club-like arrangement that middlemen, linked by kinship and ethnic ties, created to provide themselves with infrastructure: it is an informal institutional arrangement for contract enforcement, mobilizing information, capital, and reducing risks of bankruptcy. In particular, Landa focused on the role of the ethnically homogeneous middleman group in enforcing contracts via the Confucian code of ethics embedded in the group. Landa (1981) postulates that under conditions of contract uncertainty, the trader or merchant (call him "Ego") will choose as his trading partner someone whom he can trust because this economizes on transaction costs such as contract enforcement and information costs. Ego will equip himself with a "calculus of relations" (Fortes 1969) with individuals of varying degrees of social distance and will choose those as closely related to him as possible as his partner on the assumption that the closer the social distance, the higher the probability that the partner will be trustworthy. The theory of the ethnically homogeneous middleman group can also be applied to Ego's choice of cooperating partners within the firm—business partners, managers and employees—wherever relationships between Ego and his cooperating partners are characterized by a high degree of trust. We may imagine Ego, a Singapore merchant from Chip Bee (Ji Mei) village in Fukien province, equipping himself with the following calculus of relations which depict seven grades of individuals or trading partners with varying degrees of social distance and trustworthiness:

1. Kinsmen from nuclear and extended family, including adopted sons, stepsons, sons-in-law, paternal brothers;
2. Clansmen from the same village (Chip Bee);
3. Clansmen and/or fellow dialect speakers from the same county (Hokkiens from Tung An);
4. Clansmen and/or fellow dialect speakers from the same prefecture (Chuan-Chow);
5. Clansmen and/or fellow dialect speakers (Hokkien) from the same province (Fukien);
6. Non-Hokkien Chinese (Teochew, Cantonese, Hakka, Hainanese)
7. Non-Chinese (British, Indians, Malays).

The system of preference rankings of individuals can also be represented by the use of a series of concentric circles to depict differences in degree of trustworthiness, with the most trustworthy individuals located at the centre (Landa 1981, p. 353). See Figure 11.1.[2]

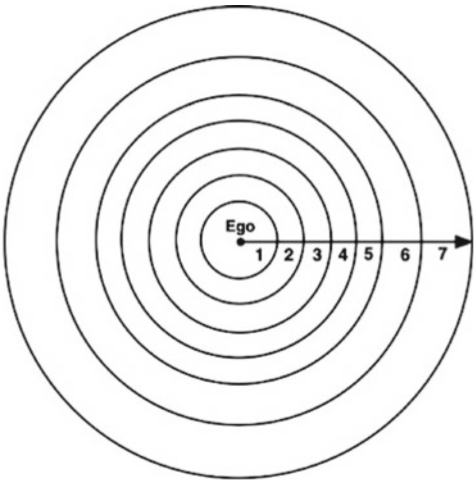

Fig. 11.1 Von Thünen concentric circles depicting Ego's (Hokkien from Chip Bee) preference ranking of seven grades of trading partners

From Ego's point of view, all members from categories 1 to 5 are regarded as "insiders," while all those beyond the ethnic group are considered to be "outsiders."[3]

This is because in overseas Chinese society, the linguistic boundary is the major boundary defining the limits of Confucian ethics of mutual aid and cooperation among Chinese. In a conflict situation between Chinese and non-Chinese, on the other hand, the Chinese ethnic boundary becomes the major boundary defining the limits of cooperation; thus the boundary dividing insiders and outsiders is situational. By confining his choice of cooperating partners within the linguistic group, Ego can economize on the costs of monitoring the behavior of his cooperating partners so as to reduce their tendency to "shirk" (Alchian and Demsetz 1972) their responsibility, hence increase the efficiency of the firm. In addition to drawing upon kinship and ethnic networks for recruitment of trustworthy personnel for the firm, Ego can also mobilize these networks to obtain other strategic inputs such as information and capital. This is especially important if the firm is to expand and adjust dynamically to the evolving opportunity structure in order to seize new opportunities for profit-making. In an economy with an underdeveloped infrastructure, a number of distinct functions are thus performed by kinship and ethnic ties: establishment of trust via the recruitment of personnel on a particularistic basis, pooling of information and capital, and reducing risks of bankruptcy. The functions of these particularistic social networks will adapt to the needs of the firm at different stages in its growth.

Using the above concentric circle paradigm, we can predict that the network of relationships expand progressively outwards with the requirements of the expanding firm. Finally, the problem faced in raising large amounts of capital will necessitate Ego to cross the ethnic boundary to raise capital from outsiders.

Mobilization of capital and information by means of kinship and ethnic networks is not a costless activity. While it is true that Ego's network of kinship and ethnic ties is given to him free of charge, by virtue of his membership in a kinship and ethnic group, the mobilization of these networks towards instrumental goals requires the merchant to invest actively in the groups. He must create and keep alive the bonds of loyalty and obligation to him and his firm. The merchant's investment initially takes the form of providing benefits to kinsmen on a person-to-person basis, such as employment, money and acting as a guarantor. But as the merchant's wealth and status grow, he also engages in philanthropy by providing much needed club goods such as schools, hospitals, and graveyards. The provision of these club goods further foster common ideology and group identity and hence strengthen the bonds of loyalty among members of his own ethnic group. Just as the father obligates his manager-son by giving him part of the wealth (Benedict 1968), the merchant as a community leader creates loyalties and obligations between members of the widest cooperating group, the ethnic group, by donating to them a part of his wealth via philanthropic activities. Thus, as the firm expands, it may be predicted that the merchant will supplement person-to-person patron-client relations with philanthropic activities (Scott 1972).

Our thesis that kinship and ethnic ties promote entrepreneurship and can be flexibly adapted to the needs of an evolving firm must respond to four main traditional assertions that particularistic ties impede entrepreneurship. The first and best known assertion is that ascriptive ties promote nepotism so that the members of the firm recruited on a particularistic basis may not have the required qualifications or talents needed for the growth of the firm. This assertion, however, assumes implicitly that extensive, specialized, and well organized structures exist in the community through which a firm can conduct a thorough search for individuals with appropriate talents. It further assumes implicitly that search costs are low, and that once people with appropriate skills are located from a wide range of potential candidates, their loyalty and trustworthiness can be ensured at low cost. However, even in a developed economy, the necessary methods of locating trustworthy personnel from impersonal groups are costly (Mayhew 1968). In an underdeveloped economy this is even more the case, and ascriptive/particularistic ties that promote mutual trust thus economize on the costs of monitoring the behavior of cooperating partners. In short, nepotism can be an efficient managerial tool.

A second assertion is that the recruitment of people based on kinship ties narrows the size of the cooperating group. The number of trained and competent managerial personnel that are drawn from one's kin group cannot be easily increased to meet the needs of an expanding firm. Family and kin groups are often too small to provide competent managers for one family firm, let alone a multi-branch enterprise. In other words, there is no guarantee that kinship groups constitute the most effective set of managers or personnel for the firm.

We believe, in contrast, that firms can make flexible use of ascriptive and ethnic ties to expand their organizations for the following two reasons. First, the definition of who is kin is rarely determined purely by biology or genealogy. In many cultures the kinship group is artificially expanded by such devices as surname change, adoption and marriage.[4]

Furthermore, the widest boundary—the ethnic boundary (concentric ring 6)—can be expanded via intermarriage. The entrepreneur may also fully use schools, apprenticeship systems and other ethnic-based community organizations to train and upgrade the personnel he hires and thereby meet new needs of the firm.

The third assertion maintains that firms built upon close personal ties cannot expand into large-scale enterprises to meet the challenges of international trade and finance without introducing outsiders, hence an impersonal bureaucracy, which will ultimately dilute family control (Chandler 1970). But there are evidence that families can still maintain their influence and even hegemony in large family-owned firms (Zeitlin, *et al.* 1980). This is certainly true in our case study of the Tan Kah Kee family firm, as we shall see.

Finally, a fourth assertion is based on the economists' traditional view of the entrepreneur as a selfish "economic man." Seen as a "lone wolf," the economic man maximizes profits unconstrained by personal ties. But the traditional model of the profit-maximizing individual unconstrained by personal ties implicitly assumes a well developed infrastructure within which the individual operates. But Singapore in the early decades of the twentieth century did not have a well developed infrastructure. Once the assumption of the existence of a well developed infrastructure is relaxed, then it is essential that profit-maximizing individuals establish mutual aid group arrangements with other individuals to provide themselves with the infrastructure essential for entrepreneurship. In the following section, we shall apply our theory of the socioeconomic functions of kinship and ethnic networks to interpret the growth of the Tan Kah Kee family firm.

3 The role of kinship and ethnic ties in the growth of the Tan Kah Kee family firm[5]

Using the theoretical framework sketched above, we shall now examine the evolution of the Tan Kah Kee & Co. and its antecedent enterprises through four main phases: (1) entry of Tan Kah Kee into his father's rice firm and the subsequent establishment of his own rice and pineapple businesses; (2) establishment of the Tan Kah Kee rubber firm; (3) forward integration of the firm into manufacturing and marketing and the emergence of Tan Kah Kee as the "Rubber King" during the 1920s; and (4) liquidation of the firm during the depression of the 1930s.

3.1 Phase 1. Tan Kah Kee's entry into the family rice firm and the subsequent establishment of his own rice and pineapple business, 1890–1905

Tan Kah Kee (1874–1961) was born in the single surname (Tan clan) village of Chip Bee (Ji Mei) in Tung An county, Chuan-chou prefecture in Fukien province, China. His father, Tan Kee Pek was a well known merchant and leader of the Hokkien community/*pang* in Singapore (see notes 5e and 5f). In 1890, at the age of sixteen, Tan Kah Kee arrived in Singapore, and in 1891 worked as an apprentice in Soon Ann Rice Company, a rice import-export firm owned by his father, Tan Kee Pek, and managed by Tan Kah Kee's uncle, Tan Eng Kan, Tan Kee Pek's younger brother. Soon Ann imported rice from Siam (now Thailand), Cochinchina (southern part of Vietnam) and Burma for sale to retailers in Singapore and neighboring Malay states. Because the rice trade was dominated by the Teochews, Tan Kee Pek thus built up a network of business connections which included Teochew merchants. He also took in as apprentices young men from the same county, one of whom was Tan Ean Kiam. After his son arrived in Singapore, Tan Kee Pek was able to expand his business, and he purchased a sago factory, a pineapple canning plant called Jit Sin and real estate. Tan Kee Pek spent half the day attending to these businesses (see note 5c). The rest of the time he worked on the affairs of the Hokkien Tan clan, of which he was the Singapore Tan clan and Hokkien *pang* leader (see note 5f).

Two main problems faced a small family firm in its early stages in those days: recruitment of personnel from a narrow circle of kinsmen, and geographical dispersion. The life cycle of successful family firms has been described as a series of transactions based on reciprocity and a complex balance of kinship rights and the demands of business.[6] For the family firm to prosper, the father must gradually place confidence in, and relinquish leadership over to, his son, and the son must be capable of taking over leadership. A son that demonstrates his trustworthiness and his own entrepreneurial talents must be acknowledged by the father eventually to become head of the firm. Mutual trust reduces the father's cost of monitoring the activities of managers, and increases the effectiveness of the business team. Indeed, our main thesis is that kinship ties perform the function of an efficient monitoring device.

The second problem faced by a small family firm is that of geographical dispersion of business contacts. In the pre-industrial trading environment where communication between ports of trade was difficult, the manager must travel in person to those localities in which he had business contacts. He must therefore leave the management to a trustworthy person while he was away on business trips (Benedict 1968). In the case of Hokkien merchants, each voyage placed a strain on those who remained to manage the firm because of the length of time to make a round-trip journey (the distance from Singapore to Amoy, for instance, exceeds 3,000 kilometers).

Tan Kee Pek's small business firm drew their managers from available domestic kinsmen, including his younger brother (concentric ring 1). Tan Kee Pek enlarged his kin circles partly through marriage. He married three times, and had ten sons. His principal wife, the mother of Tan Kah Kee and his younger brother Tan Keng Hean, remained in China. Tan Kee Pek married a second wife in Singapore, who passed away without leaving heirs, and then he married Madam Saw, who had adopted sons that were younger than Tan Kah Kee.[7] As the eldest surviving son of the principal wife, Tan Kah Kee was the first to assume an important position in the family business, and he also became a family representative. Tan Kah Kee demonstrated his business acumen, and when his uncle returned to China, Tan Kah Kee at the age of nineteen, took over the management of Soon Ann, thereby freeing Tan Kee Pek to add the Jit Sin pineapple cannery to his business holdings (Benedict 1968).

Tan Kee Pek also enlarged the work force of his family firm with apprentices from fellow clansmen, who sought him out as the leader of the Tan clan in Singapore. One of the best known apprentices was Tan Ean Kiam, born in Tung An county, who emigrated to Singapore in 1899 and sought assistance from Tan Kee Pek. Tan Ean Kiam, together with Lee Kong Chian, Lim Peng Siang and Dr. Lim Boon Keng, helped to establish the present Overseas Chinese Banking Corporation by the amalgamation of three Chinese banks in 1932. When Tan Kah Kee went back to China in 1893 at the age of twenty to marry, his uncle returned to Singapore to manage Soon Ann. In 1896 after two years, Tan Kah Kee returned to Singapore and resumed working in the rice firm. In 1899 at the age of 25, Tan Kah Kee departed for China to attend the funeral of his mother—because his father was unable to leave the Singapore business—returning again in 1900. The following year, Tan Kah Kee voyaged to China for the third time to complete the funeral arrangements for his mother, and remained there for three years. During this period, he built 30 dwellings in Amoy as an investment on behalf of the family estate (see note 5c).

In the Chinese family firm the enterprise is considered an integral part of the patrilineal heritage, and all sons share in the profits or debts unless otherwise specified (Shiga 1978). While Tan Kah Kee was in China on his third trip, his step-brothers established two new firms, Kim Seng Bee Brokerage, a commission agent, and the Kheng Seng Cement Co. The capital was obtained from Indian money lenders, to whom the properties of Soon Ann were mortgaged. The step-brothers were incompetent managers, however, and their firms incurred heavy losses. Moreover, Madam

Saw gambled heavily and drew freely from the till. As a consequence, Soon Ann and Tan Kee Pek's other holdings were endangered (see note 5c).

In 1904 when the financial position of the firm became critical, Tan Kah Kee's uncle sent for his immediate return to Singapore, but the youth arrived too late to save the firm, and it collapsed. Tan Kah Kee decided to close down Soon Ann Co. He then took responsibility to clear his father's business debts and name even though he was not legally obliged to do so (see note 5c). By clearing his father's debts, however, Tan Kah Kee not only displayed filial piety, but also enhanced his reputation for credit-worthiness, and thus induced other people to extend credit to him in the future.[8]

In 1904 when Tan Kah Kee was thirty years old, he started his own business enterprises. With business experience, a network of business connections (including Teochew merchants), but limited capital, his first investment in business was in a pineapple canning factory, in partnership with a Teochew merchant. The two partners bought the old Jit Sin pineapple factory. Later, when his partner died, Tan Kah Kee purchased his shares and became sole owner. In the same year, Tan Kah Kee built another pineapple canning factory, Sin Lee Chuan. He was able to finance his business since he obtained pineapples needed for canning on easy credit terms from pineapple dealers on the one hand, and on the other, he received payment from buyers on delivery of the finished products. By the end of the year, the two factories yielded reasonable profits. With the profits, he diversified his business by setting up a new firm, Khiam Aik Company, to handle the import and export of rice. He had acquired direct experience in the rice trade while working in his father's rice firm. He also integrated backwards into pineapple planting when he acquired 500 acres of land near his factory as a pineapple plantation, naming it the Hock San Pineapple Plantation. By vertically integrating backwards to the source of supply, Tan Kah Kee was able to economize on the costs of contract negotiations with independent pineapple dealers and to ensure the reliability of pineapple supply for his canning factory.[9] The net income from his pineapple and rice businesses was over $60,000 in 1904.[10] The next year, he established another pineapple canning factory to process pineapple imported from neighboring countries. He also installed machinery in his canning factory for the production of crystal sugar from white sugar obtained from Indonesian merchants on easy credit terms; that business itself yielded a net profit of $45,000 that year (see note 5c).

Thus, in the formative period of the family firm, recruitment of personnel, a major problem, was met through kin. For the operation of his small family firm, Tan Kee Pek relied mainly upon his family and extended family (concentric ring 1). In addition, he recruited men from his village and county (concentric rings 2 and 3). Kinsmen are not automatic candidates for managerial positions, and talent coupled with training are required. Thus Tan Kee Pek's stepsons proved to be inept businessmen and jeopardized not only their own firms but also Tan Kee Pek's firm as well. Nevertheless, Tan Kee Pek's firm functioned as an informal "business school" that provided his son, Tan Kah Kee (concentric ring 1) and his brother (concentric ring 1) and other members of the Hokkien community (concentric rings 2, 3, 4, and 5) with connections and experience. Tan Kee Pek, however, did not provide them with capital, and indeed, saddled his son with debts.

3.2 Phase 2. Establishment and growth of the Tan Kah Kee & Company, 1906–1919

Tan Kah Kee entered the second phase of his business career when new opportunities for profit-making were opened with the introduction of rubber planting in Malaya. During this period, Tan Kah Kee established his rubber firm, the Tan Kah Kee & Co. in 1919, with himself as the majority shareholder, and his brother as a minority shareholder. The company was to lay the foundations for his vast wealth in the 1920s. To exploit the new opportunities for profit-making, Tan Kah Kee drew upon a wider circle of clansmen and fellow-Hokkiens from Chuan-chow (concentric ring 4) for assistance.

Rubber was first planted on a commercial basis in Malaya in the mid-1890s on estates previously opened for sago and other crops that were increasingly unprofitable. N.H. Ridley, Director of the Singapore Botanic Gardens and Supervisor of the Straits Forest Department, spearheaded the commercial production of rubber. In Kew Gardens, England, Ridley acclimatized the wild rubber seeds gathered in the forests of Brazil, improved tapping methods to economize on labor costs and inaugurated the commercial rubber plantation in Malaya (Jackson, 1968, chap. 10).

In 1896 Ridley, who had tried without success to convince local European sago planters to experiment with rubber as a commercial venture, turned to the leading Hokkien Chinese merchants and planters of the Straits Settlements. These Hokkien merchants, particularly those from Chuan-chow, were highly regarded for their business acumen and experience. In addition, the Chuan-chow Hokkien traders had established a long history of trading relations with European traders: they were the middlemen between European traders and native producers in Southeast Asia from the earliest days of European settlement in Malaya. Ridley approached English-speaking Hokkien Dr. Lim Boon Keng of Singapore, a medical doctor trained in England. Dr. Lim not only was convinced of the profitability of rubber planting by entering the business himself, but he also recommended his friend and fellow-Hokkien, Tan Chay Yan of Malacca to invest in rubber planting.[11] Consequently, Dr. Lim Boon Keng and Tan Chay Yan became rubber pioneers in Malaya, with Tan Chay Yan credited as the first to seize the opportunity to grow rubber on a vast commercial scale (see note 5k, p. 5l). Tan Chay Yan's Bukit Asahan Estate, with an acreage of 3,000 mature rubber trees, was purchased initially with an investment outlay of $200,000. It was sold to a London syndicate for two million dollars in 1907, during the first rubber boom (1905–1908), thus yielding him an enormous profit (Song 1967, p. 294).

Tan Kah Kee greatly admired the foresight of his fellow Hokkiens who perceived opportunities for making profits before the commercial viability of the ventures was demonstrated. As a close-knit community the Hokkiens exchanged information and rendered each other assistance. After Dr. Lim Boon Keng encouraged Tan Chay Yan to take up rubber planting, Tan Chay Yan, in turn, made frequent visits to Singapore to advise and encourage his friends to invest in rubber planting in Singapore (Song 1967, p. 294). He assisted them in various ways, including selling them rubber seedlings. When Ridley approached Tan Kah Kee and told him of Tan Chay Yan's success in rubber plantations, Tan Kah Kee decided also to invest in rubber plantations. In 1906 Tan Kah Kee approached fellow clansman, Tan Chay Yan, his contemporary, four years his senior, and bought from him 180,000 seedlings at one cent per seedling. The total cost of the purchase was $1,800. Tan Kah Kee planted the seedlings between rows of pineapples in his Hock San Pineapple Plantation. In 1908 the price of pineapple declined drastically, and Tan Kah Kee reduced his acreage in pineapple and concentrated on rubber. At the outset of the second rubber boom, 1909–1912, on the heels of the foundation of the automobile industry, the demand for rubber increased several-fold. Tan Kah Kee mortgaged the Hock San Pineapple Plantation to purchase rubber processing equipment (see note 5c).

In contrast to his father, Tan Kee Pek, who obtained capital for his small family firm from Indian money lenders, Tan Kah Kee borrowed from Chinese banks for the larger amounts of capital needed for this sizeable enterprises. He first borrowed from the Kwong Yik (Selangor) Banking Corporation, which was established by Cantonese tin-miners in Kuala Lumpur in 1913. The first Hokkien bank, the Chinese Commerical Bank, was established in 1912, by Amoy-born businessman, Lim Peng Siang, in partnership with Tan Chay Yan, Lim Boon Keng and other Hokkien merchants. Tan Kah Kee then began to deal with Hokkien banks (Wilson 1972).

During the second rubber boom of 1909–1912, European companies became particularly interested in purchasing land planted with rubber trees and bought many of the Chinese rubber plantations for large sums of money (Jackson 1968, p. 246). Tan Kah Kee sold the mortgaged Hock San Pineapple Plantation with its mature rubber trees to an English merchant for $350,000, with Tan Chay Yan acting as his agent and as his guarantor. Tan Kah Kee made a huge profit from the transaction. With the profits, he paid off his bank overdrafts and loans and also invested in additional plantations which he planted with rubber seeds. During the first six years of his expanding business, Tan Kah Kee's net income was $4,730,000, most of which he reinvested in rubber plantations, the foundation of his empire (see note 5c).

Tan Kah Kee entered the second decade of the century in a strong position to seize the initiative in growing and processing tropical produce in localities in which there were as yet limited competition. For example, in 1911 when Tan Kah Kee travelled to Bangkok to establish a procuring center to purchase padi for processing in his Singapore firm, Heng Bee Rice Company, he learned that there were many pineapple plantations but no canning factories in the region, and he built the Khiam Thye Pineapple Cannery factory in Thailand in 1912 (see note 5c). In the decade after the 1911 revolution in China, which he strongly supported, he returned to China twice.[12]

It was during the second decade that Tan Kah Kee found it necessary to integrate forward into shipping. When Tan Kah Kee found it difficult during World War I to obtain transportation for his goods from their widely scattered warehouses to the customers, he first rented and then later purchased several steamships; shipping became a profitable business in itself (see note 5c).

It was also during the second decade of the 20th century that Tan Kah Kee began to involve himself in philanthropic activities in China. Using part of his profits from his business enterprises, he financed the provision of much needed local public goods such as schools for fellow villagers and fellow Hokkiens from Chip Bee and Chuan-Chow. He established the Ji Mei (Chip Bee) Primary School in 1913, the Ji Mei (Chip Bee) Normal School and Secondary School in 1918, and Amoy University [Xiamen University] in 1921.[13] In addition, he financed trade schools and a number of business enterprises—including the Amoy Canning Corporation—to create training and employment opportunities for fellow-Hokkiens in China. Tan Kah Kee himself also benefited from his philanthropic activities in two ways. First, he was able to create networks of patron-client relationships from which he could later on recruit trustworthy personnel and a better educated work force for his enterprises. Second, he was able to build up a reputation for himself as a philanthropist which accorded him esteem in his community at home and abroad. We may therefore interpret the philanthropic activities of Tan Kah Kee as consisting of two components: (a) an "altruistic" component; and (b) a "self-interested" component in which philanthropic activities may be regarded as long-term investments in the creation and maintenance of patron-client ties that provided the basis for the supply of future recruits to his firm to keep pace with the expansion and diversification of his business enterprises.

Before the long-term investments paid off, however, obtaining reliable and talented managerial personnel was a continual problem during this decade. The problem was due to the dispersion and diversified nature of his numerous enterprises, and the youthfulness of his children who were the natural heirs to the business. When Tan Kah Kee travelled to China, he called upon his brother, Tan Keng Hian, his closest family member and partner, to oversee the enterprises in Singapore. And while in China, Tan Keng Hian looked after Tan Kah Kee's schools. Tan Keng Hian, second son of Tan Kee Pek's first wife and fourteen years younger than Tan Kah Kee, was Tan Kah Kee's youngest brother, and had a close and confiding relationship with him (see note 5c). During Tan Kah Kee's absences from Singapore, the brothers corresponded on the business operations of the company. While Tan Keng Hian was in China, he looked after Tan Kah Kee's schools. Unfortunately, the cooperation between the brothers lasted only several years due to the ill health of Tan Keng Hian (see note 5e).

The difficulties of long-distance management compelled Tan Kah Kee to relinquish some of the more diverse holdings. Thus, the Heng Bee Rice Company was closed down in 1917 when it became unprofitable owing to competition from new mills in Siam (now Thailand) closer to the source of *padi* supplies (note 6c). And when his ships were sunk in the Mediterranean by U-boats in 1918, Tan Kah Kee gave up his shipping business and invested the $1.2 million, recovered from insurance compensation payments, in rubber plantations. Thus, Tan Kah Kee retained mainly the rubber milling factories and plantations after 1919. Tan Keng Hian, on his part, expanded the rubber goods industries while Tan Kah Kee was in China. Tan Keng Hian converted a mill into the manufacturing plant that in the 1920s was to produce the wide range of goods that made Tan Kah Kee a household name in Southeast Asia (see note 5c).

Long distance control and management also proved difficult in those firms in which Tan Kah Kee was investor, but not the major shareholder. At the close of World War I several of his senior employees, anxious to strike out on their own in the rubber milling business, approached Tan Kah Kee for support. He took up one-third share in each of three newly promoted companies, or around half a million dollars total investment (see note 5f and 5m). Other investors included Tan Ean Kiam from Tung An county, Tan Kee Pek's former apprentice, who was founder of the Overseas Chinese Banking Corporation, and head of the Tan Clan Association in Singapore (see note 5c). While Tan Kah Kee was in China, however, the ventures were mismanaged. As a consequence, the companies suffered heavy losses, and all were dissolved.

The scope of Tan Kah Kee's enterprises in the second decade of the twentieth century were impressive. From 1910 to 1919, when he was 36 to 45 years of age, Tan Kah Kee's investments included a full range of tropical produce. Pineapples from his plantations were canned in his factories, and he owned the largest number of canning factories in Singapore, which in 1913 produced half of Singapore's annual production of 800,000 cases. He owned rubber plantations and mills and 15,000 acres of rubber trees. The latex from these trees was processed in his own factories, and transformed into smoked sheets. They were purchased by Michelin, Firestone, Goodyear and other tire companies and shipped to the industrial countries to be manufactured into finished products. On the trading floor, the first quality of ribbed rubber sheets, Rubber Sheets Number #1, were referred to as "Tan Kah Kee Number One." He also owned rice mills, steamships, a soap factory, a brickwork, a rock sugar manufactory, and a sawmill. His total income during the war years was 4.5 million dollars. The Tan Kah Kee enterprises were the most extensive Chinese-owned holdings in rubber in the Southeast Asian region.

In sum, Tan Kah Kee during this second phase of his career, created a wider network of relations, which in turn, opened new channels of information, capital and assistance that facilitated his entry into the rubber business. In terms of Landa's (1981; see also Fig. 11.1) model of concentric circles: Ridley, the outsider (concentric ring 7) supplied Tan Kah Kee with information on the opportunities for making profit in the rubber industry; Tan Kah Kee turned to clansman and fellow-Hokkien Tan Chay Yan (concentric ring 5) for assistance—purchase of seedlings, acting as his guarantor and his agent in a transaction involving the sale of his rubber plantation to a British merchant; Tan Kah Kee approached Cantonese banks for loans (concentric ring 6), and later switched to Hokkien banks when they were established (concentric ring 5). Tan Kah Kee's choice of social networks to whom he turned for assistance was determined by his entry into a new field dominated by the early Hokkien rubber pioneers. Tan Kah Kee, in turn, sponsored men from the same village, county, prefecture, and province (concentric circles 2, 3, 4, and 5) to work in his firm and facilitated their entry into the rubber business. Throughout this period, his brother (concentric ring 1) remained his closest business associate.

3.3 Phase 3: Emergence of the packer-exporter firm and forward integration, 1920–1928

In the mid-1920s, rubber plantations and milling were at their height of profitability, and Tan Kah Kee's firm emerged as a packer-exporter firm and also integrated forward in rubber manufacturing and marketing of his goods locally and internationally. He established the Tan Kak Kee Rubber Manufactory in 1920. He became the largest and most famous rubber producer and manufacturer in the region and was nicknamed "Rubber King."

In 1922 Tan Keng Hian became ill and returned to China, and Tan Kah Kee returned to Singapore to resume management of his company. The rubber milling business had become competitive, and Tan Kah Kee was in a strong position to buy out smaller firms in Malaya, expand and modernize them. In 1923 he made a profit of $1.2 million mainly from milling and plantations. Tan Kah Kee then disposed of his matured rubber estates at a profit and acquired an overall income of $11 million, and his assets was estimated to be worth over $15 million. The rubber business reached a peak in 1925 when the British government introduced the Rubber Production Control Scheme that pushed up the price of rubber from $30 to $200 a picule (23 cents to $1.50 per pound) (see note 5c).

After 1925 the rubber trade slowed down. Tan Kah Kee sold 5,000 acres of plantations to a British company for $2.5 million, and thereafter reinvested the earnings from plantation and milling rubber into rubber manufacturing. The rubber factory began operations by making rubber soles in 1922, and by 1924 had expanded to numerous buildings on a ten acre plot of land, employing a workforce of 6,000 workers and also imported technicians from abroad (see note 5c). The largest factory of its kind in the area, the factory produced goods that included toys, erasers, hot water bags, raincoats, rubber boots, rubberized sheets, rubber tubes, and bicycle tires. At its peak in 1927 the company had 72 branches in 42 towns and cities of Southeast Asia and China (as far north as Shanghai). Tan Kah Kee appointed sales agents in the U.K., Europe and Canada; these sales agents were well-known Agency Houses with established reputations (e.g. Goodyear). See Wu (1966); (see also 5c).

The Tan Kah Kee & Co., the largest Southeast Asian Chinese company, was comprised of three main departments: (1) rubber and pineapple plantations; (2) rubber sheets for export; (3) rubber goods—smoking and manufacturing divisions. At its height, the company including the Malayan branches, hired a total of 2,000 staff and a work force of 30,000. Tan Kah Kee calculated that 130,000 individuals directly and indirectly depended upon his enterprises for a living (see note 5c).

However, there were problems with the manufacturing operations that were never fully resolved, which contributed to later financial difficulties. Tan Kah Kee was aware that the export of raw and semi-processed materials and the manufacture of simple consumer goods was less profitable than the manufacture and export of producers goods. He thus set out to manufacture automobile tires. The company obtained patents for making tires, but the manufacturing companies withheld the "know-how." He hired chemical engineers from North America, Europe and Japan, but the tires still burst after several hundred miles' use. Tan Kah Kee's third son, Tan Pok Ai, although not a trained chemist, then devoted himself to finding the solution, and closeted himself in a laboratory in the factory to do so (note 5m). Tan Kah Kee's fifth son, Tan Kok Kheng, who joined manufacturing operations in 1931, recalls that his older brother, who passed away in 1944, "probably killed himself by this kind of work, the fumes and the overwork. We can say that he sacrificed himself for the firm" (see note 5c). Much of the profits from the plantation and milling operations were channeled into the manufacturing side of business.

Another problem arose from the competition of manufacturing products with the products of British industries. The low cost of production of shoes and its protection by British Commonwealth tariffs, brought complaints by British factory owners, which led to successful efforts to curtail manufacturing in the Tan Kah Kee firm, and eventually was one of the contributing factors which forced Tan Kah Kee to liquidate his firm (see note 5m). The problem of geographical dispersion also persisted. None of his sons travelled outside Singapore on behalf of the company. Company agents were far flung. Those in China, under the unsettled political circumstances, were most difficult to control. The Shanghai office, the largest in China, was staffed by nonrelatives, whose behavior Tan Kah Kee was unable to monitor effectively. Within the firm, however, Tan Kah Kee was able to monitor the performance of managers who were primarily related to Tan Kah Kee by kinship or ethnic ties.

In the decade of the 1920s, the number of departmental managers required to meet the needs of the expanded firm exceeded the supply of family members to manage the firm. The company drew its Singapore managerial personnel, not only from Tan Kah Kee's now matured sons, but also from fellow-clansmen, fellow-villagers, and fellow Hokkiens (concentric rings 1, 2, 3, 4, 5). Thus, for example, the manufacturing branch of Tan Kah Kee & Co, located on Sumbawa Road, hired six departmental managers, five of whom were fellow Hokkiens, and the sixth was a clansman from Anhui county, Fukien. The best known examples of clansmen from the same village (Chip Bee) hired by Tan Kah Kee were the brothers Tan Lark Sye and Tan Boon Khak.[14] Tan Lark Sye was born in 1897 and attended Chip Bee Primary School. After the death of their father, the brothers emigrated to Singapore and around 1920 approached Tan Kah Kee for jobs in his firm. Tan Kah Kee took these men into his firm, thus laying the foundation for the eventual emergence of Tan Lark Sye and Tan Boon Khak as rubber dealers. In 1924, they established the Aik Hoe Rubber Comany, which by 1969, was one of the three leading rubber packer-exporters in Singapore and West Malaysia.

When Tan Kah Kee's firm integrated forward into packing and exporting, trading directly with customers in Europe, the U.K., and North America, Tan Kah Kee hired a fellow Hokkien, English-speaking Lee Kong Chian, to manage the international side of his business. Lee Kong Chian was born in 1893 in Nan-An county, Fujian Province (see note 5h). In 1903, Lee Kong Chian accompanied his father to the Straits Settlements, where he obtained a modern bilingual education and studied English language and science. Lee Kong Chian then returned to China to complete secondary school and college, with a specialty in surveying. After he joined the firm of Tan Kah Kee in 1916, Tan Kah Kee quickly saw his abilities and promoted him to one of the senior positions, as head of its rubber department.[15] Lee Kong Chian dealt with representatives from foreign firms who came to see Tan Kah Kee in Singapore, and also acted between Tan Kah Kee and the foreign banks. For example, he acted as intermediary for Tan Kah Kee in dealings with the Hong Kong and Shanghai Banking Corporation. Lee Kong Chian was able to use his English skills and his connections with foreign firms to promote the international aspect of Tan Kah Kee's firm. As Vice-Chairman of the Chinese Commercial Bank, Lee Kong Chian steered the three Singapore Hokkien banks towards amalgamation in 1932. He was Vice-Chairman of the Overseas Chinese Banking Corporation from 1932 to 1938 and its Chairman from 1938 to 1964. The Lee Rubber Company became a leading rubber exporter in the post World War II period. Lee Kong Chian, as the son-in-law of Tan Kah Kee, remained in contact with the Tan enterprises, and provided assistance to the firm in the decade of the 1930s. (See note 5c).

Tan Kah Kee married three times and bore 17 children: nine sons and eight daughters. Four of his five eldest sons and four sons-in-law entered the family business during Phase 3 and early Phase 4. (One son, ill during the period, entered a family bank at a later date). Each of the branches of the Tan Kah Kee & Company was, in the 1920s, managed by one of the sons, while a son and son-in-law worked in the manufacturing laboratory.

In summary, Tan Kah Kee reached the pinnacle of his business career in phase 3, between 1920–1928, as his business expanded by integrating forward to trade directly with customers overseas. Expansion of the firm coincided with the maturation of his children, and Tan Kah Kee was able to draw on his family circle for managerial personnel. In this expanding firm, there was considerable scope for able sons to display their initiative. They managed the subdivisions and branches of the company, attempted to expand the product lines and displayed their own decision-making abilities. In addition, Tan Kah Kee also hired fellow clansmen and fellow Hokkiens to manage his many departments. Later, Tan Kah Kee's son-in-law (Lee Kong Chian), and several clansmen took advantage of the rubber boom to establish their own rubber firms. His own sons and younger sons-in-law, who were of age in the 1920s remained in the firm until its termination.

3.4 Phase 4: Liquidation of the Tan Kah Kee Co. Ltd., 1929–1934

In 1928 rubber prices began to decline, ultimately precipitating a financial crisis in the Tan Kah Kee firm since milling was the main source of income. Tan Kah Kee stopped venturing into new fields and began to consolidate his holdings. A part of his rubber factory burned down and arson was suspected due to Tan Kah Kee's political role in leading the boycotts of Japanese goods after the Japanese military intervention in Tsinanfu, Shantung, 1928, during the course of the Northern Expedition of the Chinese Nationalist Army. Perhaps not unrelated, Japanese shoe factories flooded the market with shoes that sold for 13 cents a pair, compared with 15 cents for those of Tan Kah Kee. Despite these difficulties Tan Kah Kee continued his philanthropic contributions, but went deeper into debt.

In 1929, which marks the beginning of a 3-year period of worldwide depression, rubber prices dropped to $6 a picule in Malaya. Rubber plantations and milling suffered, and no profits from plantations or milling were reinvested in Tan Kah Kee's rubber manufacturing. But Tan Kah Kee decided not to allow his rubber manufacturing to fail because of the 6,000 workers employed in the firm. To prevent bankruptcy and to continue operations, he had to increase borrowing from banks. During this time, he borrowed mainly from foreign banks—the Hong Kong and Shanghai Banking Corporation (British), the National City Bank of New York (USA), the P. & O Banking Corporation (British), the Mercantile Bank of

India (British), and the Chartered Bank (British) – and the three predecessors of the Overseas Chinese Banking Corporation, headed by his son-in-law Lee Kong Chian (see note 5c).

To ensure that Tan Kah Kee's company remain solvent, the banks proposed their willingness to reduce their loan interest if Tan Kah Kee agreed to the conversion of the firm from a sole proprietorship into a limited liability company. Tan Kah Kee had no choice but to agree, and in August, 1931, the Tan Kah Kee & Co. Ltd. was formed with Tan Kah Kee as the major shareholder while the banks took a small share in the new company. They appointed four members to sit on the Board of Directors; one of them was appointed Assistant Manager while Tan Kah Kee was appointed Managing Director.

Tan Kah Kee & Co. Ltd. might have weathered the depression if his co-directors had been cooperative. Instead, they pursued policies directly against his wishes. Two events, one after the other, in which Tan Kah Kee was outvoted by his co-directors, culminated in the liquidation of the firm. The first involved granting sole agency rights by the co-directors to an English merchant who arrived in Singapore, armed with a letter of introduction from the head office of the Hong Kong and Shanghai Banking Corporation, to obtain a sole agency right for his firm to handle the sales of the products of the Tan Kah Kee & Co. Ltd. An agency relationship is a contractual relationship in which the principal engages another person, the agent, to perform a service on his behalf. There is no presumption that the agent, as a profit maximizer, will always act in the best interest of the principal. The principal therefore will have to incur costs of monitoring the agent's behavior.

In the world of Chinese business, the principal usually chooses his kinsmen or persons whom he trusts to act as his agent in order to economize on the costs of monitoring agent's behavior (Landa, 1978, Chapter 2). In this case, Tan Kah Kee could not consent to the appointment of a sales agent who was not only an outsider unrelated by kinship or ethnic ties, but whose reputation was not known to Tan Kah Kee. Therefore, Tan Kah Kee refused to sign the documents, but the Board of Directors override his decision. Thereafter the company ceased to accept orders from other sources, after fulfilling outstanding orders by October of that year. All sales were channeled through the sole agent. Business dwindled as the sole agent failed to fulfill his obligations satisfactorily.

Next, relations between Tan Kah Kee and his co-directors reached a crisis when the board of directors ordered that the Company's other businesses, including a biscuit factory, sawmill, brickwork, and pineapple factories to be closed. He sold the biscuit factory to Lee Kong Chian, retaining only the rubber manufacturing. Then, due to shortage of capital, two rubber milling factories were leased to Lee Rubber Co. Ltd., the company of Tan Kah Kee's son-in-law, who was on the board of directors of the bank. Rubber milling began to improve, but the bank directors insisted on closing and leasing the remaining eight factories in Malaya. The nearly 80 sales branches were closed down. Tan Kah Kee protested most strongly against closing the manufacturing side, since many workers would lose their jobs. Moreover, he foresaw that the prospects were improving. Apart from his apparently having solved the technical problems in rubber tire production, as of July 1, 1933, tariffs were raised for non-Commonwealth imports of shoes, and large orders began pouring into the factory for his shoes. Tan Kah Kee had no choice. He paid off $70,000 in goods and in kind to his creditors, so they would not suffer the consequences of the firm's failure. By February 1934, the situation was no longer tenable, and Tan Kah Kee took the fateful decision to liquidate the company. A receiver was appointed by the banks to take over the company.[16]

The final phase of Tan Kah Kee's business career dramatizes the fact that conversion of his sole proprietorship firm into a limited liability company prevented his firm from bankruptcy. Yet the conversion from sole owner-manage firm to a corporation meant that Tan Kah Kee lost control of the management of the firm to outsiders. Foreign bankers dominated the Board of Directors, and by virtue of majority voting rule, they were able to pursue policies against the wishes of Tan Kah Kee, which left him with no choice but to liquidate the firm. Had Tan Kah Kee been able to raise enough money from Chinese banks alone, the mutual aid ethics between Chinese creditors and their debtors, which reduces risks of bankruptcy, might have enabled Tan Kah Kee's firm to weather the depression of the 1930s, and to survive into the present decade.

4 Conclusions

We examined the rise and fall of the Tan Kah Kee firm, a Singapore-based family firm which was the largest Chinese rubber manufacturer and exporter in Southeast Asia during the 1920s. Using a transaction cost paradigm, we argued that kinship and ethnic ties played an important role in the growth of the Tan Kah Kee firm from a small family firm to a large, diversified multi-million dollar family firm during the first three decades of this century. Our approach differs from the traditional sociologists' approach which views the use of particularistic ties to recruit managerial personnel as impediments to the growth of a firm. Our emphasis is on mutual trust embedded in particularistic networks which, by economizing on costs of monitoring team members, facilitates the growth of the family firm. We attribute the fall of the Tan Kah Kee family firm not only to the drastic decline in rubber prices during the Depression, but also to the necessity of ceding family control to "outsiders" (British bankers and their agents).

The value of our case study of the Tan Kah Kee family firm lies in demonstrating the relevance of kinship/ethnic networks as a managerial tool by offering empirical evidence of the detailed processes involved in the expansion of these particularistic networks to meet the needs of a growing firm. By using a transaction cost approach to the study of the growth of a Singapore Chinese family firm, the Tan Kah Kee & Co, we seek to integrate economic, social, and cultural variables into a single analytical framework.

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*As this chapter is heading for the press in 2015, I have proofread the paper, and corrected a few errors in the 1986 version of the paper. I also wish to thank my brother Dr. William Tai Yuen (2013, chapter 5) for providing some useful comments which I took into account in this final version of the Landa-Salaff (1986) paper/chapter 11 of my book.

Endnotes

1. In a recent paper, sociologist Mark Granovetter (1985) examines the extent to which economic action is embedded in structures of social relations in modern industrial society. Our paper, which draws on the work of Landa (1978, 1981) explicitly considers the economic implications of mutual trust embedded in particularistic social structures.

2. Landa's (1981) concentric model for analyzing degree of trustworthiness and "social distance" is inspired by Marshall Sahlin's (1965) model for analyzing reciprocity.
3. The population in Singapore in the early decades of the twentieth century were composed of four different ethnic groups—the Europeans, the Chinese, the Indians, and the indigenous group (the Malays). The Chinese community, the largest of the three ethnic groups, was itself subdivided into five major linguistic groups—the Hokkiens, the Teochews, the Cantonese, the Hakkas, and the Hainanese. For a discussion of the segmentary nature of overseas Chinese communities, see Crissman (1967).
4. For a discussion of an example of Japanese firms demonstrating the flexibility of kinship definitions, e.g. able men are frequently adopted into the family to head the family firm. (See Fruin, 1980). For the Chinese case, see McGough (1976); and Sung Lung-Sheng (1975). Studies of Chinese banks in the 19th and 20th centuries demonstrate the flexibility of family relations, see McElderry (1976, Chapter 1). For an economic discussion of this flexibility of kinship definitions, see Carr and Landa (1983).
5. Materials on Tan Kah Kee were obtained from written and oral histories:

   (a) Biography of Tan Kah Kee in Wu Tee Jin (1966, 73–143).
   (b) Tan Kah Kee (1979). [In Chinese]
   (c) Transcription of the history of the firm and the life of its founder, written for us by the fifth son of Tan Kah Kee, Tan Kok Kheng, August, 1981, 20 pages.
   (d) Salaff's interview with Mr. Ng Aik Huan, Managing Director, Asia Insurance Co., Ltd., Singapore, August, 1981.
   (e) Salaff's interview with K.C. Tan, son of Tan Keng Hian who was the brother of Tan Kah Kee, Chairman of Chinese Chamber of Commerce, Singapore, August, 1981.
   (f) Salaff's interview with Mr. Tan Tock San, Director of the Oversea Chinese Banking Corporation, son of Tan Ean Kiam, and colleague of Tan Kah Kee.
   (g) Sim (1950).
   (h) Biography of Lee Kong Chian, in Sung Chek Mei (1969, 23–65).
   (i) Biography of Tan Lark Sye in Sung (1969).
   (j) Biography of Lim Boon Keng in Sim (1950).
   (k) Biography of Lim Boon Keng in Wu (1966, 53–72).
   (l) Biography of Tan Ean Kiam in Sim (1950).
   (m) Salaff's interview with Tan Kok Kheng, Singapore, August 1, 1981.

   The oral histories obtained via personal interviews with Tan Kah Kee's family members and relatives, are to be considered as facts or historical evidence: On the nature of such oral statements as "historical evidence," Boggars 1969, pp. 20–21) has this to say: "The essential factors in this evidence are memory and authority. An event or personality can only be historically known if someone was acquainted with them. This person then must be able to recall to the mind the event or personality and then state his recollections in terms intelligible to posterity. Finally posterity must accept the recollections as true. Such statements reconstitute historical evidence and this implies that historical truth is available in ready-made statements. The historian's story therefore stands in close relationship to this something I have called evidence…. In a customary society…the past is transmitted by tradition and oral means."

6. Benedict (1968) provides the following model: the father-son firm goes through five stages: (1) training or apprenticeship of the young son and heir; (2) accumulation of equity and authority of the son in the family enterprise as the father entrusts more important tasks to his son and the son successfully carries them out. Consultation between father and son is increasingly frequent, and the roles of father and manager, son and business associate become differentiated; (3) new managerial roles are generated that are compatible with the new economic status of the son, and typically, expansion of the business and establishment of new branches to accommodate the son's abilities and energies; (4) the incorporation of non-family members to enable the family firm to grow; and (5) the pursuit of other careers or community service by family members.
7. It was customary for Chinese merchants in Southeast Asia to marry a second wife who assisted them in business and daily living. In principle the second wife was a concubine, who did not have equal legal rights or status in the family as the first wife, but whose male offspring were accorded equivalent inheritance rights with those of the legitimate wife. Often, however, the second wives were married with a full ceremony and treated as a legitimate wife. See Kulp (1925). See also Chen Ta (1939).
8. Normative obligations for sons to clear the debts incurred by the father in the family firm is part of Confucian ethics of filial piety in father-son relationships.
9. For a discussion of the reasons for vertical integration, see Williamson (1971, 1975, 1985).
10. This is in Singapore dollars. Henceforth, all currency is expressed in Singapore dollars, unless otherwise specified.
11. See Song (1967) for the various biographies of successful Chinese merchants in Singapore.
12. Tan Kah Kee symbolically cut off his pigtail to express his support of the 1911 revolution. See note 5c.
13. Chen Ta (1939) pointed out that in the rising tide of Chinese nationalism, overseas Chinese, including those from Singapore, contributed considerable sums of money for schools which helped raise the standards of Chinese education in Kwantung and Fukien provinces. By far the greatest contribution was made by Tan Kah Kee when he established the Amoy University in 1921. Chen Ta also attributes the growth of commerce, industry, communications, transportation and steam navigation in southern China before 1940 to technical

knowledge and capital investment of the overseas Chinese. There was some interest to seek profit among the overseas Chinese, but there was also a movement in the years 1929 to 1933 to improve the social and economic conditions of the poverty-stricken villages in southern China by raising funds for schools and business concerns.

14. For the biographies of Tan Lark Sye and Tan Boon Khak, see Sung Chek Mei (1969, pp. 23–63).
15. Lee Kong Chian in later years hired the sons and sons-in-law of Tan Kah Kee to work in his Lee Rubber Company. Lee's brother, George Lee, managed two of the Tan Kah Kee enterprises in the post World War II period. See note 5h.
16. For a discussion of the role of kinship and ethnic ties between creditors and debtors which reduce the risks of bankruptcy, see Landa (1978, Chapter 7).

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PART IV

Economic Success of Chinese Merchants in Southeast Asia: Identity, Cooperation and Conflict

Chapter 12
The Bioeconomics of Homogeneous Middleman Groups as Adaptive Units: Theory and Empirical Evidence Viewed from a Group Selection Framework

1 Introduction

In a "Letter to the Editors" of the *Journal of Bioeconomics*, biologist David Sloan Wilson (2000, pp. 272–273) wrote:

> I read your paper (Landa 1999b) and enjoyed it. It fits very nicely with my new book on religion from a multilevel evolutionary perspective.. . ..The main purpose of my book (Wilson 2002) . . . is to examine the concept of religious groups as adaptive units.. . ..My empirical evidence is based mostly on detailed case studies of single religions in relation to their environments. The next step in the empirical study of religion is to become more broadly comparative. Not only should religion x have certain features to be adaptive in a given environment, but all religions occupying the same environment should converge on the same adaptive features. Against this background, the comparative study of middleman societies becomes especially important. If the Jews in medieval Europe, the Chinese in Southeast Asia, the East Indians in East Asia, etc. are all alike in some respects based on group-level adaptation to similar social environments, this is a very, very important example of convergent cultural evolution that needs to be showcased to demonstrate the power of the evolutionary perspective—both theory and empirical methods—for understanding religious groups in particular and all human groups in general.

I am responding to Wilson's (2000) letter. I present empirical evidence in the form of a number of case studies of homogeneous middleman groups (HMGs) operating in less-developed economies in various parts of the world

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to showcase the empirical reality of HMGs functioning as adaptive units; hence presenting very important empirical evidence of the existence and importance of group selection in human society. But before doing so, it is necessary to revisit the evolution of my theory of the "ethnically homogeneous middleman group" (EHMG) and link it with Wilson's discussion of human social groups as adaptive units, viewed from a group selection framework.

Section 2 presents the evolution of my economic theory of the EHMG: from a theory of the emergence of the EHMG as an institutional arrangement for the provision of contract enforcement, a local public good, to a signaling theory of homogeneous middleman groups (HMGs) in which symbols of individual and group identity play an important role in sorting potential trading partners into homogeneous middleman groups, to a theory of HMGs as carriers and transmitters of culture, to my current bioeconomics theory of HMGs as adaptive units viewed from the perspective of group selection theory drawn from evolutionary biology. Section 3 provides a brief discussion of the link between group selection theory and multilevel selection theory. Section 4 provides evidence of HMGs as adaptive units in the form of a number of case studies showing how various successful foreign merchant groups, originating from very different cultures, have adapted to the same underdeveloped economies of their host societies. Although the evidence comes from very different sources, it is striking how much these HMGs have in common, based on group-level adaptations to similar environmental conditions. Section 5 provides a summary and concluding comments.

2 A theory of homogeneous middleman groups as adaptive units: The evolution of an idea

2.1 A theory of the emergence of an ethnically homogeneous middleman group (EHMG) as a "club-like" institution for contract-enforcement (Landa 1981)

Based on my 1969 fieldwork on the Chinese merchants in Southeast Asia, I developed a theory of the ethnically homogeneous Chinese middleman group (EHMG) as a club-like arrangement in which Chinese traders within the group cooperated by providing themselves with club goods/local public goods such as contract enforcement, capital and information, in response to an environment lacking basic infrastructure such as legal infrastructure, banking and credit-rating institutions. By cooperating with each other, members of the EHMG were able to enforce contracts, mobilize information and capital, thereby reducing transactions costs, hence out-competing other ethnic groups to appropriate the role of middleman-entrepreneur (Landa 1978).

Of the various club goods provided by members of the EHMG, the most important is contract enforcement. I developed a theory of the emergence of the EHMG as a club-like institutional arrangement for coping with the problem of contract uncertainty (Landa 1981, reprinted in Landa 1994, Chap. 5). See Chapter 5 of this book. I argued that under conditions of contract uncertainty, Chinese merchants will not randomly enter into transactions with anonymous traders, but will have the incentive to preferentially choose traders whom they trust, hence particularizing exchange relations on the basis of kinship, locality and ethnic ties. This is because embedded in these particularistic exchange relations are shared social norms of behavior (Confucian ethics of reciprocity) which function to constrain traders from breach of contract; any trader who violates the ethics of the group will be punished, including being ostracized from the group. The effects of many individual trader's discriminatory choice of trading partners is the emergence of an ethnically homogeneous middleman group (EHMG), a club-like arrangement alternative to contract law for economizing on contract enforcement costs in an environment characterized by contract uncertainty. Greif (1993) developed a very similar theory for the Maghribi-Jewish merchants in medieval trade. See also Tilly's (2005, pp. 8–9) discussion of Landa's and Greif's work on "identity networks."

The ethnic boundary of the Chinese middleman group represents the outer limits of a Chinese trader's discriminatory choice of trading partners because of the Confucian code of ethics which prescribes rules of the game—mutual aid obligations/reciprocity—for members of the same ethnic/dialect group, while not extending mutual aid to outsiders. Constraints on behavior thus exist among members of the Chinese EHMG because of shared rules of the game; members of the Chinese middleman group thus form a moral community. Confucian code of ethics serves as an informal institution, an extralegal institutional arrangement for the enforcement of contracts.

2.2 Signaling theory of HMGs: Rituals, customs and symbols of individual and group identity (Carr and Landa 1983)

Carr and Landa (1983) extended Landa's (1981) theory of the EHMG to other homogeneous middleman groups (HMGs) including religious trading groups such as Jewish merchants in medieval Europe. Using Buchanan's (1965) theory of clubs, we depicted the optimal size of homogenous trading clubs by analyzing the economic benefits (lowered breach costs) and costs (enforcement and information costs) of belonging to a homogenous trading club, arguing that the economic benefits out-weighed the costs for a club member. We also explained many seemingly strange rituals and customs of trading groups such as Jewish dietary laws, Jews lending to fellow Jews at zero interest, Chinese keeping genealogical records, distinctive dress style, etc., as rational trading practices. First, we use signaling theory to argue that these rituals, customs and other symbols of religious or group identity—such as names, clan names, dietary rules, language, dress, and religion—play an important signaling function in transmitting non-price information of the identity of potential trading partners, and hence serve to economize on information costs of identifying each other. Secondly, we argue that these symbols and rituals of group identity screen out outsiders by erecting barriers to entry for those outsiders who may wish to free-ride on the benefits of club membership. We analyze these two functions of group rituals, and other symbols of group identity by analyzing, for example, Jewish dietary laws:

> . . ..Jews have a stringent set of dietary laws known as the *kashruth*. Why do members of these religious organizations restrict their eating behavior when there seem to be no apparent benefits from doing so? We argue that there are benefits. Dietary laws give religious members a feeling of shared values. These shared values give members of the religious organizations a sense of a common identity and distinguish them from non-members. It is exactly this difference between members and nonmembers that is needed to facilitate economic exchange under conditions of contract uncertainty. . ..Dietary laws also help identity club members, an especially important function if club members are geographically dispersed. Dietary laws discourage conversion by increasing the costs of joining the organization and thus serve as a barrier against those seeking to become members in order to receive the economic benefits (Carr and Landa 1983, p. 153–154).

See also Iannaccone (1992) who developed a very similar theory of the function of religious rituals.

In addition, Carr and Landa analyzed the optimal size of the ethnic trading club/ network as the club expands to include increasing number of insiders while excluding outsiders from the ethnic trade network.

Cooter and Landa (1984) extended Carr and Landa's (1983) formal club-theoretic model of the HMG one step further by analyzing the relationship between the size of trading groups and the development of the law of contracts. We think of a trading group as an informal club-like arrangement for reducing breach of contract between members. If the group expands, then members gain the advantage of a more extensive internal market. On the other hand, as the group expands, personal relations become attenuated. For a given level of expenditure by the group on enforcement, the probability of breach will increase as the group becomes larger. We prove that membership in clubs will decline if contracts with outsiders become more secure i.e. when contract law becomes better developed.

Recently, Bowles and Gintis (2004) developed a theory of trust embedded in "parochial" ethnic networks very similar to that developed by Landa (1981), Carr and Landa (1983), and Cooter and Landa (1984).

2.3 A theory of HMGs as "cultural bearing units" and "cultural transmission units" (Landa 1991)

Once HMGs emerge, what factors account for the *persistence* of ethnic trading boundaries? The answer lies in viewing a HMG explicitly as a "cultural-bearing unit," anthropologist Barth's (1969) concept of an ethnic group—instead of implicitly as in the Carr and Landa (1983) paper—and as a "cultural transmission unit" (Landa 1991), following Boyd and Richerson's (1985) theory of co-evolution of genes and culture or "dual inheritance theory," which focuses on the importance of cultural group selection.

In Landa's (1991) paper, a HMG is viewed explicitly as a "cultural bearing" unit because members use symbols of individual and group identity, including physiognomic indicators, to convey low cost non-price information of a trader's reputation for trustworthiness to potential trading partners who are members of their own ethnic group. At the same time, these symbols of group identity erect barriers to entry for outsiders who may wish to "pass" as insiders in order to improve their status by free-riding on the benefits of group membership. Such passing include changing names and religious conversion. But an outsider from a very different ethnic/racial group cannot change his ethnicity because ethnicity involves immutable physical characteristics. It is very costly for a person from a different ethnic group to switch ethnic identities. Switching an identity via assimilation is a long-term process, the "costs of ethnic identity switching are so prohibitive, both in the short and long run, ethnicity imposes an effective barrier for those attempting to pass as insiders" (Landa 1991, p. 66). I compared ethnicity as a hard-to-fake ethnic marker which is analogous to the peacock's elaborate tail discussed by biologists (e.g., Hamilton and Zuk 1989) as performing two important functions: "as identification of conspecifics, and as a screening device to screen out the weak, or cheaters/fakers" (Landa 1999a, p. 105).

Once the HMG emerges, the HMG functions as a "cultural transmission unit" which operates to maintain the HMG over time. I developed a theory of the HMG as a cultural transmission unit, using Boyd and Richerson's (1980, 1985) "dual inheritance theory" of genes and culture:

> Since many of the family firms of the deceased middlemen will be passed on to sons, social learning of the culture of the middleman group takes place through docility and "frequency-dependent bias"—sons copying the behavior of their fathers—without the need for costly trial-and-error learning. The next generation can also copy those middlemen-entrepreneurs who are especially successful and have emerged to assume roles as leaders and philanthropists in their own community. Since the enculturation process of social learning also goes on in the wider ethnic community of which the EHMG is a subgroup, new members of the ethnic group will also inherit the cultural values of the group. The rules of the game and other cultural values governing members of the present generation of middlemen, then, will be transmitted via social learning from one generation to the next. . ..Ethnocentrism of members of the EHMG is reinforced; those who are already in the middleman group will continue to prefer to choose new trading partners from the younger generation of the same ethnic group (Landa 1991, p. 69–70).

HMGs function as "cultural transmission units" because wealthy members of the HMG play an important role in providing certain local public goods, including education to fellow members, and because group cultural values are transmitted to future generations of the ethnic group via teaching (in schools and in the family) and learning from peers. The ethnic boundaries of trading networks thus persist over time because of: (1) the "conformist transmission" bias, i.e. copying from peers, etc. (Boyd and Richerson 1985); and (2) the "efficiency" of the HMGs as a cultural bearing unit, and as a cultural transmission unit, using the concept of efficiency as defined by bioeconomist Jack Hirshleifer (1982, p. 50):

> On all levels of life organisms have found it profitable to come together in patterns of cooperative association. But such cooperation is always secondary and contingent, in at least two respects: (1) in-group cooperation is only a means for more effectively and ruthlessly competing against outsiders, and (2) even within the group there will not be perfect parallelism of interests, hence cooperation must generally be supported by sanctions. . ..Efficiency, in this interpretation, is meaningful only as a measure of group strength or advantage relative to competing groups in the struggle for life and resources. . . . A totally universalistic measure of efficiency is pointless; we must draw the line somewhere, at the boundary of "us" and "them."

Hirshleifer's concept of "group competition," ignored in conventional economics, is crucial to my explanation of the emergence and persistence of EHMGs: "In the ruthless competitive inter-ethnic struggle for profit opportunities, in-group members with efficient social structures for the enforcement of cultural norms of behavior have a comparative advantage over other ethnic groups in appropriating and maintaining middleman-entrepreneurial roles for themselves" (Landa 1991, p. 71). By 1991, using Hirshleifer's concept of efficiency and group competition, I came very close to developing a bioeconomics theory of the HMG as an adaptive unit. But that theory still took some years to materialize. In the interim, I came across biologist Alexander's (1987) theory of the origins of moral systems:

> Moral systems are societies with rules. Rules are agreements or understanding about what is permitted and what is not, about what rewards and punishments are likely for specific acts, about what is right and wrong. I will argue that the *concepts* of *moral systems have been designed to assist group members and explicitly not to assist the members of other competing groups*. [Emphasis added]

Alexander (p. 79) argued that inter-group competition promotes in-group cooperation via the role of moral systems: "[H]umans alone play competitive group against group on a large and complex scale." Moral systems, rules or institutions thus divide human society into groups: "us" vs. "them," "insiders" vs. "outsiders." This ethnocentric propensity of humans to cognitively classify people into "us" and "them" led me to develop a classificatory theory of HMGs, and to coin the term "Homo *classificus*" for humans (Landa 2002).

It was not until I read Sober and Wilson's (1998) book that I developed a bioeconomics theory of Chinese middleman success and placed it explicitly on group selection-bioeconomics foundations (Landa 1999b). And not until I read Wilson's (2000) commentary on my paper, that I realized that I have sufficient number of case studies of various middlemen group-level adaptations to similar underdeveloped environment in various parts of the world (Landa 1988). So even though the empirical evidence of HMGs functioning as adaptive units was in front of my face for over a decade, I could not see it until many years later.[1] And I am sure that I would never have seen it, if it were not for the fact that I had crossed over from the social sciences to evolutionary biology, that I was able to interpret HMGs in a new way, as adaptive units.

2.4 A bioeconomics theory of homogeneous middleman groups (HMGs) as adaptive units viewed from a group selection perspective

In order to develop a bioeconomics theory of HMGs as adaptive units, it is necessary to understand the meaning of "adaptation" and also the meaning of a "group" as an adaptive unit from the perspective of multilevel selection theory. (For a brief discussion of the distinction between the concepts of group selection and multilevel selection, see Section 3). In evolutionary biology, "adaptation" is defined as "the process populations of organisms acquire properties that allow them to survive and reproduce more effectively, by being able to cope with their environment" (Ghiselin, e-mail communication, April 1, 2008). Stated more generally, ". . .adaptation designates any process whereby a structure is progressively modified to give better performance in its environment. The structures may range from a protein molecule to a horse's foot or a human brain or, even, to an interacting group of organisms such as the wildlife of the African veldt" (Holland 1975, Preface, p. v).

A group is defined as "a set of individuals that influence each other's fitness with respect to a certain trait but not the fitness of those outside the group" (Sober and Wilson 1998, p. 92). When the trait is a social behavior, Wilson (2002, p. 15) says that "the fitness of an individual is determined by its own trait and the traits of the individuals with whom it interacts," coining the term "trait group" (Wilson 1975) to emphasize the close relationship between traits and groups in multilevel selection theory. More generally, a trait group is defined "in terms of the individuals who interact with respect to a given activity" (Wilson 2002, p. 15).[2] Thus "my bowling group is the people with whom I bowl, my study group is the people with whom I study. . . ." (Wilson 2002, p. 15).

In the case of the homogeneous middleman group, it is a network of interdependent middlemen linked to each other directly and indirectly by particularistic ties of kinship, locality, and ethnicity.

In order to understand a human group as an adaptive unit, Wilson (2002, p. 25) says that it is necessary to "go beyond kin selection and reciprocity to model a complex regulatory system that binds members of a group into a functional unit."[3] Wilson's emphasis on the importance of "complex regulatory systems" such as social norms (see Sober and Wilson 1998, Chaps. 4 and 5) reflects an emerging biology paradigm of major-life-transitions in which members of groups, through regulatory mechanisms, suppress conflict/free-riding within the group, thus allowing group members to cooperate for their collective benefit—without undue self-sacrifice ("altruism") of its members—hence the group's success in out-competing other groups.[4] Wilson's emphasis on "complex regulatory systems" is to be understood in the context of his discussion of multilevel selection theory which focuses not only on within-group cooperation, but also importantly on between-group competition. Wilson's multilevel selection perspective revives group selection theory, albeit in its rehabilitated form.

The "complex regulatory system" that Wilson refers to is equivalent to the concept of "institutions"—formal and informal "rules of the game"—central to New Institutional Economics (see Landa 1994, Chap. 1). An example of a formal institution is contract law. Examples of informal institutions are social norms, ethical codes of conduct, religion, etc.

By 1999, I was able to develop what essentially is a bioeconomics theory of the HMGs as adaptive units incorporating the following essential elements (Landa 1999b):

(a) An immigrant group responds to the existence of an economic opportunity or an economic niche—for example, opportunities for middleman-entrepreneurship—in the host country;
(b) The immigrant group is a minority ethnic group co-existing side by side with other ethnic groups—including the indigenous population—who are potential competitors for occupying the middleman niche;
(c) The infrastructure necessary for entrepreneurship—contract law, banking, credit-rating institutions—is poorly developed or non-existent;
(d) To be successful in middleman-entrepreneurial role, middlemen must be able to provide themselves with infrastructure by providing themselves with club goods;
(e) Several club goods such as contract enforcement, provision of capital and information can be obtained by middlemen only if there is cooperation and coordination among middlemen functioning as an adaptive unit, in response to the poorly developed infrastructure;
(f) By forming a HMG, with members connected by kinship, ethnic, religious and other personalistic ties, social norms exist among members of the HMG to facilitate cooperation and collective action for the provision of club goods;
(g) Members of HMGs, by cooperating and coordinating their activities, provide themselves with club goods, hence can out-compete other ethnic groups to appropriate middleman roles;
(h) By transmitting cultural values of trustworthiness and cooperation to the next generation of middleman, HMGs can persist over time;
(i) The persistence of HMGs—with ethnic boundaries separating "us/insiders" from "them/outsiders" is a source of inter-ethnic conflict

and violence in multi-racial societies. See also Corning's (2007) bioeconomics theory of collective violence in non-human and human societies.

3 Current status of group selection theory and multilevel selection theory

Group selection (GS) and multilevel selection (MLS) are closely related but not identical concepts. In two important recent articles aimed at rethinking the old controversies surrounding GS theory since the 1960s, Wilson and Wilson (2007, p. 345, 2008), concluded with a summary of sociobiology's new theoretical foundation: "Selfishness beats altruism [read: cooperation (my emphasis)] within groups. Altruistic groups beat selfish groups."

It is clear that MLS theory focuses on at least two biological *levels of selection and multiple groups in a population structure*:

(a) A lower level "individual selection" or "within-group selection" where unrestrained free-riders/cheaters/selfish genes by maximizing their relative fitness within the group outcompete cooperative members; and
(b) A higher level selection—"between-group selection,"—where cooperative groups (using social controls to restrain free-riders), favors behaviors that increase the relative fitness of the whole group, hence outcompete selfish groups. MLS theory allows for the possibility that adaptations can evolve above the level of individual organisms, i.e. at the level of social groups and other higher level units, and hence according to Wilson and Wilson (2007, p. 336), Dawkins's (1976) "selfish gene" paradigm that the individual gene is the fundamental and the sole unit of selection is wrong.

On the other hand, GS theory focuses on the "between-group selection" level—the evolution of cooperative traits—in which cooperative groups outcompete selfish groups. The logic of GS theory is thus embedded in a larger and more comprehensive MLS theoretical framework, a framework which is likened to a series of nested Russian dolls (Wilson and Wilson 2008, p. 380).

Wilson and Wilson (2007, p. 339) said that despite the controversial history of MLS theory, that the theory is an accepted theoretical framework for the study of "major transitions"—e.g. single cells evolving into multi-celled organisms, honeybees evolving into the eusociality (i.e. extra high sociality) of honeybee colonies[5]—where selection within groups is suppressed, thus allowing selection among groups to emerge.

It is important to emphasize that GS and MLS theories are socio-biological theories of biological evolution that emphasize natural selection which is based on survival and reproduction expressed in biological terms of *relative fitness* comparisons. Such relative fitness comparisons have no conceptual counterparts in economics when discussing the evolution of the firm, industry, markets, etc. As Metcalfe (2008, p. 25) states: "economic evolution is not biological evolution for [there is] nothing in the economic world to correspond to the exact processes of biological inheritance, sexual reproduction and gene transmission over time." However the basic GS theoretical framework can still provide a powerful bioeconomics framework for understanding how one trading group comes to dominate middleman-entrepreneurial roles: If traders can form a homogeneous middleman group and can cooperate and coordinate their collective efforts in the provision of local public goods, and are able, via social controls and social norms, to punish selfish individuals (free-riders in the group who wish to benefit from public goods without contributing), then the trading group can outcompete other less cooperative groups, in functioning as a group-related adaptive unit, hence able to appropriate and maintain the role of middleman-entrepreneur. As Wilson and Wilson (2007, p. 343) noted: "The psychological traits associated with human moral systems are comparable to the mechanisms that suppress selection within groups for other major transitions, such as chromosomes and the rules of mitosis within multicellular organisms and policing mechanisms with eusocial insect colonies." This is exactly the group selection framework that is used in Section 2.4 of my bioeconomics theory of HMGs as adaptive units.[6]

Once the HMG emerges, *cultural group selection* plays an important role in helping the HMG to *persist* over time via its role in transmission of social norms to future generations of middleman. Here, the theory of gene-culture co-evolution associated with the work of Lumsden and Wilson (1981, revised and expanded 2005 edition) and Boyd and Richerson's (1985, Richerson and Boyd 2005) "dual inheritance theory" are relevant, although in Section 2.3 of this chapter, my focus is exclusively on Boyd-Richerson's dual inheritance theory emphasizing cultural group selection.[7]

Wilson and Wilson's (2007, especially 2008) articles also provided empirical evidence for group selection mostly drawn from non-human societies. In the next section, I will provide empirical evidence for the existence of group selection in human societies in the form of a number of case studies of HMGs.

4 Homogeneous middleman groups (HMGs) as adaptive units: Some case studies

This section provides empirical evidence—in the form of several case studies—that successful trading groups are adaptive units with shared traits in common. The following are brief summaries of mostly prior work on case studies of merchants in various parts of the world, either based on my own fieldwork (Landa 1978, 1983) or drawn from the studies by other scholars (Landa 1988).[8]

4.1 Chinese middlemen in Southeast Asia (Landa 1978, 1981, 1983, 1988)

The marketing of smallholders' rubber in West Malaysia is dominated by a particular Chinese ethnic/dialect group—Hokkien-Chinese traders—who function as middlemen between smallholders (largely indigenous Malay population) and overseas buyers. In 1967 there were 2,240 licensed rubber dealers. Members of the middleman group were arranged in a pyramidal marketing structure with specialization and division of labor among the different levels of middlemen: village dealers, town dealers, and packers/exporters.

A closer scrutiny of the Chinese middleman group in Singapore and West Malaysia revealed the existence of a tightly knit ethnically homogeneous Hokkien-Chinese group. Within the Hokkien-Chinese group, six clans from Chuan-chow and Yung-chung counties in Fukien province in China—Tan, Lee, Ng, Teh, Lim, and Gan—dominated the marketing network. The Hokkien ethnic community is the most wealthy and powerful of the five major Chinese ethnic/dialect groups (Hokkien, Teochew, Cantonese, Hakka, and Hainanese) by virtue of their dominance of the smallholders' rubber trade (see Landa 1978, Chap. 3; 1988). Of the Tan clan in Southeast Asia, Tan Kah Kee emerged to become the "Rubber King" by 1925. Using part of his profits from his business enterprises, Tan Kah Kee, as "Rubber King" and as leader of the Hokkien Huay Kuan (the Hokkien dialect association), engaged in philanthropy by financing the provision of much needed local public goods such as elementary and middle schools and the Amoy University for fellow villagers and fellow Hokkiens in his native province of Fukian as well as schools for fellow Hokkiens in Singapore. See Landa and Salaff (1980, 1986 revised; chapter 11 of this book).

Interviews that I conducted with a number of Hokkien rubber dealers in Singapore and West Malaysia in 1969 revealed the importance of the role of kinship and ethnic ties as a basis for establishing mutual trust and the informal sanctions that operated to enforce contracts. One rubber dealer said:

> Because of the risks involved in advancing money without security, based purely on trust, we tend to trade with those whom we trust; they are often kinsmen, friends, people from the same place in China and those who speak the same dialect. Because of the longer association of Hokkiens with each other in the rubber industry, we find it easier to give credit to a fellow-Hokkien because there are ways of finding out the creditworthiness of that person—about his background, his associates, his ethical code and so on (Landa 1983, p. 90–91).

The "ethical code" refers to the traditional Confucian code of ethics which overseas Chinese in Singapore and Malaysia have adapted to their new homeland where the Chinese community as a whole constitute an ethnic minority amongst the Malay majority. Beyond the role of ethics embedded in particularistic exchange relations, social sanctions existed for punishing those who deliberately breach the trust of their trading partners: shaming a person, withdrawal of credit, and ostracism from the trading network (Landa 1981, 1988, pp. 83–84).

The following case which I obtained from an interview with a rubber dealer dramatically reveals a Chinese rubber dealer's attitude towards those who do not abide by the rules of the game of the group:

> Mr. X was sued by his creditors. He was unable to pay his debts. To make matters worse, he showed contempt and spite towards his creditors. Mr. Y, a creditor, was very angry with his debtor. He was on a business trip to Hong Kong but flew back to Singapore to attend the court case. The case was initiated by the whole group of creditors. Mr. Y said that the case involve only a few thousand dollars. But he was willing to pay for the trip back to Singapore and then return to Hong Kong to finish his business deal. The airfare plus lawyers' fees all added up to a significant amount. In fact he lost more money by prosecuting the debtor. But he did it simply because the debtor did not show respect for the principles of Chinese methods of conducting business. When he could not pay his debt, instead of attempting to remedy the situation, he worsened it by showing contempt for his creditors. Mr. Y said, "this man is not suitable to remain in the business community; he does not deserve cooperation or help from his colleagues" (Landa 1988, p. 94)

This case study provides an excellent example of prosocial behavior in the form of "altruistic punishment" (Fehr and Gächter 2002) in which an individual in an ethnic trading network is willing to punish another individual in the same network, at a cost to himself by ostracizing the offending party from the Chinese business network.

4.2 Chinese merchants in People's Republic of China (Landa 1998)

Since embarking on an ambitious program of economic reforms in 1978, the People's Republic of China (PRC) has enjoyed a degree of success in making the transition from a centrally-planned economy to a market-oriented economy. The major economic reform took place in rural China with the introduction of the Household Responsibility System (HRS). The HRS decollectivized people's communes by reintroducing the family farm. Farmers, after fulfilling their government quota, have the right to sell their surplus in private markets where prices are higher. As a result of the HRS the number of rural and urban markets increased, and with it the emergence of a network of middlemen connecting rural with urban markets. Watson (1988) noted the existence of social and cultural ties between the newly emergent network of middlemen. I interpreted the existence of homogeneous particularistic network of middlemen as a response to the environment of contract uncertainty in PRC's transition to a market-oriented economy.

4.3 Indian merchants in India: the Jains-Marwari traders (Iyer 1999, Laidlaw 1995)

Iyer's (1999) paper outlines some fundamental features of dominant Indian merchant groups, focusing especially on the Jains-Marwari traders. The Indian merchant community as a whole belongs to the Vaishyas caste, one of the four hierarchically ranked Hindu castes in descending order of status: the Brahmins (priests), the Kshtrigas (warriors), the Vaishyas (traders), and the Sundras (peasants and laborers). Besides caste homogeneity, the Hindu merchant communities are subdivided into merchant groups according to their place of origin.

The dominant merchant communities are the Marwaris, traders who originated from Marwar in Northwest India, and the Gujaratis originating from Western India, including Bombay. Marwari merchant communities are further sub-divided into various smaller more tightly-knit homogeneous "jatis" (family descent), "the endogamous hereditary and named social groups. . ." (p. 104). "It is the *jati*. . .that clearly identifies the social group to which a particular merchant belongs. . .(p. 104). And it is the organization of the merchants into *jatis*, that led to the establishment of codes of conduct for each *jati*, which translates into strong sources of credit" (p. 107).

Furthermore, Marwari traders are united by a common religion, Jainism, a religion which "not unlike Buddhism, prescribes definite codes of conduct for monks and laities alike and the laity is expected to follow "lesser vows" comparable to the "great vows of the ascetic" (Iyer p. 106). An ascetic lifestyle, however, is not inconsistent with the accumulation of wealth, as Iyer (p. 106) explains: "The frugal Jain lifestyle and inner-worldly asceticism finds parallels with Weber's 'Protestant Ethic'." [See also Wilsons's (2004) discussion of the relationship between Jainism and Jain merchants]. And indeed, I might add: it is this "Protestant ethic" with its emphasis on asceticism together with the concept of "calling," that Weber used to develop this theory to explain why Protestants, and not Catholics, dominated entrepreneurial roles in Europe.

In India, wealthy merchants are also very religious: they contribute generously to donations to temples, social and other educational institutions (p. 106), This in turn increase their reputation in the merchant community. A merchant who has a good reputation is able to access informal financial credit and market information (p. 109). Wealthy Jains merchants dominate the emerald gem export market. They extend credit to each other, and use the *hundi,* a kind of promissory note whose use requires a great deal of trust. Loss of credit and reputation results if a dealer did not pay the debt in full and upon demand (Laidlaw 1995, p. 354; see also Wilson 2004).

A merchant family's good credit and reputation is also facilitated by good arranged marriage alliances (Laidlaw 1995, p. 335). The result of personalized exchanges, based on ties of *jati*, caste, locality and religion, among Jains-Marwari merchants is that, "Jain businessmen throughout India and beyond have consistently fit into particular commercial niches and making use of ready-made networks of credit and social relationships..." [(Iyer, p. 108 citing Dundas (1992, p. 169)].

4.4 Indian merchants in Central Africa (Dotson and Dotson 1968)

The largest single foreign ethnic group involved in the African trade as middlemen in the 1960s was the Indians. The Indians came from India to Africa through their early connections with Arabs and Portuguese, and especially with the British. Because of their historical ties with Britain, they are mostly found in British East and Central Africa (Rhodesia, Zambia and Malawi) than elsewhere in Africa.

The middleman role in Rhodesia, Zambia and Malawi is dominated by Hindu Indians coming from peasant families in the Gujarat region in India. The group is tightly knit, consisting of kinsmen bearing the surname Patel associated with the Patidar caste. There is a high degree of internal solidarity among the Patidar merchants not only because of the existence of kinship ties but also of caste ties. In India, members of Hindu society are born into a particular caste for which they have life-long membership and from which they cannot escape from their caste status. Each caste has its own values and norms. With no option to cross caste boundaries, this means that the Hindu caste code prescribes a high degree of mutual cooperation among caste members. Dotson and Dotson (p. 66) explain why Indians in Central Africa were successful in their middlemen roles: “The same culture provides them with a normative basis for effective social cooperation in small tightly knit kinship, caste and locality groups.”

The Gujarati Indians are especially prominent in the more profitable wholesale African trade where almost all sales are made on credit. How do they minimize credit default? Unlike the Europeans in Africa who resort to formal contracts in their business dealings, the Indians use the status of kinship, caste and religion in their dealings with each other to protect against credit risks. With increasing competition from African traders at the retail level, Indian wholesalers are prepared to do business with African retailers, but they fear the risks of credit default.

4.5 Indian traders in South Africa (Godsell 1991)

Godsell (1991) described the homogeneous network of Indian traders in South Africa where Indian entrepreneurs were mainly Muslims. Family, religious and friendship networks play an important role in Indian business success: Indian entrepreneurs obtained import/export contacts as well as start up capital from family, friends and co-religionists. The Indian businessman prefers to extend help, “first to a family member, second to a co-religionist, third to another Indian” (p. 87). Their success was due to the fact that “they were able to draw on their religious, family, and ethnic resources to overcome the obstacles placed in their way by legislative and social discrimination” (p. 89).

4.6 The Lebanese traders in West Africa (Dotson and Dotson 1975)

The Lebanese traders came to West Africa around 1900. Dotson and Dotson (1975, p. 589) comparing the Lebanese with the Indians, offer the following explanation of Lebanese merchant success:

> Although quite different in major ethnological characteristics, these two Oriental peoples were remarkably similar in those aspects of traditional culture and social structure that predisposed them to success in business. Both, for example, possessed a family system extended beyond the immediate "nuclear" unit of parents and dependent offspring. The extended family is conducive to successful business entrepreneurship in two ways. At the value level, the strong sense of obligation and family continuity inculcated by it helps to create and constantly reinforce the future orientation that we have described as a shopkeeping prerequisite. Organizationally, on the other hand, the small, tightly knit unit so created provides the foundation for co-operative action, capable of transcending the limitations of either the capital resources or the functional capabilities of single individuals. Particularly when initial resources are small, this capacity gives such a group tremendous competitive advantages over isolated individuals....Indians and Lebanese came from peasant villages, it is true; but as Orientals they also came from societies in which commerce and trade were anciently established and well-understood in principle, even by their peasant populations.

4.7 Jewish merchants in medieval Europe and elsewhere

4.7.1 Jewish merchants in medieval Europe (Zenner 1983)

Jews played a prominent role as merchants in long-distance Mediterranean trade in the Commercial Revolution of the Middle Ages, 950–1350. In the long-distance trading networks, Jews played an indispensable role in the medieval city-state of Venice, linking the Italian merchants with other foreign merchants who came to Venice to trade during the heyday of the Venetian empire. According to Zenner (pp. 151–152) the medieval development of the Jews as a trading diaspora—a network of dispersed trading settlements—was made possible by the organization of trust over long distances:

> . . . long-distance trade centered around family firms and often ethnically and culturally homogeneous groups. Common ancestry, languages, and religion provided the basis for a moral community which could enforce ostracism (for example, boycott, ex-communication) when no common territory existed....

> The fact that such a moral community over long distances supports trade also reinforces the diaspora as a whole, since the survival of the group depends on having communications, distinctiveness, and a way of enforcing its norms over great distances. Being involved in an occupation with other members of one's group means that your livelihood depends on your fellow kinsmen and co-ethnics (co-religionists) and makes leaving the group more difficult.

4.7.2 Jews in Jerba, Tunisia (Udovitch and Valensi 1984)

By the first half of the eleventh century, Jews in Jerba emerged as a well-established community. They participated in the Commercial Revolution of the Mediterranean world: they were engaged in trade that extended from Spain through Tunisia and Sicily to Egypt and beyond to South Arabia and India. As part of the international network, they traded not only with co-religionists from Tunisia and Egypt but also with Italians from Amalfi, Genoa, and Venice who came to North Africa to trade.

Within Jerba, the Jews dominated two occupations, textiles and the jewelry trade. It is precisely in the jewelry trade, where mutual trust is crucial between exchange partners, that:

> . . .the clientalization of exchange does not cross ethnic boundaries but takes place between the Jewish producers in the Jara and their co-religionists merchant-distributors in the suq (p. 117).

Within the close-knit social and economic network, the mutual trust between the jewelers are based on Jewish cultural and legal traditions. The Jews, according to Udovitch and Valensi (p. 29), are "people of the law" and adhere strictly to the law. The same values of trust and integrity in business dealings among the jewelers, are also extended to economic transactions across religious boundaries in economic transactions with Muslims in the suq/market.

Furthermore, Udovitch and Valensi (p. 111) pointed out the multiple roles the Jerban Jewish jeweler played in the Jewish community:

> . . .individual jeweler fulfill several functions in different spheres simultaneously. A Jewish jeweler is not simply a jeweler; he may also be the head of a synagogue, a part-time scribe, the community circumciser, or a member of the burial society. In Jerba, possessing the skills to produce or sell jewelry is not enough to make one a jeweler. One has, first and foremost, to find a place within a closely knit social—even more than economic—network. Since similar rules govern other occupations, it is once again, according to ethnic, religious and communal affiliations that the division of labor operates and perpetuates.

4.7.3 Jews in present-day Antwerp, Amsterdam and New York (Gutwirth 1968)

The number of Jews living in Antwerp, Belgium in 1966 was estimated to be 10,500 out of a total population of 550,000. Antwerp, a major center of commerce and industry, is one of the largest ports in the world. About 80 % of the Jewish population dominated the diamond industry, import-export trade and in the occupation of cleaving (transforming rough diamond into brilliant ones). Diamond transactions require a great deal of trust on the part of dealers because of the need to constantly bargain and negotiate about the quality of diamonds transacted between buyers and sellers, and because of the opportunities for theft and fraud. This explains why the diamond trade:

> . . .takes place within a comparatively close and limited group: the participants (often linked by friendship) are formed into a loose type of association with its own codes and sets of rules to which they adhere. . . .Yiddish, a true lingua franca of the diamond community emphasizes the confidential nature of the economic arrangements (Gutwirth p. 133).

The group involved in the diamond trade and industry is a highly homogeneous religious group whose members speak the same language, Yiddish (Gutwirth p. 124). Within the group, there is a further specialization and division of labor along religious lines: the export trade is dominated by the less orthodox Jews, while the ultra-orthodox Hassidic Jews—identified by their long beards, sidelocks, gaberdines and fur hats—dominate the import/local diamond markets. Hassidic Jewish merchants in Antwerp, like the Jews in Jerba, played multiple roles in their community: They played an important role in maintaining Jewish cultural identity via dietary laws (*kashrut*) and other religious and ritual practices. Prominent members of the diamond trade and industry were often also the leaders of the various associations and cultural clubs whose functions include assisting immigrants from Central Europe into Antwerp, promoting *tsedake* (charity and solidarity as it was practiced in Central and Eastern Europe), as well as various cultural functions.

The same attributes of honesty and reliability in transactions explains why the diamond trade in Amsterdam and in New York is dominated by a close-knit group of Jews who conduct transactions among themselves without relying on the state for the enforcement of contracts. For more recent empirical studies of diamond merchants in New York, see Bernstein (1992), Richman (2006).[9]

5 Summary and conclusions

From the case studies of various successful merchant groups operating in underdeveloped countries and elsewhere in present-day Antwerp, Amsterdam and New York, we observe that these successful middleman groups share the following adaptive characteristics:

1. Middlemen belong to tightly-knit groups so that middleman exchange—with specialization and division of labor among middlemen—is characterized by personalistic exchange based on kinship, ethnic or religious ties. The greater the degree of trust involved in transactions, the more homogeneous and tightly knit the HMG becomes, e.g. the Yiddish-speaking Hassidic Jews dominate the diamond trade in Antwerp and in New York, while the very religious Jains-Marawari traders dominate the emerald gem trade.[10]
2. Kinship and ethnic ties, as well as shared social norms embedded in these HMGs serve as constraints on the behavior of group members, and hence functioned to provide members with club goods.
3. Wealthy members of the HMGs who are also leaders of their own ethnic communities, especially Chinese and Jewish merchants, played key roles in transmitting cultural values to future generations of merchants via their roles in promoting education, etc.

My empirical evidence on various HMGs—based on my own field work, and drawn from other scholars' historical and ethnographic studies—shows that not only the Chinese merchants in Southeast Asia have adapted themselves to the environment of under-development by forming an ethnically homogeneous middleman group, with shared Confucian social norms, so as to provide group members with club goods, but other trading groups occupying similar environment of underdevelopment in other parts of the world also converged on the same adaptive features. The formation of HMGs, with social/religious norms embedded in these kinship and particularistic trading networks, provide an important example of convergent cultural evolution, and hence demonstrating the power of multilevel evolutionary perspective for understanding homogeneous middleman groups functioning as adaptive units. The various case studies of HMGs in this chapter collectively demonstrate the existence and evidence of the importance of cultural group selection in human society.

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Endnotes

1. As (Wilson 2002, p. 133) so aptly puts it: "There are certain things in front of our faces, and our challenge is to discover the theoretical framework." The real life phenomena of HMGs in various parts of the world sharing the same traits in response to the same environment can be viewed afresh from the theoretical perspective of multilevel selection theory.
2. I thank David Sloan Wilson for sending me a galley proof copy of his book (Wilson 2002) prior to the book's publication.
3. Wilson identifies three mechanisms for achieving in-group cooperation: kinship, reciprocity, and social norms. For additional pathways to cooperation, see Hirshleifer (1999)
4. For an example of major transitions paradigm in evolutionary biology, see Michod (1997). Michod studies the transition in evolution from cells to multicellular organisms, saying that "the two issues considered are applicable to all major transitions in the units of evolution that share two themes: the emergence of cooperation and the regulation of conflict among the lower-level units, in this case cells" (p. 607). Michod says that "the major transitions in evolution are from individual genes to networks of genes, from gene networks to bacteria-like cells, from bacteria-like cells to eukaryotic cells with organelles, from cells to multicellular organisms, and from solitary organisms to societies" (p. 607).
5. For the bioeconomics of honeybee scouts using the unanimity voting rule for collective choice of a new nest, see Landa (1986)
6. For the bioeconomics literature on group selection, see Buchanan (2000), Rubin (2000), and Gifford Jr. (2000).
7. My chapter does not address biological group selection which, according to Field (2001, 2008), needs to be included in a comprehensive theory of human behavior.

8. The case studies not included in Landa (1988) are: Chinese merchants in People's Republic of China (Sect. 4.2); Indian merchants in India: the Jains-Marawari traders (Sect. 4.3), and Indian traders in South Africa (Section 4.5).
9. Even present day Jewish merchants engaged in diamond trade in Antwerp, Amsterdam, and New York are HMGs. It is not that the legal framework is not well-developed, but because Jews had a long history of dominance of the diamond trade, a monopoly due to their ability to enforce contracts among themselves in the days when contract law was not well-developed.
10. For many other HMGs in cross-cultural trade, see Curtin (1984).

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Chapter 13
Sows, Cows, and Coase: The Conflict of Cultures

I went into the garden; there I found Cross-patch and Suck-suck rooting up carrots. I whipped them myself and led them out by the ears.

—Beatrix Potter (1988, p. 14)

Starting a riot is as easy as killing a cow, or smearing pig's blood on a mosque.

—*The Globe and Mail* (January 24, 1989, p. A8)

1 Introduction

Coase 's (1960) seminal paper, "The Nature of Social Cost," provided a new conceptual framework for the analysis of the problem of social costs or externalities, which is different from the standard Pigovian/Pigouvian analysis. The so-called "Coase Theorem" states that given the initial assignment of property rights, parties to a dispute will make bargains or contracts with each other to exchange rights in order to internalize externalities, assuming there are zero transaction costs involved in the exchange of property rights, all rights are alienable, no legal barriers to contracting, and no wealth effects.[1] The ultimate result of exchange of rights (which maximizes the value of the product) is independent of the legal system. No government intervention via a system of Pigouvian taxes—after the British economist Arthur C. Pigou—or subsidies is necessary beyond the initial assignment and enforcement of rights. The Coase Theorem, with its zero transaction costs assumption, is relevant for situations involving two/small number of

I dedicate this chapter to the memory of Nobel Laureate Ronald H. Coase who passed way on September 2, 2013. The chapter is a slightly revised version of my paper entitled, "Sows, Cows, and Coase: The Tragedies of Cultures" (Landa 1989). See also Acknowledgements.

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parties to a dispute. Coase's contribution to the newly emerging law-and-economics literature is to direct economists' attention to the importance of *positive* transaction costs which makes bargaining difficult in the presence of *many* parties to a dispute, and the role of alternative non-market institutional arrangements—the firm, vertically integrated firm, government intervention in the form of Pigouvian taxes/subsidies, and even "doing nothing"—in coping with the problem of social costs. Because Coase placed great emphasis on his analysis of the nature of social costs in a world with positive transaction costs, I shall call this version as the "Coase Theorem-Version II" to differentiate itself from the standard Coase Theorem.[2] Both versions of the Coase Theorem implicitly assume the existence of a state with well-developed legal framework for the settlement of disputes of parties embedded in a culturally homogeneous population.

This chapter extends Coase's analysis of the problem of social costs to three new Coasean scenarios in non-Western cross-cultural contexts in which parties to a dispute belong to different cultural/ethnic groups: (a) "taboo" pigs trespassing across spatial and cultural boundaries in Siam Village in Kelantan; (b) pigs trespassing across spatial and tribal boundaries in stateless societies of New Guinea; and (c) trespassing water, flooding neighboring paddy plots in Siam Village.

I will show that in these three settings, Coasean bargaining did not occur even for the small numbers case when transaction costs are low. In the case of (a) and (c) this is due to the existence of inalienable religious rights which make Coasean bargaining impossible. In the case of (b), there is no market for the exchange of rights because in stateless tribal societies there is no overarching state to define and enforce property rights of parties to a dispute who belong to different tribal groups. Instead of Coasean bargaining, novel institutional arrangements and non-market, non-Coasean solutions such as violent self-help remedies like pig killing, the "kaiko" (a pig festival), "brokers of morality" are used to cope with the problem of social costs in cross-cultural contexts. The paper will provide law-and-economics explanations of the observed novel institutional arrangements and non-Coasean solutions for internalizing externalities.

The chapter is organized as follows. In Section 2, I describe Coasean scenarios of trespassing in Western and non-Western institutional settings, and present examples of how animal trespass disputes are resolved in Western and non-Western economies. I also examine the problem of water trespassing in a non-Western cross-cultural setting. In Section 3, I use the Calabresi-Melamed (1972) conceptual framework, as well as the extensions of their framework by James Buchanan (1973), to help me explain the existence of certain non-market/non-Coasean solutions and institutional arrangements for coping with the problem of social costs in cross-cultural settings. In Section 4, I provide an analysis of culture as an ethnic-specific asset, a public good from the perspective of group members and as a public bad from the perspective of outsiders, and how fundamental conflict of values between different cultural groups in so-called "plural societies" give rise to what I call the "tragedy/conflict of cultures." I argue that the "legal pluralism" paradigm used by law-and-society scholars provides a more suitable framework for analyzing the tragedy/conflict of cultures. Section 5 examine some theoretical and policy implications of trespass cases in cross-cultural contexts. Section 6 provide a brief summary and concluding remarks.

2 Coasean scenarios in various institutional settings

2.1 Animal trespass in western economies

In Great Britain, the landmark English water trespass case of *Rylands v Fletcher* (1866)[3] establish that owners of domestic cattle are strictly liable for property damage caused by their trespassing animals:

> The law as to them seems to be perfectly settled from early times; the owner must keep them in at his peril, or he will be answerable for the natural consequences of their escape; that with regard to tame beasts, for the grass they eat and trample upon....

The following is a newspaper account of a rather unusual English case involving trespassing cows in pursuit of a bull. The plaintiff sued his neighbor for $450, 000 in damages:

> Miss Wright owns a herd of cows and 50-year old Mr. Lloyd says his prize stud, *Pioneer Emperor Arab*, had to be destroyed after about 10 of Miss Wright's cows strayed into the bull's paddock. Anything other than platonic love was strictly a no-no for the 4-year old bull because he was still recovering from injuries received nine months earlier while mating. The strain proved too much for the convalescing beast and Mr. Lloyd said he had to destroy him two weeks later. The farmer is angry because he insists his bull could have serviced another 250,000 cows and that means a loss in stud fees of about $4-million. Miss Wright's lawyer recently told the court that Mr. Lloyd's figures were wrong and that in fact the bull was only of carcass value. The worried former school teacher insists her cattle would not do what Mr. Lloyd says they did. (*The Globe and Mail,* Aug. 1, 1980)

In Canada, the Ontario case of *Curtis v. Lyle* (1944)[4] involves a bull "running at large" (i.e. bull breaking down fence and trespassing on to neighbor's property) in pursuit of cows. The plaintiff owned a herd of thoroughbred, registered and certified Holstein bulls and heifers. In the spring of 1942 he placed eight young heifers out to pasture in his field. The defendant's large Durham bull broke down parts of the fence that separated the two neighbors' property, trespassed on to the plaintiff's field and impregnated the heifers. The plaintiff sued the defendant for damages sustained as a result of his heifers producing calves of a mixed pedigree. The court awarded the plaintiff damages amounting to $550 plus costs of action.[5]

The Ontario case of *Acker v. Kerr* (1973)[6] is a classic Coasian example of the conflict between a cattle owner and a farmer who grows crops. The plaintiff, residing in the Township of Proton in the County of Grey, sued the defendant for $2,650 in damages caused by defendant's cattle trespassing on to his property and destroying some of his crops in the years 1969–1971. Even though the plaintiff failed to keep his portion of the line fence in good repair, the court ruled that the defendant was strictly liable for the damages caused by the animals' trespass. The court awarded the plaintiff damages plus the costs of action, but reduced the amount of damages to $579.05.[7]

British Columbia's *Trespass Act*, dealing with animals straying into lands unprotected by a lawful fence, does not apply to swine which are absolutely prohibited from being at large.

In the United States, the evolution of California trespass laws between 1850–1876 has been described by Kenneth Vogel (1987). California trespass laws include: (a) fence laws that favor the rancher in that the rancher was given the right to allow his cattle to roam. To protect his crops from trespassing animals, the farmer either had to buy the right from the rancher/ranchers or he had to construct a "lawful fence," a standard set by the *Trespass Act* of 1850, to fence out animals. If he did not have such a lawful fence, as in the case of *Comerford v. Dupuy* (1861)[8] the plaintiff could not recover damages from the owner of trespassing animals; (b) trespass laws are liability rules in favor of the farmer, since the laws allow the farmer to recover expenses incurred while caring for an estrayed animal; (c) estray laws, in addition to those expenses allowed under trespass laws, gave the farmer the right to collect damages for lost crops and damages to the land. In the case of *Hahn v. Garratt* (1986),[9] the plaintiff was awarded crop damages caused by defendant's trespassing animals under an estray law applied to Santa Clara County; (d) pound and criminal laws also gave farmers some protection against trespassing animals, but they involve cumbersome procedures and contain various exceptions to the rule. Under the criminal laws, the ranchers are punished via fines for allowing their cattle to roam; but farmers are not compensated for the value of crop damaged; and (e) fence-in laws (enacted in the 1860s in response to high costs of fencing out trespassing animals, greatly encouraged the development of wheat farming in California).

In a study of how animal trespass disputes are settled in Shasta county, California, Robert Ellickson (1986) found that for open-range areas which give the rancher the right to allow his animals to roam, what actually governs the behavior of Shasta county ranchers and farmers are not legal norms but informal norms of cooperative neighborly behavior: i.e. the owner of livestock is responsible for the acts of his animals, and that a rancher should keep his animals from eating a neighbor's grass, regardless of whether the range is open or closed. The enforcement of this norm is made possible by the continuous ongoing relationship among the residents. As for deviants who do not conform to this overarching norm of neighborliness, there are measures for disciplining the deviants: (a) self-help such as negative gossip, threat of killing a trespassing animal—even though it is a crime in California; and violent self-help such as killing the trespassing animals; (b) complaints to public officials, who would use threats to caution repeat offenders, and especially complaining to his elected county supervisor—the person best situated to change stray-cattle liability rules; and (c) claims for monetary damages. Because of the norms of neighborliness observed by Shasta county residents, claims for monetary damages are very rare. "Although trespasses are very frequent, Shasta County's rural residents virtually never file formal trespass actions against one another" (Ellickson 1986, p. 681).

What emerge from the above descriptions of trespassing animals in certain Western institutional settings is the orderly way in which animal trespass disputes are settled, either through the formal legal system or through the informal norms of neighborliness.

2.2 Animal trespass in non-Western cross-cultural settings

Presented below are two scenarios of trespassing animals in non-Western cross-cultural settings. In both settings, the trespassing pig/sow holds center stage as the tragic hero or villain as the case may be.

2.2.1 Trespassing "taboo" pigs: Siam village in Kelantan

The setting is that of Siam Village, a tiny village in the state of Kelantan located in northeastern West Malaysia. The Thais, an ethnic minority, live in Siam Village surrounded by the indigenous Malay majority. The Thais raise pigs, not for their own consumption, but for sale to Chinese merchants who, in turn, sell pork to the Chinese living in Malaysia. Pig-raising by Siam Villagers lead to the destruction of garden crops by trespassing foraging pigs. Anthropologist Louis Golomb (1978, p. 141) described the reaction of Thai and Malay villagers to the problem of trespassing pigs in Siam Village:

> So serious are the pigs' incursion upon these crops, that many Siam Villagers have been dissuaded from cultivating them unless they have been able to construct especially sturdy fencing around their garden plots (pigs have a habit of digging their way under fences).
>
> Inevitably, pigs do stray onto neighboring Malay land; in particular, they are attracted to the manioc gardens of nearby Malay compounds. *When a pig is caught in Malay territory, and especially when it is destroying Malay property, it receives a beating from which it is not likely to survive*. [Italics mine]. When the owners of the erring swine discover its absence, they trace it to the spot where it has been slain and fetch the carcass home. The meat is then divided among friends and relatives. Never throughout this sequence do Thais and Malays exchange words about what has transpired. During fifteen months of 1973 and 1974, two Siam pigs died in this way. The Thai villagers, surprisingly, regarded both incidents as instances of bad luck and did not seem to harbor any vengeful feelings toward the Malays who had beaten their swine. There is a general belief among Siam Villagers that, if a person provide his pigs with enough feed, they will not stray out of their compounds in search of additional food. *It should be noted that stray cattle, sheep, goats, or fowl are never harmed by members of either village*. [Italics mine] There is, in fact, a law forbidding the destruction of stray animals, but Siam Villagers, as usual, prefer not to prosecute the offenders in those cases where pigs are involved.

Golomb explained the reason for pig-killing by Malays. Malays are Muslims who are forbidden by their Islamic religion to eat pork; beef is their main ritual food. In addition, Malays have an intense fear of personal contamination through contact with swine and the desecration of holy places by these animals. *Pigs are taboo* because they pollute and desecrate the environment. The presence of large numbers of foraging pigs had been a continuous source of inter-ethnic tension making the interspersion of Malay and Thai household plots non-feasible. "Pig beating, in a sense, has evolved as a bilaterally acceptable form of social justice which spares both groups from undesirable entanglements with authorities" (Golomb, p. 142).

2.2.2 Trespassing pigs and the "Kaiko": The Tsembaga in New Guinea

The next scenario, taken from results of anthropologist Roy Rappaport's (1968) fieldwork in 1963, involves the pig-loving Tsembaga people, a remote group of Maring tribesmen living in the Bismarch Mountains of Madang of the Australian-administered Territory of New Guinea. Pigs formed the most important form of domestic animals kept by Tsembaga.

To the tribes in New Guinea and the South Pacific Melanesian islands, pigs are holy animals that must be sacrificed to ancestors and eaten on all important occasions, such as marriages and funerals, to declare war and to make peace. As the pig population increases so does the incidence of pigs trespassing on to neighbors' gardens, resulting in serious disputes among neighboring peoples, the Tuguma group in New Guinea. Rappaport (p. 81) reported that six Tuguma pigs were shot and killed after having damaged gardens:

> Feelings run high after such killings; the owner of a slain pig is likely to make an attempt on the life of the garden owner, his wife, or of his pigs. If a peaceful settlement can be achieved the flesh of the slain animal is apportioned among the agnates of the two principals to the dispute, who may redistribute it to others. The owner of the slain pig is then supposed to repair the fence that the animal damaged in breaking into the garden, and the garden owner is supposed to present him with a piglet to replace the one killed. When this animal matures, it is killed and both parties to the dispute share its flesh evenly, according to informants.

The violent self-help remedy of "a-pig-for-a-pig," characteristic of intertribal conflicts in primitive societies, had produced the year-long pig-festival called the "kaiko," in which large numbers of pigs were slaughtered. Rappaport suggested that the "kaiko" was, in effect, a peace-making ritual to keep peace between the warring Maring groups.

2.2.3 Trespassing water in flooding Thai paddy plots: "We Thais don't raise water buffalos"

The largest area under wet rice cultivation in Malaysia in the 1960s was in Kelantan. Both Thais and Malays were engaged in wet rice cultivation. Siam Villagers raised only cows but not buffalos; their Malay neighbors raised buffalos. This appears puzzling since cows fear water and therefore cannot be used to plow or harrow deeply flooded paddies. Buffalos were used for harrowing rice paddies when the paddies were not deeply submerged. When paddies were deeply submerged, the more wealthy Malays hired tractors to plow their paddies. As Malays gradually adopt double-cropping wet rice technology, the new technology posed a problem for Thai Villagers. Golomb (pp. 179–180) explains:

> Interspersed Malay and Thai paddies are being planted on different growing schedules. Double-cropping necessitates the sowing of rice varieties with shorter growing seasons, whereas traditional, heavier single cropped varieties require as long as two or three additional months to mature. Since Siam Village plots constitute a minority of the cultivable land in the area, they

> are perforce affected by the prevailing irrigation conditions in adjacent Malay plots. Beginning in about 1972, certain Siam Villagers found that the level of the floodwater on their plots would thereafter be dictated by the irrigational needs of neighboring Malay paddies, which were in different stages of maturity. One consequence of the conflicting schedules was the increased flooding of many Thai plots at the traditional plowing time. The upshot was a new need for buffalo power in the harrowing of the more deeply flooded plots. By mid-1974 eight Siam Village households were hiring Malays to harrow plots which had formerly been harrowed with Siam Village oxen. This number was expected to increase as all surrounding Malay paddy was adapted to the double-cropping schedule.

Golomb observed that up to 1974, throughout all these agricultural changes, no Siam Villager has seriously considered buying a buffalo. If they needed buffalos, they will hire them from Malays. One Siam Villager was even observed to harrow his plots by hand with a hoe, a most unpractical method, rather than depend on Malay buffalos. Golomb (p. 175) explained why "We Thais don't raise water buffalos": *the evolution of informal prohibition on raising water buffalos was the result of Thais' conscious use of cows to culturally differentiate themselves from the Malays. Both pig-raising and cow-raising serve as Thai boundary markers.* [Italics mine]

3 Trespassing pigs and water in non-Western cross-cultural settings: A law-and-economics analysis

3.1 "Taboo" pigs, entitlements, externalities, and transaction costs

I analyze the problem of externalities involving "taboo" trespassing pigs in cross-cultural contexts with the help of the legal conceptual framework developed by Calabresi and Melamed (1972), a framework which extends the Coase theorem involving many parties to a dispute to include the problems of free-loading/free-riding and hold-out problems not discussed by Coase (1960).

Calabresi and Melamed developed a taxonomy of rights or entitlements protected by a property rule or a liability rule where for the cattle raiser and the farmer, there are four possibilities: (1) if the cattle-raiser's entitlement to allow his animals to roam is protected by a property rule, the cattle-raiser may allow his cattle to destroy crops unless the farmer gives him acceptable compensation not to allow him to destroy crops; (2) if the cattle-raiser's entitlement to allow his cattle to roam is protected by a liability rule, the cattle-raiser may be enjoined through action by a farmer, but the cattle-raiser must be compensated; (3) if the farmer's entitlement to crops is protected by a property rule, the cattle-raiser cannot allow his animals to stray unless he obtains permission or offers acceptable payment to the farmer; and (4) if the farmer's entitlement to be free of trespassing animals is protected by a liability rule, the cattle-raiser may be sued for damages but not enjoined. Where the number of parties involved in an externality relationship is large, Calabresi-Melamed argue that the Coase bargaining solution breaks down because of the free-loader/free-rider and the holdout problem.

Economist James Buchanan (1973) further extended the Calabresi-Melamed framework by showing that for two possible property rights assignments protected by property rule: (1) cattle raisers have legal rights to allow cattle to stray/cattle raisers' entitlements protected by a property rule; and (2) cattle raisers have no rights in croplands /farmer's entitlement is protected by a property rule—there are eight possible institutional settings which can be arranged in a four-by two matrix arrangement. See Figure 13.1. Buchanan showed that inefficient results occur in Cells III and VII due to the to free-rider problem, and in Cells IV and Cell VII due to the holdout problem. Both the free-rider and the hold-out problems can be overcome if many farmers form themselves into a coalition and bargain as a single unit with the cattle raiser/cattle raisers. I shall adapt and extend Buchanan's analysis to the case of taboo trespassing pigs in cross-cultural settings. See the same Figure 13.1 where I have added "Pig raiser/raisers" and Cells labeled IA to VIIIA.

Of critical importance to my analysis of trespassing pigs in non-Western cross-cultural settings is the notion that there is not just one but *two* potential sources of externalities. The first potential source of externalities is the usual one associated with crop damage. The second source of externality which I identify is novel, and is associated with the *taboo nature of the pig* viewed from the perspective of the Malay crop farmer. "Taboo" is an English word which is derived from the Polynesian word "*tabu*" meaning *"forbidden."* Anthropologist Mary Douglas (1966) have analyzed the concept of taboo in terms of the concepts of ritual pollution and defilement.

For my purposes, I argue that pig contact with the Malay farmer's crops/ land give rise to "pig pollution" and hence impose "defilement costs" on the farmer. *These defilement costs consists of purely subjective costs which can neither be quantified nor monetized since there is no market for the buying or selling of the inalienable right to practice religious beliefs, a priceless good.* As shall be seen, the existence of pig-pollution externalities critically change the outcomes summarized in Figure 13.1 in Cells IA through VIIIA.

	Cattle/Pig Raisers have Legal Rights to allow Animals to Stray	Cattle/Pig Raisers have No Rights in Cropland
One Cattle/ Pig Raiser One Farmer	I Bilateral bargaining toward efficient allocation	II Bilateral bargaining toward efficient allocation
	IA No bargaining predicted due to extortion	IIA No bargaining; inability to compensate farmer for pig pollution damage
One Cattle/ Pig Raiser Many Farmers	III Inefficient results due to freeriding among farmers	IV Inefficient results due to holdout power
	IIIA No bargaining; free–rider problem	IVA No bargaining; holdout problem by each farmer
Many Cattle/ Pig Raisers One Farmer	V Efficient results with minor bargaining costs under perfect competition	VI Efficient results with bargaining costs under perfect competition
	VA No bargaining; due to extortion by pig raisers	VIA No bargaining; inability to compensate farmer for pig pollution
Many Cattle/ Pig Raisers Many Farmers	VII Inefficient results due to free–rider problem	VIII Inefficient results due to holdout power
	VIIA No bargaining; free–rider problem	VIIIA No bargaining; holdout problem

Fig. 13.1 Entitlements protected by property rule (Source: Adapted from James M. Buchanan (1973, p. 71)

Attention is directed to results in Cells IA, IIA, VA, and VIA since these results differ critically from the results depicted by Buchanan summarized in Cells I through VIII:

(1) Cell IA. The Malay farmer must offer acceptable compensation to the Thai pig-raiser. Because the Thai pig-raiser knows the revulsion of the Malay farmer to pig pollution, there is an incentive for him to extort exorbitant sums of money from the Malay farmer as compensation for reducing the size of his pig herd. In fact, knowing that he must be offered compensation, the Thai pig-raiser can threaten to increase the

size of the pig herd if he does not receive acceptable compensation. The possibilities of extortion and blackmail rule out the classic Coasean bargaining solution.[10]

(2) Cell IIA. The pig raiser must buy the right, to allow his pigs to stray, from the Malay crop farmer. The Thai pig-raiser and the Malay farmer will have different *subjective* estimates of the amount of compensation required. When subjective estimates of the amount of compensation differ, bilateral bargaining will likely not occur to internalize the externality.[11] The Malay crop farmer has a reservation price for permitting pig-pollution and unless the Thai pig raiser pays him a sum exceeding the Malay crop farmer's reservation price, mutual bargaining will fail. For example, since the Thai pig-raiser does not know the reservation price of the Malay crop farmer, the offer might well be rejected by the latter as below the reservation price. And even if the offer is above the reservation price, the Malay crop farmer may still reject the offer and ask for much more than his reservation price since he knows that the Thai pig raiser does not know his true reservation price.

(3) Cell VA. No bargaining outcome is predicted in this case, because the many Thai pig-raisers could engage in extortion and demand exorbitant amount of compensation from the Malay farmer.

(4) Cell VIA. No bargaining is predicted to occur where the Malay farmer could ask for exorbitant sums of money which is much more than his true reservation price to compensate him for crop damage plus defilement costs.

Furthermore, even if many farmers depicted in Cells IIIA, IVA, VIIA and VIIIA form a coalition to bargain with the pig raiser/raisers, no bargaining would occur. The scenario involving taboo trespassing pigs is critically different from the standard Coasean/Calabresi-Melamed/Buchanan scenario involving non-taboo trespassing animals.

Would a shift from a property rights assignment protected by a property rule to one protected by liability rule facilitate Malay-Thai Coasean bargaining in the internalization of externalities? As Calabresi-Melamed and others have argued, a shift from property rules to liability rules would overcome the free-rider, holdout, and extortion problems.[12] Consider two legal regimes in which entitlements are protected by liability rules: (a) pig-raiser's entitlement to allow his pig to roam is protected by a liability rule; here the farmer can get an injunction to stop pig-raiser's pigs from straying but farmer must pay compensation to the pig-raiser, the amount to be determined by a third party. In the context of rural West Malaysia, the third party is usually the village *penghulu*, a Malay official; and (b) farmer's entitlement to his croplands is protected by a liability rule. In this case, the farmer can sue the pig-raiser for damages but not enjoin the cattle-raiser; the amount of damages is usually determined by the village *penghulu*. For these two possible property rights assignments protected by a liability rule, there are also eight possible institutional settings which can be arranged in a four-by-two matrix arrangements. The results are summarized in Figure 13.2.

(1) Cell I. Whatever amount that is assessed by the village *penghulu* against the Malay crop farmer is likely to be deemed "too much" by the Malay farmer who probably reasons that social justice requires a legal regime that protects the Muslim-Malays' entitlement to be free of pig pollution especially since they are the "sons of the soil" and therefore should not have to bargain with minority immigrant communities who bring with them their foreign/alien cultural habits like pig-raising that interfere with Malay traditional land use patterns. Once we take into account unequal historical starting points, as well as the fact that the law is not neutral with respect to initial entitlements to be free from certain harmful activities, the Coasean reciprocal externalities/causation argument is

	Pig raiser's entitlement to allow cattle to roam	Farmer's entitlement to croplands
One Pig–Raiser One Farmer	I Farmer feels amount assessed "too much"	II Pig–reiser feels amount assessed "too much"; farmers feels "too little"
One Pig–Raiser Many Farmers	III Farmers feel amount assessed "too much"	IV "free–floating fear" by potential victims
Many Pig–Raisers One Farmer	V Farmer may vote–with–the feet	VI situation like that depicted in cell II; but with increased transaction costs
Many Pig–Raisers Many Farmers	VII situation like those depicted in cell III; but with increased transaction costs	VIII "free–floating fear" by potential victims is accentuated

Fig. 13.2 Entitlements protected by liability rules

no longer valid. In that case, what will most likely govern the behavior of both Malays and the Thais is an informal norm that puts the burden on owners of pigs to restrain their pigs from trespassing.

(2) Cell II. In this case, farmer can sue for damages, the amount of damages to be set by a third party. Whatever this third party—the *penghulu*—assesses against the pig-raiser is likely to be deemed to be "too much" by the pig raiser (whose subjective estimates of defilement costs will most likely differ from the Malay farmer), and deemed "too little" by the Malay farmer.

(3) Cell III. In this case, Malay farmers may feel that whatever the *penghulu* assess is "too much," as in our arguments for Cell I.

(4) Cell IV. In addition to the problem discussed in Cell II, there is a new problem. What about all those other Malay farmers who have not being invaded by trespassing pigs but are fearful and anxious? Who will compensate the potential victims for such "free-floating anxiety/fear" (Nozick 1974, p. 68)?[13]

(5) Cell V. The situation is like Cell I, only worse since the Malay farmer has to take account of a legal regime which requires him—a "son of the soil"—to pay compensation to the many Thai pigs-raisers in order to induce them to reduce the size of the pig-herds. The costs of doing so may be greater than the benefits; in that case the Malay farmer may choose to "vote-with-the-feet" (Tiebout 1956) by moving away from pig-raising areas.

(6) Cell VI. The situation is similar to the result described in Cell II, with the additional problem of increased transaction costs of dealing with many pig-raisers.

(7) Cell VII. The situation is similar to the result depicted in Cell III, with the additional problem of increased transaction costs of dealing with many Thai pig-raisers.

(8) Cell VIII. The problem here is like the problem depicted in Cell IV, only worse since the problem of "free-floating" pig pollution fear is increased because of the presence of many pig-raisers.

Thus, even when entitlements are protected by liability rules, parties to a dispute involving taboo trespassing pigs are not satisfied with the outcomes of their attempts to bargain with each other indirectly via third party intervention. At the root of the problem here is that members of different culture groups do not perceive themselves as members of a single cultural or legal community and hence cannot agree that there is a single person to adjudicate disputes that parties to a dispute are prepared to agree is neutral or unbiased. For example, Thai crop farmers will always feel that the

Malay penghulu is inherently biased in favor of Malay crop raisers even if the *penghulu* is a man of integrity.

An even greater difficulty arises when one of the parties to a pig trespass dispute is not allowed to bargain with the pig-raiser with respect to the reduction in the size of the pig herd because of the *inalienable right of a Malay to be free of pig pollution*. In the Calabresi-Melamed article, the authors discussed the concept of entitlements protected by an inalienable rule, i.e. "inalienable entitlements," e.g. a person cannot voluntarily sell himself or herself into slavery because such transactions are legally prohibited by society. Nicolas Tideman (1972) suggests that one way of looking at the concept of an inalienable entitlement is that it is a collectively administered entitlement in which a change in the entitlement requires a collective decision by the group involved. In the context of Malays' inalienable entitlement to be free of pig pollution, it is hard to imagine how a fundamental religious norm of pig-avoidance can be changed. In fact, fundamental religious norms cannot be modified at any group level, including the highest, without serious risks of creating schisms in the faith. The right to be free of pig-pollution is a fundamental religious norm observed by Muslims all over the world. Thus there is no relevant decision making-group for the Malay crop farmers at any level with respect to a change in the entitlement—it is an inalienable entitlement. Under these circumstances, the informal norm of pig-killing by Malays, a violent self-help remedy, is equivalent to a fine or a Pigouvian (I shall call it "Pigtabuvian") tax—which Malay farmers impose on Thai pig-raisers to deter future pig trespassing since Malay farmers are not compensated for costs of crop damage nor of pig-pollution. Unilateral pig-killing appears to be an equitable as well as a stable solution in the game-theoretic sense because it is tacitly accepted by both Thai pig-raisers and Malay crop farmers for coping with the problems of measurable as well as non-measurable social costs of pig trespassing across spatial and cultural boundaries.

Unilateral pig-killing may also be an "efficient solution," given the institutional context in which prohibitive transaction costs in the form of costs of ostracism—are imposed by Malays on those fellow-Malays who would consider bargaining with the "heathen" pig-raisers for the internalization of externalities. The concept of transaction costs is central to Coase's analysis of the nature of social cost and alternative institutions for minimizing these costs. Transaction costs refer to the usual species of costs associated with searching for price/trading partners, negotiating and enforcing contracts. In the context of taboo trespassing pigs, it is inappropriate to refer to the costs of ostracism as a species of transaction costs even though it is a source of costs, hitherto not identified, that causes Coasean bargaining to break down. It should be emphasized that the concept of efficiency can only be discussed in a meaningful way within the set of feasible institutional settings. That is, the violent self-help, nonmarket method of unilateral pig killing is not a first-best optimum because a first-best optimum (a Coasean bargaining solution) does not exist within the possible set of institutions in our cross-cultural context. It is, however, the most efficient solution, given the cultural-institutional constraints.

In Western societies, the only time that the law permits violent self-help remedies such as shooting or poisoning trespassing pigs is when the pigs are dangerous or vicious. Vicious pigs come under the law of trespass with respect to dangerous animals. The owner of a dead vicious pig has no right to claim compensation for the dead pig from the pig-killer. In her analysis of trespassing vicious hogs, Susan Rose-Ackerman (1989) asks the question:

> "Does a hog have to act like a psychopathic killer before you can kill him in 'self-defence,' or is it sufficient for him to snarl at you or act belligerently, for example, keeping you a prisoner in your outhouse (p. 35)?"

An answer to the question, which flows directly from our analysis of trespassing taboo pigs is: "If you are a Muslim, you are entitled to kill the pig/hog in self-defense, even if the pig is docile, because a *taboo pig* is by its very nature *inherently vicious*."

3.2 Trespassing pigs in stateless societies and the institution of "Kaiko"

A crucial assumption underlying the "Coase Theorem" is that rights of parties are well-defined, and that the state exists to assign initial rights and to enforce exchange of rights. In stateless societies in New Guinea and South Pacific Melanesian islands, however, rights of parties to an externality relationship do not exist where the parties concerned belong to different tribes. Without a state to assign rights and to enforce the exchange of rights for all members, it is impossible for the members of the *different* Tsembaga and Tugma tribes to engage in Coasean bargain regarding trespassing pigs. To deter future pig trespassing, these tribes adopted "a pig-for-a-pig" violent self-help remedy typical of clan/tribal-based stateless societies, to resolve the problem of crop damage arising from trespassing pigs. Since much of tribal land is communally owned, a vengeance against a wrong such as pig trespassing is a collective responsibility.[14] Inter-tribal wars in primitive stateless societies are thus costly. The evolution of the novel institution, the "kaiko," the year-long pig slaughter festival, may be interpreted as a non-market institutional arrangement which emerged in primitive stateless societies to cope with the problem of crop damage caused by trespassing pigs and to reduce the costs of inter-tribal warfare.[15]

3.3 Trespassing water, technological involution and cultural prohibition on the use of water buffalo technology

In tort law, the landmark case of *Fletcher v. Rylands* (1866)[16] views escaped water exactly the same way as escaped animals in that both damage the property of the adjourning landowner. Thus trespassing water can be analyzed using the same analytical framework we used for analyzing trespassing pigs.

The adoption of the new technology of double-cropping by Malay paddy farmers imposes negative externalities on Thai farmers because of water escaping from Malay paddy lands and flooding neighboring Thai paddy plots. If Malay farmers' right to flood Thai paddy fields is protected by a property rule, Thai farmers will have to bribe Malay farmers to stop flooding Thai paddy plots. However, the bargaining solution breaks down because of the problem of free-riding by many Thai farmers. If Thai paddy farmers' right to be free of flooding is protected by a property rule, then the bargaining solution will also breakdown because of the holdout problem by Thai farmers.

On the other hand, if Thai farmers' right to be free of flooding is protected by a liability rule, Thai farmers could ask for compensation from Malay paddy farmers for the purpose of buying a water buffalo/buffalos.

Externalities could thus be internalized if Thai farmers adopt the new water buffalo technology. Instead of responding to the water trespassing problem in this way via Coasean bargaining, Thai farmers' response manifest itself in what I call "technological involution"[17] a phenomenon which refers to the progressive complication of the same technological methods used for wet-rice cultivation by Thai farmers (e.g. a Thai farmer harrowing his rice fields by hand with the use of a hoe), rather than adopting new technology, to cope with the problem of flooding of paddy fields.[18] The cultivation of wet-rice continues by culturally prescribed ways—hence "We Thais don't raise water buffalos" (Golomb 1978, p. 175)—even though it is rational to adopt the new water buffalo technology by buying/raising water buffalos.

Thai cultural taboo against the raising of water buffalos has the same effects as Malay religious taboo against coming into contact with pigs. The Thai rice farmer's right to be free of water buffalo technology is an inalienable entitlement which is associated with his cultural/ethnic identity of being a Thai, with cow-raising as a symbol of Thai individual and group identity. See Carr and Landa (1983); chapter 6 of this volume. Furthermore, there is also the threat of ostracism—from the other members of the Thai community—of a Thai farmer who wants to adopt the water technology. This explains why it is that Thai farmers are observed to either adopt a "do-nothing" policy or "rent Malay water buffalo" policy with respect to the problem of social costs arising from trespassing water. The culture of a group is thus not neutral with respect to the choice of technological innovations for coping with the problem of social costs in multi-ethnic societies.

4 Culture as a public good/public bad, plural society, legal pluralism, and the "tragedy/conflict of cultures"

An ethnic group consists of members who share a common culture, fundamental moral values, play by the same rules of the game, and share similar set of symbols of identity (Barth 1969, p. 14–15). Members of an ethnic group form a moral community in which members trust each other more than they trust outsiders. Because of this, ethnic trading networks have evolved as institutional arrangements, alternative to contract law or the vertically integrated firm for economizing on the costs of enforcing contracts, hence facilitating ethnic middleman entrepreneurship (Landa 1981; Carr and Landa 1983; Cooter and Landa 1984). The culture of an ethnic group, including culturally-evolved norms of behavior, may be considered an ethnic-specific asset, a public good for group members (Landa 1988). To prevent outsiders from "passing" as insiders and free-riding on the benefits of group membership, ethnic boundary markers such as language, religion, dietary rules, rituals, dress, etc., are maintained over time. This may explain why for Thais and Malays in Kelantan, for example, "eating beef is part of being a Malay, just as eating pork is an outstanding emblem of Thai-ness" (Golomb 1978, p. 144), and why the Thais continued the practice of raising pigs, even when pig raising has been economically impractical for years: "pig's major importance derives not so much from its commercial or gastronomic merits, but rather from its role as a symbol of group allegiance for the local Thai villagers" (Golomb, p. 145). Similarly cow-raising is a symbol of Thai cultural/ethnic identity even though it is more efficient for Thai rice farmers to raise/buy buffalos. These symbols of ethnic group identity or ethnic markers act as boundary maintenance mechanisms, and as cultural barriers to entry to outsiders which play an important role in creating and maintaining the division of labor along ethnic lines, including the role of foreign ethnic middleman-entrepreneurship.

In a multi-ethnic society such as West Malaysia, where Europeans, Chinese, Indians, Thais, and. indigenous Malays live together, the culture of an ethnic group can become a public bad for members of another ethnic group. Cultural or religious prohibitions, while strengthening the group's identity, impose cultural barriers to Coasean bargaining in the form of costs of ostracism. Unilateral pig-killing by Malays in Siam Village of trespassing pigs, the tit-for-tat "a pig-for-a pig" killings by two different tribes in New Guinea, and the phenomenon of technological involution are manifestations of the "tragedy/conflict of cultures." Such a cross-cultural analysis of the institutional responses to the problem of social costs has not been analyzed in the existing law-and-economics literature, partly because of its "legal centralism" perspective. Implicit in the law-and-economics paradigm of the nature of social cost is the view that the state is the sole source and enforcer of rules, and rights/entitlements. This perspective, called "legal centralism" by law-and-society scholar Mark Galanter (1981), cannot take account of the realities of complex societies, and especially of "plural societies" and of stateless societies.

The concept of "plural society" was coined by John Furnival (1956), a British colonial administrator and writer, to describe a distinctive feature of tropical colonial societies of Southeast Asia: a multi-ethnic society with specialization and division of labor along ethnic lines. In such a plural society, each ethnic group "holds by its own ideas and ways. As individuals they meet, but only in the market-place in buying and selling" (p. 304). To anthropologist M. G. Smith (1960) the essence of the concept of plural society is "cultural pluralism"—the cultural incompatibility of wide cultural differences among the different segments of the plural society. Lacking common values, the different ethnic groups meet only in the marketplace.

It is clear that it is more appropriate to use the "legal pluralism" perspective developed by law-and-society scholars (Moore 1978; Galanter 1981; Arthurs 1985; Griffiths 1986) rather than the "legal centralism" perspective to examine the problem of social cost in cross-cultural contexts. The legal pluralism perspective emphasizes the fact that there is not just one legal order but several legal orders co-existing within the same society. Sally Moore (1978), for example, suggests that society consists of a series of "semi autonomous social fields" in which members interacting with each other on an on-going basis generate their own extralegal norms or rules for regulating the behavior of members. Thus, in the case of plural societies of Southeast Asia, we may consider the shared cultural norms embedded in the many ethnic/ religious communities, as well as the ethnically homogeneous trading networks as examples of semi-autonomous social fields. Because the social fields such as ethnic groups are semi-autonomous in the sense that they are not created by the state, the ethnic/religious groups and trading networks are also examples of "private orderings" (Galanter 1981; Williamson 1985, p. 9). Legal pluralism is thus a feature of all complex societies and especially of plural societies.

If one of the essential features of a plural society is the existence of private orderings within the same society, it is also true that the "cultural pluralism" aspect of a plural society emphasizes the sharp cleavages in value systems, i.e. the cultural incompatibility of the value system of the different segments of the plural societies. When the activities of members of one ethnic group impose externalities on members of another ethnic group, and when the interacting groups lack common shared values and overarching norms, the scene is set for "tragedy/conflict of cultures" which manifest itself in unilateral pig killing and tit-for tat "a pig-for-a-pig" killing scenarios.

Unilateral pig killing by Malays, in the context of cultural pluralism, serves an important signaling function to members of the Malay-Muslim community: the reaffirmation of its cultural/religious values, its group solidarity and group identity; in short, pig-killing serves as a boundary maintenance device. Pig-killing by Malays also reflect the outcome of the struggle of competing cultural norms in which the norms of the dominant Malay majority prevail over the norms of the Thai ethnic minority.[19]

5 Some theoretical and policy implications of trespassing in cross-cultural contexts

5.1 Theoretical implications for understanding present-day examples of conflict of cultures

If culture is viewed as a public good by members of a group, then group members will try to preserve the groups' cultural boundary markers—language, religion, dietary rules, etc. Any transaction across cultural boundaries—voluntary exchange or coerced exchange as in the case of taboo trespassing pigs and trespassing water—that could dilute or denigrate the group's culture will be met with emotional reactions ranging from resentment and anger to physical violence. Likewise, outsiders can easily stir up emotional reactions from members of another cultural group by attacking the group's symbols of identity. My analysis of trespassing pigs and trespassing water set in cross-cultural settings help us better understand the following present-day examples of the conflict of cultures:

5.1.1 "Israeli patients dies waiting for Arab heart"

> A Jewish man in Israel lay dying after failed heart surgery. The only way to save him was to find a new heart. There was a healthy organ available inside another dying patient at a hospital in East Jerusalem. But it was the heart of a Palestinian, a Muslim hit in the brain by a plastic bullet fired from an Israeli army rifle. The transplant never took place. (*The Toronto Star*, January 3, 1989, p. A3).

The Palestinian was shot when he joined the Arabs in the fight against West Bank and Gaza Strip. For Muslims, it is considered improper to give away an organ of a living man while his heart is still beating even though he may be brain-dead. The Jewish man's family offered more than $500,000 for the heart. But the dying man's father said, "From a human standpoint, it was possible to consider giving the heart. . . . But after the solders shot him, we could not give the heart up" (p. A8).

5.1.2 "Dead cow arouses sectarian anger"

> They found a dead cow lying in a park near Sultanpuri Road last Friday morning. No one really know how the cow had died, but it wasn't long until an angry crowd gathered and word of the "incident" began to spread.
>
> A dead cow is an emotional matter in India, where the gentle beasts are sacred to Hindus. A truck driver who accidently hits one on the highway had better keep rolling, because he may be a dead man if he stops to investigate. (*The Globe and Mail*, January 24, 1989, p. A8).

An angry crowd believed that Moslems had killed the cow and dumped its body in this strategic spot. But what really happened was that the owner of the cow had tied her to a tree. Pregnant and afraid she became entangled in the rope, toppled over and strangled herself. But communal incidents like this in India are routine. *"Starting a riot is as easy as killing a cow, or smearing pig's blood on a mosque* (p. A8). [Italics mine]

5.1.3 Salman Rushdie (1988) and the "Satanic Verses"

Rushdie's book contained a dream sequence in which Mohamed is portrayed as human and fallible and his wives' names are used to name prostitutes. Muslims feel that the book insults Islam and is blasphemous. As a consequence, the book had been banned and burned throughout the Islamic world. The author, born in Bombay (Mumbai) but schooled and settled in England, described himself as no longer an observant Muslim. Fundamentalist Muslims are generally intolerant of those outside of their faith, but are especially intolerant to outsiders who were once insiders. This resulted in Iran's Ayatollah Ruhollah Khomeini in 1989 issuing a "fatwā" ordering Muslims to kill Rushdie. Numerous attempted killings resulted from Muslim anger over the "blasphemous" novel. In response to the outpouring of strong emotions against him, Rushdie said:

> Powerful taboos have been erected. One may not discuss Mohammed as if he were human, with human virtues and weaknesses. One may not discuss the growth of Islam as a historical phenomenon, as an ideology born out of its time. These are the taboos against which *The Satanic Verses* has transgressed. . . . . it is for this breach and taboo that the novel is being anathematized, fulminated against and set alight (*The Toronto Star*, February 18, 1989).[19]

Rushdie has apologized to Muslims, angered by his novel, stating that "Living as we do in the world of many faiths, this experience has served to remind us that we must all be conscious of the sensibilities of others." (*The Toronto Star*, February 19, 1989, p. Al).

5.2 Theoretical implications for economic development and cultural change

If the culture of an ethnic group is viewed as an ethnic-specific asset then technology will be resisted if it threatens the distinctiveness of the group's culture and identity. This means that a technology which will internalize an externality will be likely to be adopted if it is culturally neutral. Since economic development depends upon, among other things, the introduction of new techniques of production, this implies that the rate of economic development also depends upon the rate of cultural change.

5.3 Some policy implications and solutions for ameliorating the conflict of cultures and the problem of technological involution

In the case of Thai-Malay interaction, strengthening the legal system by making Thai pig-raisers strictly liable for damages caused by trespassing pigs—both crop damage and damages for pig pollution—may provide the incentive for Thai pig-raisers to move away from Malay residential area or build fences strong enough to fence in pigs. Pig-raising as a Thai ethnic marker may be made so costly relative to the benefits that the Thais may, in the long run, be encouraged to abandon pig-raising altogether.

In the meantime, inter-racial tension arising from unilateral pig-killing by Malays is reduced by the existence of a novel institutional arrangement, the "brokers of morality" (Golomb 1978, p. 94). In their role as "heathens," the Thais facilitate the violation of local Islamic moral codes by scattered elements of the Malay Muslim community by accommodating Malay deviants (p. 103). Furthermore, as "brokers of mortality," rather than undermining Malay morality, "Siam Villagers actually help to safeguard it by isolating the transgressors and reducing intra-village conflict over moral issues" (p. 103).

As for the problem of social costs arising from flooding of Thai paddy fields by Malay rice farmers, it may be that the problem of technological involution associated with water buffalo technology can be solved by Thai farmers adopting alternative cost-effective and culturally-neutral ways of flood prevention—such as building dikes, digging ditches, etc.[20]

6 Summary and conclusions

In this chapter, I revisited Coase's analysis of cattle/animal trespassing in Western economies and extended his analysis to non-Western cross-cultural settings. I described several trespassing scenarios—pig trespassing and water trespassing—in Western and non-Western economies. I used the Calabresi-Melamed/Buchanan conceptual framework to explain trespassing animals/water from a cross-cultural perspective. My conclusions are:

(1) Where taboo pigs trespass onto a neighboring Malay's paddy field, no Coasean bargaining takes place between the Thai pig-raiser and the Malay rice farmer, even for the small-numbers case where transaction costs of bargaining are low. Instead the Malay rice farmer usually beats the pig, often to death to avoid crop damage and "pig pollution." This is because Malays have an alienable right to practice their religion, where contact with pigs is taboo. "Pig-killing" by a Malay rice farmer of a pig trespassing on to his land can be considered a "Pigtabuvian" tax imposed on the Thai pig-raiser. The Coase Theorem is not applicable in cross-cultural contexts involving taboo pigs.

(2) In the large numbers case, in which many Malay farmers—considering bargaining with the pig raiser for compensation for crop damage, and for "pig-pollution"—risk being ostracized from his fellow Muslim community. The costs of ostracism being very high, no bargaining occurs between many Malay farmers and the pig-raiser. The "Coase Theorem—Version II" also fails here, not because of high transaction costs,

but because of cultural barriers to bargaining, given the high costs of ostracism from one's own religious community. I identified a source of prohibitive costs, costs of ostracism, a new type of costs not hitherto identified in the Coasean literature on social costs, as well as a new barrier to Coasean bargaining beyond the free-rider and holdout barriers to bargaining identified by Calabresi and Melamed.

(3) In the water trespass case, I explained Thais adopting a policy of either "doing nothing" or renting Malay water buffalo to mitigate the effects of flooding of paddy fields, rather than buying and raising water buffalos because of Thais conscious policy of preserving their ethnic identity. Cows are Thais' symbol of identity, just as buffalos are Malays' symbol of identity.

The chapter's contribution to the law-and-economics/New Institutional Economics (NIE) literature on the problem of social costs is two-fold:

(1) It integrates the law-and-economics/NIE analysis of the problem of social costs with the law-and-society "legal pluralism" perspective, thus enabling us to better understand the phenomena of the tragedy/conflict of cultures in its various manifestations. In particular, the legal pluralism perspective enables us to understand the effects of the lack of shared values in a plural society and the resulting dramas such as unilateral pig-killings that serve to preserve and protect Malay-Muslim group norms and cultural boundaries.

(2) It focuses on a problem, hitherto generally ignored in the Coasean literature on social costs, namely that there are certain rights which are *inalienable* rights, priceless goods, for which Coasean bargaining is impossible. Malay inalienable right to be free of pig pollution is a dramatic cross-cultural example used in this chapter. But our analysis is more general in that there are many similar situations in all societies in which Coasean bargaining fails because there is no market for the exchange of inalienable rights. Thus, our explanations for the existence of novel institutional arrangements such as the "kaiko" and "brokers of morality" for ameliorating some of the effects of cross-cultural conflicts. Our explanations also provide a better understanding of the relationship between economic development and cultural change and the role of *institutions* and *technology* in internalizing externalities. Finally, my analysis of trespassing in cross-cultural contexts also provide a better understanding of some present-day examples of conflict of cultures, one dramatic example being the Salman Rushdie case. The other dramatic historical example is the May 13, 1969 deadly racial riots in Malaysia where Malays killed hundreds of Chinese; the proximate cause was the

political elections, reflecting the ultimate cause of the hate and envy of the Malays of the economic success of the Chinese in Malaysia.

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Endnotes

1. For surveys of the literature on various aspects of the "Coase Theorem," see Zerbe (1980), and Veljanvoski (1982). See also Hoffman and Spitzer (1982) for an extensive listing of the articles dealing with the "Coase Theorem."
2. This is the crystal clear massage that Coase (1988) wished to convey. Coase (1937) introduced the concept of "transaction costs" into economics.
3. *Rylands v. Fletcher*, [1866], L.R. 1 Exch. 265, affirmed (1868) L.R. 3 H.L. 330; a landmark English water trespass case.
4. *Curtis v. Lyle*, (1944), 0.W.N. 50
5. Damages were also awarded to plaintiffs in the Saskatchewan cases involving defendant's bull running at large and impregnating plaintiff's pure bred heifers: *Cousins v. Greaves*, [1920], 13 *Sask. L. R.* 443, and *Popowich v. Letweniuk*, [1972], 1 W.W.R. 641
6. *Acker v. Acker*, (1973), 2 OR (2d) 270 (Ont. Co. Ct).
7. The Sasketchewan case of *Dobrolowski v. Danyluk*, (1921), 2 W.W.R. 729; and the Alberta case of *Fladhamar v. Andrus* (1958), 13 D.L.R. (2d) 479, provides further examples of cases where the plaintiffs were awarded damages for crop destroyed by trespassing animals. But the common law rule imposing liability for animal trespass may be abrogated by municipality by-law where the owner of animals are lawfully entitled to allow their animals to run at large and not liable for any damages which his animals may do on adjourning property of the plaintiff. See the Saskatchewan case of *McKay v. Loucks* (1920), 13 Sask. L. R. 338
8. *Comerford v. Dupuy*, (1861),17 Cal. 308
9. *Hahn v. Garrett*, (1886), 69 Cal. 146
10. See e.g. Mumey (1971) and Demsetz (1972).

11. See Buchanan and Faith's (1981) Austrian/subjective analysis of the Coase Theorem.
12. See note 11.
13. Professor Mitchell Polinsky told me that there had been a move towards compensating potential victims of cancer for "fear of cancer" (personal communication, February 16, 1989).
14. For a discussion of the characteristic features of primitive societies, see Posner (1980). For a discussion of land as communal property in Papau New Guinea, see Trebilcock (1984).
15. For a discussion of primitive law and order, see Posner (1980). For a discussion of *Kula* gift exchange system as a way of achieving social order which, in turn, facilitates inter-tribal exchange in primitive societies, see Landa (1983).
16. See note 3.
17. I adapt this term from anthropologist Clifford Geertz (1963), who coined the term "agricultural involution" to describe the self-defeating process in which wet-rice cultivation becomes more and more labor intensive in response to increases in population. Geertz, in turn, borrowed the term "involution" from American anthropologist Alexander Goldenweiser who used the term to describe those culture patterns which, after having reached a certain pattern, nonetheless fail to transform themselves into a new pattern, but continue to develop by becoming internally more complicated.
18. I borrow the ideas in this paragraph from Friedman's (1989, p. 1594) discussion of trials as "boundary-maintaining" devices which help "cement social solidarity by redefining and proclaiming the norms."
19. We may consider the *Satanic Verses* as the "paper pig" polluting Islamic beliefs, the burning of the book as "killing" the paper pig, and the attempt to kill Rushdie as an attempt to kill the "real pig" behind the paper pig.
20. But it does not necessarily imply that the adoption of alternative culturally-neutral ways of flood prevention such as building dikes, digging ditches, etc. is not without potential problems. Dikes, ditches are local public goods, hence there is the free-rider problem associated with their provision and maintenance. For a discussion of the role of dikes in prevent flooding of neighboring property, see Rose-Ackerman (1989). For a discussion of the importance of dams, sluices, ditches, dikes in Japanese rice cultivation to ensure flooding of rice fields, see Ramseyer (1989).

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Chapter 14
The Law and Bioeconomics of Identity, Ethnic Cooperation and Conflict in Plural Societies of Southeast Asia: A Theory of Chinese Merchant Success

> As we write, there are many parts of the world where it is obvious to outsiders, and to many of the inhabitants, that almost everyone would be better off if they ceased to identify with subgroups—Muslim, Serb, or Croat; Tutsi or Hutu; Jew or Arab; Protestant or Catholic—and worked together for the common good. Yet a sufficient proportion of the population identify with one or other subgroup, rather than with the human population of the region as a whole, to make such co-operation impossible. Why?
>
> The clue is that group identity, and hence behaviour, is influenced by myth and ritual, as well as, and even to the exclusion of, rational self-interest... The obvious...[evolutionary explanation] is that human groups that could instil group loyalty into their members would be more successful, and so individuals in the group would transmit more of the genes that made group loyalty possible. But is such an explanation plausible?
>
> John Maynard Smith & Eörs Szathmary (1999, pp. 146–147)

1 Introduction

The ethnically homogeneous Chinese middleman group (EHMG) is ubiquitous in the economies of Southeast Asia. Their ubiquity in Southeast Asia prompted Furnivall (1948) to coin the term "plural society" to describe the pattern of specialization and division of labor along *racial/ethnic* lines.

The process Furnivall describes is illustrated by the large-scale Chinese immigration into British Malaya in response to the development of the rubber industry in the late nineteenth and early twentieth centuries. This

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created a classic Furnivallian plural society: *Europeans* were exporters of estate rubber, *Malays* were producers of smallholders' rubber, and the overseas *Chinese* were middlemen/merchants who linked the Malay rubber smallholders with the European exporters. The Chinese community itself was a plural society embedded within the larger multi-ethnic society: the *Hokkiens* dominated the middlemen roles in the marketing of smallholders' rubber, the *Teochews* dominated the production and marketing of pepper and gambier in the mid-nineteenth century, and the *Hakkas* dominated the pawnshops and Chinese medicinal shops.

Historically, Chinese middlemen success in Southeast Asian countries had generated tension and conflict between the Chinese and the indigenous population (the Malays). In Malaysia, ethnic conflict and violence reached its peak during the racial riots and violence by Malays against the Chinese on May 13, 1969. The prevailing Marxist theory of Chinese middlemen success contributed to the racial tension: Chinese middlemen were deemed exploiters of indigenous peoples and they were said to "fossilize" the indigenous population in their traditional peasant roles (Myint 1954). But the Marxist theory of Chinese middlemen success is fundamentally flawed because the theory does not explain how the Chinese were able to *appropriate the middleman role in the first place*. I developed an alternative theory of Chinese middleman success (Landa 1978), drawing on property rights-public choice theory, which is part of the New Institutional Economics (NIE). This chapter restates my theory of Chinese middlemen success by expanding my theory to incorporate concepts from cognitive science and evolutionary biology. The expanded theory can explain not only ethnic cooperation, but also ethnic conflict.

The chapter is divided into seven sections. Section 2 sketches William Glade's (1967) general framework for analyzing entrepreneurial emergence and combines it with Harvey Leibenstein's (1968) theory of N-entrepreneurship. Section 3 shows the analytical links between the concepts of N-entrepreneurship and "infrastructure" in the context of less-developed countries. I argue that members of the EHMG, through in-group cooperation by providing infrastructure for themselves, are able to gain a differential advantage over other competing ethnic groups in appropriating middleman roles for themselves. Section 4 links the concept of "infrastructure" in development economics with the concepts of institution and transaction costs in New Institutional Economics, and with Mary Douglas's (1986) concept of institution-as-classification system in cognitive anthropology. I argue that members of the EHMG, by providing the legal infrastructure for the enforcement of contracts, facilitate middleman-entrepreneurship by economizing on transaction costs associated with breach of contract. Section 5 provide some bioeconomic ideas of EHMG as a "cultural transmission unit" and as a unit of selection in the evolutionary biology approach to competition and the struggle for existence and scarce resources. Section 6 provides a discussion of the role of government in provision of infrastructure, designed to promote inter-ethnic harmony by increasing the supply of indigenous middleman entrepreneurship. Section 7 provides a summary and conclusion.

2 Glade's theory of entrepreneurial formation

Glade (1967) provides a useful general theoretical framework for analyzing the emergence of entrepreneurship in less developed countries. Glade suggests that a theory of entrepreneurial formation must take account of the demand and supply of entrepreneurship: (a) the role of opportunity structure, the exogenously determined structural or environmental factors such as technological change, population shifts, and shifts in demand, that determine the *demand* side of entrepreneurship; and (b) the conditions for opportunity appropriation: given an objective structure of opportunity, what are the factors that determine who will *perceive* and *appropriate* the opportunities. Glade suggests that the ability to exploit new opportunities will depend on entrepreneurs obtaining *all* key inputs and not just the conventional categories of inputs, such as land, labor and capital. These key inputs that may be critical to the emergence of entrepreneurship in less-developed countries include political connections, information networks, arrangements for protection of contracts, and capital-mobilizing mechanisms. Restated in terms of Leibenstein's (1968) theory of entrepreneurship, the conditions of opportunity appropriation depend on "N-entrepreneurship," i.e. the "gap-filling" or "input-completing" functions of entrepreneurship. According to Leibenstein (1968, pp. 73–75):

> . . .the activities necessary to operate or carry on an enterprise where not all the markets are well-established or clearly defined and/or in which the relevant parts of the production function are not completely known. In both cases, the entrepreneur coordinates activities that involve different markets; he is an inter-market operator. But in the case of N-entrepreneurship, not all the markets exist or operate perfectly and the entrepreneur, if he is to be successful, must fill in for the market deficiencies. . .. As we have defined the entrepreneur he is an individual or group of individuals with four major characteristics: he connects different markets, he is capable of making up for market deficiencies (gap-filling), he is an "input-completer," and he creates or expands time-binding input-transforming entities (i.e. firms).

The greater the prevalence of incomplete and imperfect markets, the greater the significance of N-entrepreneurship which includes the capacity to reduce risks and uncertainties associated with imperfect markets. Nathaniel Leff (1979, pp. 48–49) suggests that given the greater risks and uncertainties in less-developed countries that:

> . . .entrepreneurship in the less-developed countries is likely to involve more than the psychological capacity for perceiving an aggressive investment policy. The special conditions affecting risk and uncertainty, and the need to open new channels for factor mobilization and product supply are likely to impose additional requirements.

Expanding on Leff's statement suggests that a more complete theory of entrepreneurship in less-developed countries requires an integration of modern Austrian theory of entrepreneurship as developed by Israel Kirzner (1973) with the Glade-Leibenstein's theory of entrepreneurship. The Austrian theory of entrepreneurship assumes well-developed markets, consequently the subjective *ability to perceive opportunities* becomes the critical factor in entrepreneurial emergence. Thus, a subjective and objective theory of N-entrepreneurship in less-developed countries must take account of not only the important role of cognition, but also the ability of entrepreneurs to *efficiently* create the *objective* conditions for appropriation of opportunities for entrepreneurship. The ability of N-entrepreneurs to create the objective conditions for appropriation depends on entrepreneurs' ability to perform gap-filling roles to make up for market deficiencies. Since the infrastructure for facilitating the emergence of profit-seeking entrepreneurs is underdeveloped in less-developed countries, N-entrepreneurship in these countries crucially involves creating the requisite infrastructure essential for profit-seeking activities.

3 The EHMG as a club-like economic organization for provision of infrastructure in less developed countries

The concept of infrastructure, coined by development economists, is often used interchangeably with the concept of "social overhead capital." Albert Hirschman (1959) included law and order, education, public health, transportation, communications, power, water, irrigation, and drainage under the category of social overhead capital. Clifton Wharton (1967) provided a comprehensive typology of the components of agricultural infrastructure, which with slight modification, can be used to describe the components of marketing infrastructure for middlemen activities. In Wharton's typology there are three major categories. First, there is the capital intensive infrastructure which heavily involves reproducible capital for the provision of services such as: (a) transport facilities (roads, railroads, bridges, boats, airplanes, ports, docks, harbors); (b) storage facilities such as silos, warehouses, and go-downs; (c) processing facilities such as machinery, equipment, building, etc.; and (d) utilities such as electricity, gas, drinking water systems, etc. Second, there is the capital-extensive infrastructure in which the capital component is negligible such as: (a) statistical reporting services; (b) credit and financial institutions; and (c) insurance schemes for pooling risks. Third, there is the institutional infrastructure: the formal and informal institutions of a legal, political, and sociocultural nature.

Development economists have traditionally emphasized the first two components of infrastructure while neglecting the third component, with the significant exception of Kenneth Parsons (1967). Parsons, in commenting on Wharton's typology of infrastructures, emphasized the importance of the "institutional infrastructure" that Wharton listed but did not discuss. Parsons argued that the fundamental institutional problem is that of *law and order*: an economy must have a structure of rules that provide order. Thus, "the institutional infrastructure, the *institutions* basic to the structure of the economy, are the truly fundamental parts of the infrastructure" (Parsons 1967, pp. 144–145). But why is infrastructure in general, and the institutional infrastructure, in particular, so important to the efficient functioning of a decentralized exchange economy? Wharton's (1967, p. 109) broad definition of agriculture infrastructure provides an important clue:

> The physical capital and the institutions or organizations, both public and private, which provide economic services to and which have a significant effect, directly or indirectly, upon the economic functioning of the individual farm firm, but which are external to the separate, individual farm firm.

An essential aspect of infrastructure, then, is its *public good externalities* aspect. In public goods theory, law is a classic example of a pure public good, as Buchanan (1975, p. 111) states:

> It is not difficult to see that a legal structure confers benefits on all members of the community in most cases, benefits that stem from the order that is introduced. The appropriate comparison is with the anarchistic alternative which is, in the limit, characterized by a total absence of behavioral constraints.

In linking the writings of development economists with Buchanan's, I have shown the analytical links between the concept of infrastructure/institutional infrastructure in development economics, and the concept of public good externalities in public goods theory.[1]

In developed market economies, infrastructure is provided by a number of separate specialized institutions. For example: (1) the state provides the basic legal infrastructure of the decentralized market economy; (2) credit-supplying institutions such as banks and financial institutions provide capital; (3) credit-rating institutions provide information on the creditworthiness of the individual; and (4) insurance firms provide insurance against certain types of business risks. In less-developed economies, on the other hand, where the infrastructure is not well-developed, entrepreneurs in order to succeed must perform N-entrepreneurial/gap-filling roles by forming "club-like" organizational arrangements to provide themselves with infrastructure essential for profit-making entrepreneurship. The EHMG is precisely such an informal club-like organization for the provision of infrastructure for members of the group (Landa 1978). Within the structural organizational arrangement of the EHMG are located various institutional equivalents of specialized institutions for the provision of a number of local public goods: (1) The Confucian code of ethics, embedded in the EHMG, is the functional equivalent of modern contract law, that generates public good externalities by economizing on transaction costs of private protection of contracts; (2) the informal credit networks, made possible by the underlying collective trust of members in the EHMG, provide the functional equivalent of banks and financial institutions for the supply of credit, that economize on the opportunity costs of holding cash; and (3) the flexibility of creditor-debtor roles among Chinese middlemen in the EHMG provide a built-in insurance for reducing risks of bankruptcy.

The effects of the EHMG "club" provision of each of the three components of infrastructure can be treated analytically in the same manner as an improvement in technology in the traditional theory of production in reducing transaction costs for members of the EHMG. Emerging from the analysis of the EHMG is my central thesis of the success of Chinese middlemen (Landa 1978, p. 227):

> Chinese dominate middlemen roles without special barriers to entry other than arising from the organizational efficiency of the EHMG "club" organization in the provision of infrastructure/public good externalities, externalities that are *external* to firms in the Chinese middleman economy, but are *internalized* by Chinese middlemen via the networks of mutual aid and cooperation among middlemen. The result is the creation of an efficient (i.e. least cost) Chinese middleman economy.

It is the organizational efficiency of the EHMG that explains why the Chinese emerged in the role of middlemen in the first place. My theory of

Chinese middleman success emphasizes the importance of in-group co-operation among members of the EHMG—the subset of Hokkien-Chinese among the larger Chinese population consisting of five major Chinese dialect/ethnic groups (Hokkien, Teochew, Cantonese, Hakka, and Hainanese)—in providing for infrastructure in explaining why the Chinese middlemen are able to out-compete other ethnic groups to appropriate middleman roles for themselves. (More of this in Section 5.)

The next section, drawing on central concepts of institutions and transaction costs in New Institutional Economics (NIE), provides a deeper understanding of the EHMG as a club- like organization for the provision of institutional infrastructure for contract enforcement in less-developed countries.

4 The EHMG as an efficient club-like institutional arrangement for contract enforcement in less developed countries: NIE and cognitive-anthropological perspectives

"Institutions matter in economizing on transactions costs" is a central theme of New Institutional Economics (NIE), which comprises various sub-disciplines within economics such as law-and-economics, public choice theory, and the new economic history (Landa 1994, chapter 1; Williamson 1985, chapter 1; Eggertsson 1990, chapter 1). Ronald Coase's (1937) seminal article on the nature of the firm laid the foundations of the transaction cost approach that underlies the NIE. Institutions are rules, formal (e.g. contract law) or informal, for example, ethical codes, which constrain human behavior (North 1990, pp. 3–4). Transaction costs include all kinds of costs involved in economic transactions: search for information on prices, costs of negotiation and enforcement of contracts. I developed a theory of contract law as a public good that economizes on various types of transactions costs of private protection of contracts (Landa 1976). My theory of contract law is extended to less-developed countries where I developed a theory of EHMG as the functional equivalent of contract law in the enforcement of contracts (Landa 1981).

Under conditions of contract uncertainty where the legal infrastructure for contract enforcement is not well-developed, a rational trader will have the incentive to protect his contracts from breach by particularizing exchange relations on the basis of kinship or ethnicity. Chinese middlemen in Southeast Asia, for example, use an informal institution, the Confucian code of ethics that is embedded within the EHMG, to reduce contract-uncertainty.

Under conditions of contract uncertainty, Ego (e.g. a Hokkien-Chinese) will have the incentive to identify his potential trading partners who share the Confucian code of ethics because he cannot rely upon formal contract law for the enforcement of contracts. Ego will arm himself with a subjective "calculus of relations" (Fortes 1969) that establishes a discriminatory system of classifying all traders in a market into seven categories, corresponding to different "grades" of traders in descending order of trustworthiness: (1) kinsmen from the nuclear family; (2) distant kinsmen from the extended family; (3) clansmen; (4) fellow villagers; (5) people speaking the same dialect from the same province in China (for example, Hokkiens from Fukian province in China); (6) Chinese speaking a different dialect (Teochews, Cantonese, etc.); and (7) non-Chinese (Malays, Indians, Europeans).

The principle of classification for the Chinese in Southeast Asia is supplied by the informal institution of Confucian ethics (of mutual aid) that provided the typical middleman, Ego, with his "subjective" classification of all traders into seven categories. This is because the Confucian code of ethics prescribes differences in the patterns of mutual aid obligations between people with varying degrees of social distance within a well-defined social structure—near kinsmen, distant kinsmen in extended family, clansmen, fellow villagers, and people speaking the same dialect. Kinship relations within the family in which social distance is at a minimum are strong ties that involve the severest degree of constraints in dealings among kinsmen. Thus near kinsmen are thought to be the most trustworthy people with whom to trade. Because of the differences in institutional constraints, each of the five categories of members occupies a special place within the overall social structure of a specific Chinese ethnic community. This implies that different behaviorial patterns can be predicted for each of the five categories of traders: close kinsmen will be predicted to be the most reliable traders, while Hokkien-Chinese will be predicted to be the least reliable traders. Across the major racial boundary, Ego classify traders into two major categories: insiders and outsiders. Thus Ego's discriminatory system of classification of all trading partners into seven categories reflects the *content* and the *limits* of the Confucian code of ethics. In a connected marketing network, each individual trader's choice of trading partners along kinship or ethnic lines will result in the emergence of the macro-phenomenon of the EHMG. Any trader within the EHMG that violates the Confucian codes of ethics will be ostracized and excluded from future trading with members of the group. The EHMG turns out to be an efficient club-like organization that functions as an alternative to contract law for the protection of contracts in less-developed countries.

The Confucian code of ethics embedded within the EHMG, which economizes on transaction costs by promoting mutual trust among members, is thus an *ethnic-specific asset* (Landa 1988) which is a form of "social capital" (Coleman 1990, chapter 12; Landa 1988, p. 65). There is a universal tendency for all ethnic groups to develop a classification system based on kin, clan, village, and language/ethnic group that correlates with different degrees of trust. But the overseas Chinese had a greater incentive to use the Confucian code as a guide to behavior relative to the Chinese operating in China because the Chinese in Southeast Asia operated as a minority group in a plural society dominated by non-Chinese, who were frequently hostile to Chinese. The minority status of the foreign Chinese middlemen implies that they: (1) are better able to create and maintain an "optimal" club size for the monitoring of members' contract behavior since larger trading club size yields fewer benefits in terms of generating mutual trust among members of the EHMG (Carr and Landa 1983, Cooter and Landa 1984); and (2) the Chinese middlemen have the incentive to create and maintain an optimal club in terms of membership composition by keeping the group homogeneous by excluding outsiders and by erecting barriers to entry in the form of imposing food taboos/dietary restrictions on members and choosing hard to imitate traits such as race (Carr and Landa 1983, Landa 1991; see also La Croix 1989).

Carr and Landa (1983) generalized Landa's (1981) theory of the EHMG to other ethnic trading groups such as the East Indians in East Africa, the Syrians in West Africa, the Lebanese in North Africa, and the Jews in medieval Europe.[2] Like the Chinese in Southeast Asia, the East Indians in East Africa, the Syrians in West Africa, the Lebanese in North Africa, and the Jews in Europe and elsewhere all have their own ethnic/group specific norms of behavior embedded in their trading networks (Landa 1988).

In a more recent paper, I used anthropologist Mary Douglas's (1986) concept of institution-as-classification system to extend my theory of EHMG (Landa 1981) to incorporate ideas from cognitive anthropology (Landa 2002). Douglas criticized the "unsociological" weakness of rational choice approach to the analysis of institutions by arguing that institutions that promote cooperation and social solidarity need to be grounded by cognitive devices for individuals to be certain about the other person's strategies, and generate the necessary trust in the other individual's behavior (Douglas 1986, p. 55). For human discourse and cooperation to be possible, individuals have to agree on basic categories of thought. That, according to Douglas (1986, p. 55, 91), is provided by institutions that "confer identity" and "do the classifying." The first basis of classification by an individual is to distinguish between oneself and others (Douglas 1986, p. 62). Institutions classify individuals by providing "labels": "People have always been labeling each other, with the same consequence—labels stick" (p. 100); "persons realize their own identities and classify each other through community affiliation" (Douglas 102). By treating institutions in their dual roles as providing rules and as classificatory systems, I put my theory of EHMG (Landa 1981) firmly on rational choice *and* cognitive/classification foundations (Landa 2002).[3] Ego's subjective calculus of relations is, in fact, a cognitive device to economize on the limitations of memory by sorting/classifying all potential trading partners into a *limited* number of categories in terms of trustworthiness; the same classificatory system also provides the basis for a rational choice of trading partners.

5 The EHMG as a cultural transmission unit and as a unit of selection: a bioeconomics approach

5.1 The EHMG as a cultural transmission unit

The Confucian code of ethics, as stated earlier, can be viewed as an ethnic-specific asset of the Chinese middleman group. One consequence of the embeddedness of ethnic specific cultural norms (Confucian code of ethics) in the EHMG is that the capital-asset feature of informal cultural norms necessitates its maintenance and its transmission to future generations of the EHMG since members of the present group of Chinese middlemen will eventually all die. Drawing on the work of Robert Boyd and Peter Richerson (1980, 1985), I developed a theory of the EHMG as a cultural transmission unit (Landa 1991).

Boyd and Richerson argue that conventional sociobiological theory cannot explain the great diversity of human behavior among ethnic groups, even though genetic differences between such groups are relatively trivial; nor does it explain that much of human social behavior is culturally acquired. They argue that what is needed is an extension of conventional sociobiological theory to include cultural transmission of behavior. Their model, which includes both genetic and cultural transmission of behavior, is called a "dual inheritance theory" of genes and culture. In this theory, the concept of culture is crucial and is defined by Boyd & Richerson (1980, pp. 101–102) to be:

> …quite broadly as the transmission of the determinants of behavior from individual to individual, and thus from generation to generation, by social learning, imitation or some other similar process. From our point of view, the essence of culture is that it constitutes a second, supplementary system of inheritance.

The relative success of cultural transmission, defined as the inheritance of the determinants of behavior, depends on parents teaching their children, and children learning from or imitating the behavior of others (teachers, priests, etc.). Social learning causes the communication of cultural traits directly from individual to individual, so that culture is a “population-level phenomenon” (Boyd and Richerson 1980, p. 6). Cultural inheritance is important in the evolution of human behavior because of the costs of learning. If individuals have to discover the optimal local adaptive behavior by trial-and-error methods, and such methods involve significant costs, selection will provide short-cuts to learning. Cultural inheritance is adaptive precisely because it is such a short-cut. Individuals, embedded in a cultural population, can learn to adapt to local conditions with a much smaller investment in learning compared to what is required in an a-cultural population. Social learning can occur as a result of “direct bias,” that is, trial-and-error learning which can be costly. Where decision-making costs are likely to be high, the adoption of the following two rule-of-thumb methods for acquiring culture can be efficient: “frequency-dependent bias” (i.e. copying or imitating the everyday behavior of others) and “indirect bias” (i.e. imitating those who appear to be notably successful in a particular habitat).

I used the Boyd-Richerson theory to develop a theory of the EHMG as a cultural-transmission unit, via family learning, that helps the codes of ethics embedded in the EHMG to persist over time. Present members of the EHMG share the same cultural values, including the rules of the game, but they will eventually die and are replaced by new members. Since many of the Chinese family firms will be passed on to sons, social learning of the culture of the middleman group takes place through frequency-dependent bias—with sons copying the behavior of their fathers—without the need for costly trial-and-error learning. Since the enculturation process of social learning also goes on in the wider ethnic community of which the EHMG is a subgroup, new members of the EHMG will also inherit the cultural values of the group. The rules of the game and other cultural values promoting trustworthy behavioral patterns of the present generation of middlemen will be transmitted via social learning from one generation to the next. These cultural rules of the game, as ethnic-specific capital, which is inter-generationally transmitted, are thus maintained and preserved by the members of the EHMG over time at a low cost. Because of this, ethnocentrism of the members of the EHMG is reinforced under conditions of contract uncertainty where the legal infrastructure for the enforcement of contracts is not well-developed: those middlemen who are already in the EHMG will continue to prefer to choose new trading partners from the younger generation of the same ethnic group. Hence the practice of excluding outsiders is maintained.

5.2 The bioeconomics of group competition and group selection

The emergence of the phenomenon of the EHMG and its persistence over time is a manifestation of what evolutionary biologist Richard Alexander (1987) calls the "biology of moral systems." According to Alexander, "Moral systems are societies with rules" (p. 1); rules, as discussed earlier, consist of formal and informal rules (e.g. codes of behavior/social norms). Elsewhere, Alexander (p. 1) speaks of moral systems as systems of indirect reciprocity and provides a biological theory of moral systems:

> . . .the concepts of moral and ethical arise because of the conflict of interest, and that—at least up to now—moral systems have been designed to assist group members and *explicitly not to assist the members of other competing groups*. [Emphasis mine].

Alexander's evolutionary biology perspective of moral systems provides a new perspective of the role of social norms beyond that provided by New Institutional Economics perspective. Whereas New Institutional Economics views the role of social norms as performing a coordinating function which lower transaction costs of group members, central to Alexander's (1987, pp. 78–79) perspective is his emphasis on inter-group (between-group) competition, and the conflict of interest between groups that promotes within-group cooperation. Alexander (p. 79) argues that "humans alone play competitive group-against-group on a large and complex scale."

This new perspective from evolutionary biology, taken together with the New Institutional Economics perspective, has great potential for developing a bioeconomics[4] theory of ethnic cooperation and conflict in three ways. First, we link Alexander's biological perspective on moral systems with the concept of "group competition" developed by economist Jack Hirshleifer (1982). Second, group competition leads to the related concept of group selection and group selection theory that several biologists have attempted to resurrect in recent years. Thirdly, it leads to biologist Michael Ghiselin's (1995) view of Darwin's view of competition.

Hirshleifer (1982, p. 50), a founder of bioeconomics, emphasizes the concept of "group competition":

> On all levels of life, organisms have found it profitable to come together in patterns of cooperative association. But such cooperation is always secondary and contingent, in at least two respects: (1) in-group cooperation is only a

> means for more effectively and ruthlessly competing against outsiders, and (2) even within the group there will not be perfect parallelism of interest hence cooperation must generally be supported by sanctions. . .Efficiency, in this interpretation, is meaningful only as a measure of group strength or advantage relative to competing groups in the struggle for life and resources. . ..A totally universalistic measure of efficiency is pointless; we must draw the lines somewhere, at the boundary of "us" and "them."

Viewed from an evolutionary perspective, Hirshleifer's concept of group competition is crucial to our explanation of the emergence and persistence of the EHMG. In the ruthless, inter-ethnic struggle for profit opportunities, in-group members with efficient social structures and economic organizations for provision of infrastructure/public goods, including the institutional infrastructure for the low-cost enforcement of contracts, have a competitive advantage over other ethnic groups in appropriating and maintaining middleman-entrepreneurial roles for themselves.

By invoking the idea that members of an ethnic group, by providing public goods for themselves, are able to out-compete members of other ethnic groups, I am linking the concept of group competition with group selection theory, a theory which was first proposed by Darwin (1871). Evolutionary biologists argue that efficient populations will evolve because they have more offspring than inefficient populations. Group selection theory became a controversial topic in the 1960s and 1970s as evolutionary biologists (e.g. Williams 1966) argued that groups cannot be the units of biological selection because of free-riding by individuals within the group, and because group extinctions are too rare to generate evolutionary change. Williams therefore concluded that groups cannot be units of selection, and that the gene is the "fundamental unit of selection" because the gene is a replicator, an idea that is further developed by Dawkins (1976, 1982).

In the 1980s and 1990s, however, Boyd and Richerson (1980, 1985), David Sloan Wilson and Elliott Sober (1994), Joseph Soltis et al. (1995), and David Sloan Wilson (1998) have attempted to resurrect group selection theory. Boyd and Richerson introduced their "cultural group selection" variant of group selection theory. According to Soltis et al. (1995, p. 474) :

> Cultural group selection is analogous to genetic selection but acts on cultural rather than genetic differences between groups. This distinction is important. We will argue that cultural variation is more prone to group selection than genetic variation and that this may explain why human societies, in contrast to those of other animals, are frequently cooperative on scales far larger than kin groups.

In the functional interdependence of a culturally homogeneous (Chinese) middleman trading network, the in-group cooperation of members of the

EHMG, a group larger than the kinship group, made possible the provision of public goods which benefited members of the EHMG. Thus Chinese merchants were able to out-compete indigenous populations for the role of middleman-entrepreneurs. In my cultural group selection theory of Chinese middleman-entrepreneurial success, the EHMG is seen as the unit of selection

Sober and Wilson's (1998) book, *Unto others: the evolution and psychology of unselfish behavior*, is an attempt to resurrect group selection theory. The authors argue (Chapter 4) that humans can choose those with whom they wish to cooperate. So discriminating altruists will choose other altruists and the resulting assertive interaction is a mechanism for the evolution of altruism of the group. The group of like-minded altruists in the group will punish those members who do not cooperate. This kind of conscious choice of cooperating partners on the basis of individual and group identity, and the punishment meted out to those who violate the norms of the group, is exactly the same kind of behavior exhibited by Chinese merchants in Southeast Asia.

Sober and Wilson (chapter 5), in a survey of a randomly selected sample of twenty-five societies, found that social norms existed in most of these societies. These social norms played an important role in homogenizing behavior of members, so that norms can be enforced by members at low cost. The existence of social norms limits the benefits of free-loading/free-riding behavior, thus limiting within-group competition. This ensured the success of the group as an adaptive unit, i.e. functionally designed to maximize the members fitness relative to other groups, thus allowing one group to out-compete another in between-group interactions. In other words, "social norms function to keep the group together and that if norms fail, the group will dissolve and be replaced by other groups, with a more robust social structure" (p. 173).[5]

Finally, modern evolutionary biology can provide further insights into the bioeconomics of the emergence and persistence of the EHMGs in less-developed countries. According to Ghiselin's (1995, p. 1034) interpretation of Darwin's view of competition:

> Darwin tended to conceptualize evolutionary change in terms of what might be called "competition push" rather than "opportunity pull." It is clear that he had both possibilities in mind. On the one hand, organisms in a saturated environment would gain more resources if they utilized them more efficiently than their competitors. On the other hand, the very availability of underutilized resources would create a kind of ecological vacuum which might favor those individuals that could take advantage of them.

However, Ghiselin prefers to view competition not in terms of a stronger species "wedging" out another weaker species but in terms of an "opportunity pull" model:

> With increasing division of labor, there is increased efficiency in the utilization of resources, and furthermore resources are utilized in new ways, increasing the amount of life that the environment can support. New places are created, and occupied, in the process. In this rather limited sense there has been a shift away from a push model to a pull model.

In Ghiselin's "opportunity pull" model, one group of species may expand at the expense of another group to take advantage of the expanding opportunities. This expansion may have occurred because of a technological innovation that confers, in Darwin's words, "competitive highness" on the expanding group. What gives the innovation its directional character is that once gained, it is likely to be retained, preserved and transmitted.[6] Substitute *institutional* innovation (e.g. EHMG) for technological innovation, and we have a direct analog of success of certain species in the natural economy outcompeting other species, with the success of Chinese middleman groups outcompeting indigenous groups for the role of middlemen in the political economy: The Chinese were able to seize opportunities for middleman profit-making activities in the manner conceptualized by Glade's "opportunity pull" entrepreneurial model, by creating the "club" economic organization of the EHMG which lowers transaction costs of middleman-entrepreneurship. Chinese middleman/merchant success, through in-group loyalty and cooperation which excluded outsiders (the indigenous population), is at the economic root of the envy and hatred of the Chinese middlemen by the indigenous population; this periodically has led to episodes of inter-ethnic violence in the histories of the plural societies of Southeast Asia.[7] A dramatic historical example is the May 13, 1969 racial violence and killings by Malays of the Chinese in Malaysia.

6 Policies for promoting inter-ethnic harmony in Southeast Asian plural societies

How then to promote inter-ethnic harmony in a society in which homogeneous foreign merchant groups dominate the trading sector of the economy? My answer was as follows (Landa 1978, p. 235):

> One policy implication flowing from my theory of Chinese middlemen success is government's role in the provision of infrastructure. By providing infrastructure, the comparative advantage of Chinese middlemen over the

> indigenous population would be narrowed; this may encourage a greater supply of indigenous middleman-entrepreneurs.

But as Thomas Ireland (Landa 1978, p. 235) pointed out:

> An adequate set of legal sanctions would reduce costs of transactions between group members and non-group members but it would also reduce the comparative advantage of group members as middlemen. If the group is small enough their particular entrepreneurial advantage would be a scarce resource collecting quasi-rents that would be lost if adequate legal sanctions had the effect of increasing the supply of potential entrepreneurs. If the quasi-rents are more valuable to group members than lowered general transaction costs, legal sanctions could not be Pareto-optimal without compensation.

I still hold the same policy prescription that government provision of basic infrastructure, including legal infrastructure for the enforcement of contracts, is the best policy for promoting inter-ethnic harmony in Southeast Asian plural societies. In a paper by Kevin Davis et al. (1998, pp. 57–58), the authors use the New Institutional Economics to analyze the reasons for dominance of certain "ethnically homogeneous commercial elites in developing countries" (e.g. the Chinese in Malaysia and Indonesia, the Indians in Fiji, the East Indians in Uganda, etc.). They arrived at basically the same policy recommendation that I (Landa 1978, p . 227; see section 2) arrived at more than two decades ago:

> . . . states in developing countries with ethnically homogeneous elites ought to address their efforts primarily toward redistributing the wealth generated by those elites rather than attempting to alter their composition. We would expect this redistribution generally to take the form of in-kind transfers of goods and services that are better provided by public rather than private institutions, namely: healthcare, education, infrastructure, and personal security.

Davis et al.'s (1998) paper was written as a response to Amy Chua's (1998) analysis of the same problem; they differed in their main policy recommendation from that of Chua who recommended direct government intervention, which the authors consider to be "misdirected" because Chua failed to examine the economic causes of the dominance of ethnic minorities.

7 Summary and conclusion

The phenomenon of the EHMG is widespread in less-developed countries. The success of the Chinese in Southeast Asia in appropriating middlemen roles for themselves, hence excluding the indigenous population, has historically been a source of inter-ethnic conflict and violence. In this chapter, I have shown how my New Institutional Economics-bioeconomics theory of the EHMG enables us to understand the bioeconomic bases for foreign middleman success, in terms of both the emergence and persistence of the EHMG. In emphasizing the bioeconomic bases of Chinese middlemen success, I have singled out the role of Chinese middlemen in performing N-entrepreneurial roles in providing infrastructure/public goods through the organizational arrangement of the EHMG, essential for their profit-making activities. The EHMG is a low-cost club-like economic organization that provides infrastructure (including the legal infrastructure for the enforcement of contracts) for members of the EHMG, which economize on transaction costs. In this chapter, I have linked my "cognitive anthropological law-and-economics" theory of Chinese middlemen success to some important concepts and theories in modern evolutionary biology such a biology of moral system, group competition, cultural group selection, and the opportunity pull Darwinian model of competition. I suggested that the "opportunity-pull" model for one species out-competing another species in the natural economy has a direct analog in the political economy of Chinese middleman-entrepreneurship: Chinese middlemen, by creating an institutional innovation of the EHMG in less-developed countries, through in-group cooperation, are able to seize opportunities for middleman profit-seeking activities, hence out-competing/excluding the indigenous population. Thus, contrary to Smith & Szathmary (1999, pp. 146–147) who argued that the tendency for everyone to identify with subgroups is contrary to rational self-interest, my theory of Chinese middleman success argues that it is rational for Chinese merchants to identify themselves with subgroups, like the Hokkien-Chinese. Finally, I address the issue of policy recommendations for promoting inter-ethnic harmony by increasing the supply of indigenous middleman-entrepreneurship via the role of government in providing for basic infrastructure of the economy.

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Endnotes [* denotes that the footnote was added after publication of Landa's (1999) paper.]

1. The precise analytical links between these concepts, however, have not been explored in the economics literature.
2. See historian Curtin's (1984) description of various cross-cultural trading groups in world history. See also economic historian Avner Greif's (1989, 1993) analysis of the "Maghribi traders coalition," a theory very smiilar to my theory of the ethnically homogeneous middleman group (Landa 1981).
3. While my approach to trust and informal institutions has points of contact with Douglass North's (1993, Denzau and North 1994) mental models of institutions, my approach differs in an important aspect from their approach in that I incorporate the cognitive anthropological work of Mary Douglas (1986) which makes my approach a "cognitive anthropological law-and-economics" approach to trust and informal institutions.

*4. Bioeconomics is a new subdiscipline within economics; it is the integration of economics with biology. For a discussion of bioeconomics and some of the topics that fall into the domain of bioeconomics, see Landa and Ghiselin (1999). Bioeconomics has its own journal, *Journal of Bioeconomics*, launched in 1999; Janet Landa was the Founding Editor-in-Chief (1999–2009), with Michael Ghiselin as the Biology Co-editor.

*5. Since the publication of Landa's (1999) paper, there is further development in cultural group selection theory. The rehabilitation of cultural group selection theory was completed in an article by biologists Edward O. Wilson and David Wilson and Edward Wilson's (2007), with its core statement: "Selfishness beats altruism within groups. Altruistic groups beat selfish groups. Everything else is commentary." For a discussion of this, see Landa (2008); see Chapter 12 of this book.

6. This part of my paper has benefitted greatly from conversations with Dr. Michael Ghiselin during my stay, as a Visiting Scholar/Research Associate at the California Academy of Sciences, San Francisco, February 27–April 6, 1997.
7. For different theories of ethnic conflict, see Weingast (1998); see also Kuran's (1998) "reputational cascades" theory of ethnic polarization and ethnic conflict.

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