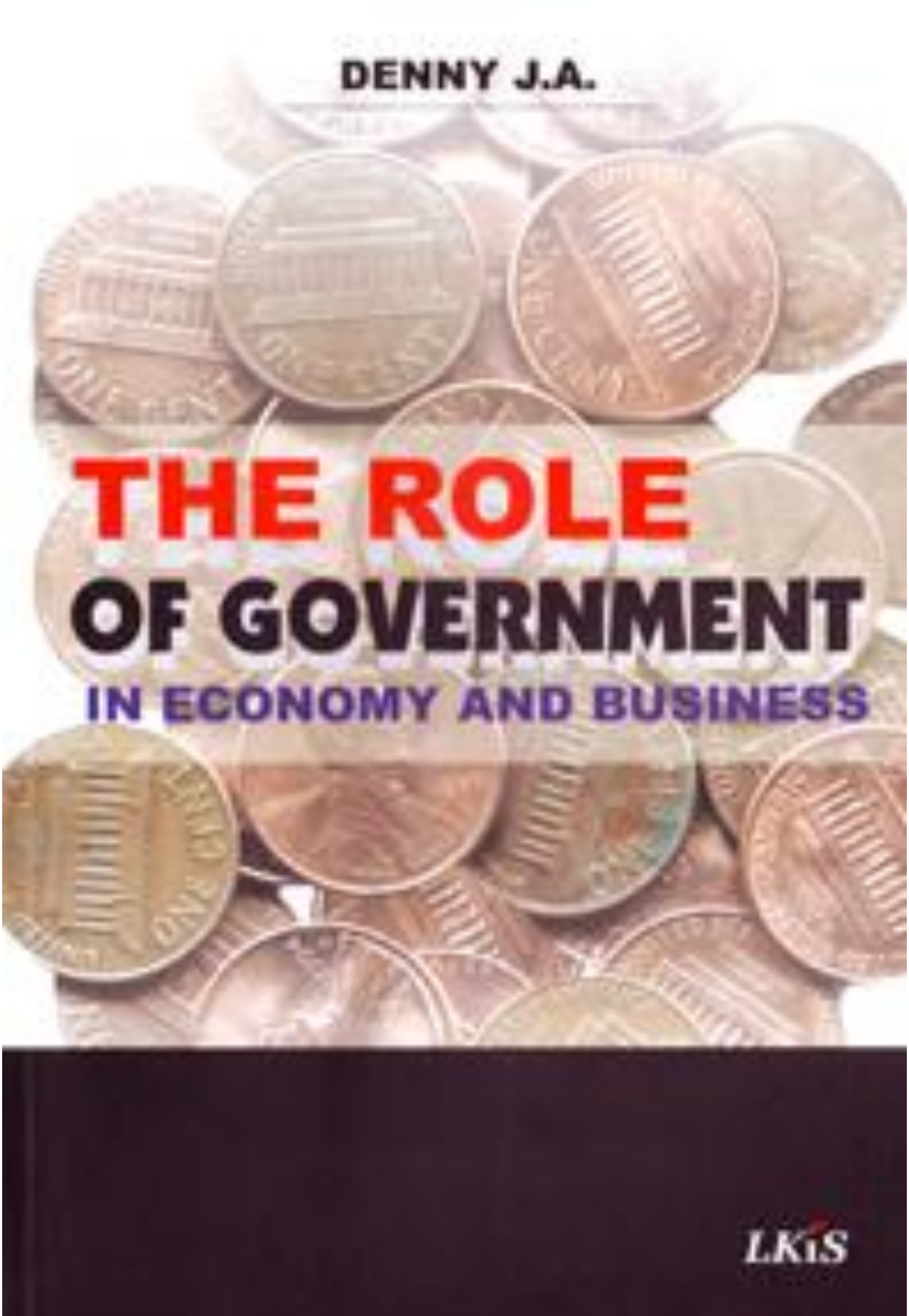
DENNY J.A.
THE ROLE
OF GOVERNMENT
IN ECONOMY AND BUSINESS
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The Role of Government in Economy and Business

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Preface

The roles of government in business and economy are varied and different from time to time, and place to place. Comparative studies of business history in the era of pre-industrial revolution, post-industrial revolution, inter-war periods, and post war years in United States, British and Japan, show the evolution, change or even inconsistency of the government roles.

Sometimes, a government takes very minimal roles, only providing the framework to protect and guarantee market mechanism. Sometimes, the government also provides aids for publics goods by funding infrastructure of transportation: railroad, airports, and canals.

Sometimes government directs business (directs aid) by providing administrative guidance, cheap loan, research facility and industrial policies. Sometimes government also regulates environment to increase quality of life, such as laws on environment and civil rights. Obviously, not all government also roles are good for business. Government could also be responsible for the decline of business as happened in British. In 1997, the big crisis in Asia was caused partly by the wrong doing of government.

What are the independent variables contributing to the changes of those roles? Why is a government intervention in economy less or more intensive in a certain period than those in other period of time? What makes of government adopt and then change from one type of the state to another: from the minimal state to the welfare state and the development state, or in reverse?

This book is compiled to explore those questions, consisting of four chapters written in different time. A part of those chapters were written for the purpose of the classes I took when I was in Ohio State University, 1996-1998. I modify all the chapters to make it a little bit integrated as a short book, a very short book.

I give all my gratitude to all my friends and family encouraging me to learn, to read and to write.

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Chapters 1

Minimal State, Regulatory State, Developmental State and Predatory State: Comparative Study

Peter Evans categories states into three types based on their roles in economic development – *the minimal state*, *the developmental state*, and *the predatory state*. To apply this categorization to the history of business, I will add another type: *the regulatory state*. However, these four types of state are only ideal types. Given the complexity of reality, countries have historically applied a combination of them.

The minimal state is a concept from Adam Smith. The supporters of this concept argue that market mechanism knows best and works more efficiently than governments. To have the most favorable conditions for business, the role of government should be kept as minimal as possible.

Based on this framework, the role of government is restricted only to preventing monopoly and externalities, providing-public goods, and enforcing the law. Government's help to business should be indirect and non-selective.

The regulatory state goes one step further than the minimal state. The supporters of the regulatory state argue that the government is also responsible for the welfare of society as a whole and may help business people by ensuring a better environment. From the point of view , indirect help is not and never sufficient. Government should be more active in giving direct help and should sometimes be selective.

Two variants of the regulatory state are associative state and the welfare state. The associative state frames government to work together with business people and labor to mobilize production and apportion social welfare. The welfare state frames government to distribute welfare programs (e.g. housing, unemployment aid, and health care) and, sometimes, to protect small business from the threat of big businesses.

The developmental state goes one step further than the regulatory state. The supporters of the developmental state argue that the government should direct the trend of national industries and pick “the winners” to become the leading industries (business locomotive). To play this powerful role, the government should manipulate industrial policies (protection, subsidies, lower tax), offer cheap loans, and give administrative guidance that can direct business people to choose certain business strategies. The assumption of this approach, contrary to the minimal state, is that the government knows more than the market how to achieve the highest national economic growth.

The last one is the predatory state. The easiest way to describe the predatory state is a follows: “The predatory state is developmental state without bureaucratic competence”. As a developmental state, the predatory state also directs the trend of business and picks “the winners”. However, the criteria for this intervention are not technical competence based on assessments of expertise, but nepotism and corruption. The government’s high officials act as rent-seekers, giving government facilities and protection to business people, and getting personal benefits in return.

The indirect role of government refers only to the minimal state. In this category, the role of government is only to protect market mechanism and to build infrastructures for the economy. The government may spend much money to build railroads or highways. This role is still considered indirect, since what is created by it is a part of public goods. The direct role of the government refers to *the regulatory state*, *the developmental state*, and *the predatory state*, since in these states the government’s role is to be selective and more than just to protect market mechanisms.

History

In business history, the governments of the United States and Great Britain play roles as minimal state, the regulatory state and the developmental state interchangeably, from one point of time to another. Compared to Great Britain and the United States, Japan acts as the developmental state in many more periods of time.

a) Pre-Industrial Revolution (1500s – 1750s)

In the pre-industrial revolution, 1500s – 1750s, the political rulers in Britain, North America (British colonies) and Japan played the roles close to that the minimal state. Their help to business were indirect by preparing political unity and stability to provide favorable condition for commercial economies to grow. These political stability and unity encouraged the growth of cities, market economies, regional specialization, and foreign trade (except Japan). However, the Great Britain in this period acted as the developmental state as well, since she adopted the Navigation Act regulating the business of shipping in her jurisdiction (colonies).

In this era, in Great Britain, William became the King of England but he ruled under the control of the parliament. British rulers also issued Toleration Act on healing religious differences. British began to build empire. Later than British, North America achieved a true political unity in the era of American Revolution of 1776 and adopted a constitution. In this era, Japan was under Tokugawa (1600s – 1860s) who ruled all of Japan and was helped by local lords and the administrators of samurai, the former warriors.

b) Industrial Revolution (1750s – 1910s)

Industrial revolution began in 1750s and Great Britain was the first industrial country, followed by the United States (1820s) and then, Japan (1900s). A new source of power, steam power, was discovered. New technologies, such as interchangeable parts, were invented. All of the new things led to increase of productivity. Process of production was much faster and the volume of production was much higher.

In this era, governments in Britain and in the United States played roles close to those of the minimal state and the developmental state. British government gave indirect help to business community by repealing many laws on limiting interest rates, and direct help by training workers. However, the British government provided less aid to finance and railroads compared to the United States and Japan.

As British, the United States government also gave indirect aid for business people by strengthening the framework of nationwide market. Some regulations were adopted in the US to omit the constraints for interstate trade and commerce crossing state lines. However, more than the British, the US government also gave more aid to finance national railroad across Appalachian Mountain, canals (e.g. Erie Canal) and path-breaking railroads.

In Japan, during Meiji period (1860s – 1910s), emperors returned to power, and started to have modern cabinet system and modernized civil services. The government provided indirect aid to business people, by ending political barrier to internal trade encouraging population mobility by abolishing the class system, and allowing peasants to grow whatever crops. At the same time, the government gave more aid, by building the first railroad connecting Tokyo and Yokohama.

However, more than the US government, Japan acted as developmental state as well by providing subsidies to ocean shipping companies, and giving funds to certain types of industries e.g. mining, shipbuilding and cotton.

In the 1850s, the United States started to have many big businesses, from railroad, steel, automobile to tobacco. Big businesses came to Britain late and Britain was continuously dominated by small business. Big businesses also came to Japan late. However, since 1900s, Zaibatsu, a Japanese big business, has existed. Different from big businesses in the USA, Zaibatsu is a more diversified unit of business. For example, Zaibatsu could own manufacturing ventures, a bank, and trading company at once.

c) Inter-War (1910 – 1945)

During the inter-war period (1911-1945), the governments of Britain and the USA were more involved in business. The role of the government of both countries in this era was close to the regulatory state and the developmental state.

In the United States, during the administration of Herbert Hooner in 1920s, the government initiated cooperation between the government and business groups to mobilize industries for war effort. A World War Industry Board was established for this purpose. Historians labeled that nature of government-business relationship in this era as "associationalism."

Roosevelt brought the role of the government one step further by creating welfare states of the United States. For the first time in US history, the federal government assumed responsibility for general welfare of its society. The Social Security Acts was adopted to give legal framework for welfare programs. At the same time, the government also acted as a *developmental state*. The National Industry Recovery Act was established, and this helped many companies, such as IBM, to product punch-card machines. IBM and other high-tech companies also received aids from the government for the R & D (Research and Development).

During the inter-war years, the British government was also more active in directing business. The government encouraged business to adopt mass production for the reason of efficiency. Between 1939 and 1946, Roll-Royce, the manufacturer of high quality automobiles, did not produce any automobiles at all but produced over 80,000 aero engines for war purposes, instead.

The Japanese government was involved deeply in directing the industry in the inter-war years. The government encouraged industries to do away with light industries and moved to heavy industry. For war purposes, heavy industry was really important. The Japanese government purchased many products of steel, chemicals, and machine. In 1935, for the first time heavy industries became more important than light industries. The new Zaibatsu raised in this era were based on heavy industry. Nissan is the biggest new Zaibatsu.

d) After the Second World War (1945 – 1970)

After the World War II, 1945 – 1970, government of many countries led by the United States brought business to a new stage – the era of global economy. World economic recession is suspected as one of the causes of the world war. To increase global prosperity is perceived as one of the solutions to prevent another world war. The United States and Great Britain led the world to have global framework for encouraging international trade. This is a kind of indirect aid of government to the community of business all over the world.

There were some important institutions created in this era. First, the Briton Wood agreement adopted the fixed exchange rate for international currency exchange. By having fixed exchange rates, business environment was more stable and favorable for business planning and prediction.

Second, the world community adopted GATT to reduce national barriers and to liberalize international trade. Since 1945, the term "multi-national corporation" has been heard. This globalization opens new large market for many big companies. Third, the United States declared a Marshal Plan to help in European Economic Recovery. In reality, the United States did not only help Europe but also Japan.

In 1970s, the US government adopted e new type of regulations on civil rights, environmental protection, consumer protection, and good workplace for labors. The whole purpose of this regulation is to guarantee "the quality of life" of US people based on equality and healthy environment. Since the prosperity of US people increased significantly after the World War, the need of US people changed from "the quantity of material worlds" to "the quality of life".

In Japan, developmental states achieved its peak under MITI (Ministry of International Trade and Industry), according to Charmers Johnson. From the ruin and defeated state of the World War II, Japan rose to gain respect as the world economic super power. Experts label this amazing achievement as the Japanese miracle.

Many researches were conducted to explain this miracle. One of the influential explanations is from Chalmers Johnson who claims that MITI (developmental state) is responsible for achieving the miracle of Japan. MITI directs the industries in Japan, from light industry to heavy industry, and then to high-tech industries. Later, this explanation got a lot of criticisms from other experts.

While Japan achieved its peak, since 1970s, Britain has experienced relative decline. As the first industrial country and the first world hegemony, Britain could not grow as fast as the United States and Japan. How should one explain the British decline? Did the roles of British government contribute to this decline?

Experts assess there are two reasons responsible for this decline. First, public attitudes of British people are hostile to industrial values. The strong tradition of the British aristocratic and conservative cultures contradicts some basic values of entrepreneurship. The lifestyle of gentlemen, noble families, the idealization countryside, the importance of harmony and gradual change, could become serious constraints for the growth of industrial values, such as rapid change, money-oriented motives, and meritocracy.

Second, the alternation of government policies hurts the certainty and continuity of businesses. Since World War II, Britain has been ruled by Labor and Conservative parties interchangeably. The spectrum of ideology, between Labor and Conservative parties, is widely dispersed, wider than that between Democrat and Republican Parties of the USA. One of the examples of this polarization is the policy of nationalization and privatization of industries. The Labor Party supports nationalization, while the Conservative Party is in favor of privatization (de-nationalization). Nationalization and de-nationalization rule industries on and off, confusing the business community.

The Varieties of Government Roles and the Reasons

The roles of government in business and economy are varied and different from time to time, and place to place. A comparative study of business history in the era of pre-industrial revolution, post-industrial revolution, inter-war periods, and post-war years in the

United States, Britain and Japan, shows the evolution, changes and inconsistency of government roles.

Sometimes, the role of government is very minimal, only providing framework to protect and to guarantee market mechanism. Sometimes, a government also provides aids for public goods by funding infrastructure of transportation: railroad, airports, and canals.

Sometimes, the government directs business (direct aids) by giving administrative guidance, cheap loans, research facility and industrial policies. Sometimes the government also regulates environment to increase quality of life, such as laws on the environment and civil rights.

Obviously, not all government roles are good for business community. A government could also be responsible for the decline of a business as happened in Britain.

a) How should one explain those inconsistencies and the changing roles of the government? What are the independent variables contributing to the change of those roles? Why is in a certain period, the US government intervention in economy less or more intensive than those in other periods of time? What makes a government adopt and then change from one type of the state to another, from the minimal state to the welfare state and the developmental state, or reverse?

Politicians ruling a government are influenced by many variables. Whether those politicians choose *the minimal state*, *the regulatory state*, *the developmental state* or *the predatory state*, it depends on some variables as follows:

First, ideological preferences matter. There exist various ideologies about a good or a bad society. Every ideology has its own philosophy and economic policy.

The Neo-classical believes that the best government is the least government. *The market* mechanism through the invisible hand will work in the most efficient way compared to government's hands. This ideology will influence politicians to adopt the minimal state.

However, the followers of Keynes (and John Rawls) believe that market alone cannot distribute resources fairly and does not care of the weakest and the poorest. Government should play an active role at least to distribute the resources fairly. This ideology will influence the politician to adopt *the welfare state*.

Politicians and policy makers in the third world may have their own perception as well. As the late comers of industry, they think the third world countries cannot compete and win in the market mechanism. Those industries need government's hand to survive and expand through many kinds of industrial policies. This ideology will influence the politicians to adopt *the developmental state*.

Second, the pressures of interest groups matter. The primary motives of politicians are to be reelected and have to a secure political career. For this reason, to get supporters from groups of people, strong interest groups are very important. No wonder, many politicians may adopt a certain economic policy not because it is good in terms of economic, but it is good for their next election (their political career).

Black people and elderly groups in the US may influence politicians to adopt welfare state to distribute welfare programs. Groups of farmers in Japan may influence politicians there to adopt the developmental state, to protect agricultural sector from foreign competitors. Big businesses in Great Britain may force politicians to take the minimal state, and to privatize some government companies.

Third, the world economy matters. After the Second World War, many world leaders were willing to build a new international economy. For this purpose, they needed to establish economic regimes based on free trade. This new trend encourages many politicians (national governments) to keep away from the developmental state, to reduce trade barriers. However, in 1970s world competition was very high and oil prices were up. These conditions encouraged many politicians (national governments) to go back to the developmental states again, to adopt protectionism (industrial policies).

The above three variables, among others, matter in determining the change of government's role overtime. Ronald Reagan, for example, was a conservative. He would adopt the minimal state. His policy would be different from that of the other US president, the populist Theodore Roosevelt, the defender of the welfare state.

b) The next question is which government's role is better for the economy? Would Japan be better if Japan's government did not give direct aid and subsidies? Would Britain do better if the British government acted as a developmental state? Is the developmental state able to bring economic growth faster than any other type of states?

At least for Japan, according to Chalmers Johnson, the developmental state is much better. Chalmers Johnson claims that developmental state (MITI) is responsible for the miracle of Japan's economic growth. According to Johnson, MITI is competent and has a strong vision on economy. MITI has also the best graduates from the best university in Japan. By intervening in the market, MITI directs Japan's industries to have the most added values. It is the government's hand (the developmental state), not the market mechanism (the minimal state) that makes Japan grow faster than any other countries.

However, many research disprove Johnson's claim. Richardson proves that Japan's economic policies are more complicated than what Johnson's claims. Government intervention (help) is not always based on rational calculation for having the most value added industries. Richardson proves that one of the targeted industries (shipping) does not have the most added values. In reverse, this industry is sick and MITI helps them to recover.

Friedman also proves that the success of machinery tools in a region of Japan is caused by the innovation of the business people themselves, not caused by the help of the government. Others also prove that automobile gets more success than the computer chips although the automobile gets less attention from the government.

Based on theoretical speculation, the neo-classical economies may give the rival hypotheses that in case the Japanese government (MITI) lets the market mechanism work (the minimal state), instead of government's hand (the developmental state), Japan may grow faster.

I myself happen to believe that the minimal state (free market) is better than others (the governed market: the regulatory state, the developmental state, the predatory state) for the growth of national economy. To see my arguments in detail, please read Chapter Two (the debates on the Free Market versus Governed market).

Another issue on the role of the government is about the structure of business. The different roles of government lead to different performances of business. The following is one of the evidences.

Big business rose in the United States first, not in Japan, and not in Britain as the first industrial country. The rise of big businesses is a kind of paradigmatic shift in business world since big businesses really bring many new things. Big businesses are involved with big capital (more than 1 million US dollar), big number of employees (more than 500 workers), economies of scale, hierarchical management, and with the department of research and development. All of these are strange to the previous businesses practices. While the United States are dominated by big businesses, the Great Britain is still dominated continuously by small businesses, and Japan is in between.

What makes the structure of businesses in the United States, Britain and Japan different? How should one explain why big businesses rose in the United States first? There are some reasons and one of the reasons is related with the public policy adopted by the government.

Indeed, the national market of the United States is bigger, more homogeneous and more prosperous. The national market of the US, compared to that of Britain and Japan, is much more favorable for mass production – homogeneous and many units – of products. Mass production encourages the rise of big businesses.

However, the distinctive factor is the role of the government. The United States has Sherman Act that prohibits monopoly and cartel, while in Britain and Japan in this era, cartels were allowed. Since, in the United States, cartels are not allowed, the only way left for the business people to maximize their profit and to increase their control of the market is by adopting vertical integration. Through vertical integration, the structure of companies is bigger and is more hierarchical.

In Japan and Britain, because cartels are allowed, vertical integration was not really a must. Instead of choosing mass production and vertical integration, in Japan, before World War II, Zaibatsu adopted diversified companies. Great Britain is also still dominated by network of small businesses.

In this case, government role, by allowing cartels or not, matters in determining the strategies and structure of businesses.

Indonesian Case

How is Indonesia? What are the government's roles in business there? What makes this country different? Economists usually divide Indonesia into four periods of time. The first period is the Old Order, from the years of independence of 1945 to 1965. This period is under President Soekarno. In this period, Indonesia applied the strong planned economy in the framework of nationalistic and leftist sentiment. Under Soekarno, there was a program named "Benteng Projects". This program gave special treatment and privilege to indigenous business people. Through this program, those indigenous people received government facilities, such as loans and subsidies.

The type of the state in this era was interventionist. However, the Indonesian state of Soekarno lacked bureaucratic competence. This incompetence made Soekarno regime different from the concept of the developmental state of Japan. A better way to identify the type of the state in the Soekarno era is the development state with racial sentiments.

The second period is the beginning of the New Order in 1966 to 1974. This is the era of economic consolidation under the new President Soeharto. In this period, Indonesian economy shifted to become much more of a market system. President Soeharto economic team was very competent; they graduated from the United States' universities. They were technocrats with a strong vision of modern economics.

In this era, Indonesia opened its system to massive foreign capital. A new regulation of foreign investment was adopted. Indonesia was committed to building the infrastructure for the economy, i.e. railroad and telephone network. While endorsing the rise of the private sector, Indonesian government owned and ran many profit-making companies.

The role of the government in this era fits the ideas of *the minimal state*, *the developmental state* and also *the predatory state*. It is a developmental state since the government owns many companies. It is a minimal state as well since the government starts to build infrastructure for the market economy. However, it is also a predatory state since there existed cases of power abuse. Through his personal relationship, President Soeharto endorsed some of his friends and families to hold monopolies in certain industries (e.g. cement). Big businesses started to rise among Soeharto's cronies.

The third period is from 1974 to 1982. This is the era of oil boom. As the country of oil, Indonesia got much benefit from the rise of oil price in the 1970s. Government revenues increased in double and triple. However, the big riot in 1974 forced the government to be sensitive with the issue of distribution and small-scale businesses.

In this era, the government acted mostly as a *welfare state*, *developmental state and still as* a *predatory state*. Government started to give special loans for small businesses. However, the government also developed her own companies, such as Pertamina (an oil company) and national banks. Soeharto's cronies were growing to dominate Indonesia's business.

The fourth period is from 1982 to 1998, the fall of the New Order. In this era, oil price declined and government revenues from the oil became less and less. However, the government gave very good response to the difficulties. The bad times created good policies. A wave of deregulation touched many sectors.

In this era, there was tendency that the government was away from the developmental state and close to the minimal state. However, elements of the predatory state were still there. In this period, Soeharto increasingly used his political power to help the business of his friends and families. Many conglomerates were born in this era. Many of them were Soeharto's cronies. Corruption and nepotism spread in government bureaucracy. Soeharto's sons and daughters rose among the biggest conglomerates (big businesses) in Indonesia.

What made Indonesia become dominated by the predatory state type? I will use two variables to explain this difference; the regime type and the leader's preference. On the regime type, different from the United States, Great Britain and Japan, Indonesia prior to 1999 was not democratic. The type of Indonesian political system was authoritarianism. There was no strong public control to the flows of capital. As a result, the predatory behavior of high officials dominated government policies. The tendency to the minimal state, the welfare state and developmental state of Indonesia was distorted by wrong doings.

On the leader's preference, Indonesia from 1966 to 1998 had been ruled by President Soeharto. Since influenced by Javanese culture, Soeharto had no good understanding of the principle of modern state. In many occasions, he gave the impression that he could not differentiate what were allowed and forbidden by the modern state's principles. The way he ran the country was not like that of a modern president but like a Javanese king who owned the country. As a result, he easily distributed public money and projects to his own cronies.

Since there was no democratic procedure and no strong public control, corruption and nepotism. The predatory state of Indonesia overshadowed all other types of the states in Indonesian history since 1966.

Until 1997, Indonesian economy still survived and grew. Superficially, it seems that the predatory behavior of high officials was still controllable to produce economic development. However, undersurface, these predatory behaviors were the hidden virus. In 1997, Indonesian economy collapsed and will be remembered as the worst crisis of Asia. Among others, the predatory behavior is responsible for this crisis.

Chapter 2

Free Market or Governed Market: Which Is Better?

A number of scholars have credited Japan's allegedly highly-competent and influential bureaucracy with the country's high growth rates in the 1950's and1960's. Others argue that Japan's industrial policies were much more complex and ambiguous phenomena, wherein lobbying between ministries, parties and unions resulted in interests being negotiated in ways that produced a very different kind to policy environment than that described by the dominant "school of bureaucracy". Which interpretation is right?

The background to these debates is the miracle that has taken place in Japan. Over time these debates have widened to include other countries in what has become known as the miracle of Asia. Examples of other countries in the East Asian region which have achieved a very high economic growth, besides Japan, are South Korea, Taiwan and Singapore, Indonesia, Thailand and Malaysia have begun to emulate the high growth rate of those countries. This high growth is puzzling, since other region in Latin America, Africa and even in western countries grew much slower during this period.

The debate was triggered by the controversial and provocative book from Chalmers Johnson: "MITI and the Japanese Miracle". Johnson argue that Japan achieved this miracle because of the role of the government in intervening and directing the economy. Different from neo-classical principles, Johnson says that the government's role is positive because the government is competent, has strong vision, and knows which industries should be helped.

Johnson's study is followed by the other studies in the same tradition. Many literatures on the developmental state have arisen to explain the specific case of East Asia. At the same time, neo-classical economist and pro-market political scientists have a different explanation for the Asian miracle. The latter argue that the extension of market mechanisms is responsible for the Asian miracle. The debates spread out over various arguments. However, those debates could be categorized into these two schools of thought: pro free market or pro governed market (the dominant bureaucracy school).

Dominant Bureaucracy School's (Governed Market)

Arguments

The governed market is a market characterized by government intervention through many mechanisms (tax, tariff, subsidies, cheap loans, aid). In this section, I will assess the best argument from the supporters of the governed market, Robert Wade and Chalmers

Johnson. Why is a governed market better for economic growth? There are a number of reasons, according to Robert Wade (1st, 2nd and 3rd), Ronald Coase (4th) and Chalmers Johnson (5th).

First, economies of scale give disadvantages to newcomers. The world of big businesses and industries has reached a new stage, economies of scale. This term refers to marginal utility. The more products one produces, the cheaper the production cost of that product will be. Technology of mass production helps a company to produce cheaper products. Bigger companies (greater capital and better management) easily exploit economies of scale to kick their competitors out the market. In world trade, since the market is vast, economies of scale are powerful weapons for big businesses.

Newcomers have more constraints in confronting competition in the era economies of scale. However, governments can help these newcomers. Subsidies, tariffs, cheap loans, and technological aid from government are really significant for the newcomers to survive, and then expand. The governed market is legitimate in this context, especially in protecting domestic infant industries.

Second, world trade is imperfect. There is no purely fair and free competition without barriers in world trade. Distortion of the market is everywhere. The world is divided into many trading blocks. Each of the trading blocks has different regulations and privileges for its own members. There is also an oligarchic structure in certain industries. Aircraft industries (Airbus, Boeing), for example, are dominated by the United States and a consortium of European countries. Using the free market mechanism alone, no other private enterprises can compete in these industries. Once again, government intervention may help.

Third, market failure is extended. Different from the neo-classical point of view, the governed market approach extends the ideas of market failure so widely that they also include the development of technology and education. The private sector, according to this approach, is not willing to invest big amounts of money in risky and very long-term projects. Government can help invest much money in research and development for many strategic industries and also in education. Government intervention, in this case, will stimulate national economy.

Fourth, government can make transaction costs cheaper. Vertical integration among firms can make transaction costs cheaper. A big business that integrates all processes, from raw materials acquisition to the process of production and networking of distribution, can reduce the costs of transaction. The costs of negotiation and litigation of those transactions are cheaper since all of them are under one management. The cheaper the transaction cost is, the cheaper the cost of production will be. This mechanism can help a company to sell cheaper products. Government can direct and help the vertical integration of many companies and thus make transaction costs among them cheaper.

Fifth, government can direct the national market and industries to have the most value added industries. Johnson claims that MITI, in Japan, chose this strategy. MITI, according to Johnson, has a strong vision to shift industries in Japan away from light to heavy industry, and then to high-tech industry. MITI, then, selects certain industries as the locomotive of growth.

To run this selective intervention effectively there should be certain conditions, according to Johnson. MITI, as an economic bureaucracy, should have high technical competence. MITI recruits the best graduates from the best universities, and has the best managers and policy makers. The government should also have a strong vision and understanding on which industries are the most valuable for now and for the future. Government, then, can give administrative guidance and financial aid to direct the market in achieving its vision.

In third world, the reasons and legitimacy for a government intervention to the market goes hand in hand with the reality of that world. In this region, governments are very strong while societies are relatively weak. State are autonomous and lead not only the political system but also the economy. A strong state is ready and willing to apply interventionist policy. No wonder many developmental policies are popular in the third world.

Free Market Arguments

Contrary to those of the governed market, the supporters of the free believe that the market is the most effective mechanism. In the free market, government's role is very minimal. The governed market is misled.

In this section, I will assess the best arguments for the free market from Milton Friedman and Buchanan (Public Choice Theory). I will also asses the wrong perception about the governed market, as criticized by Bradley Richardson. There are several reasons why market mechanisms are the best and a governed market is wrong.

The free market stands on some assumptions. First, individuals are rational and self-interested, and will not trade unless they get profit. Second, the economy is not a zero sum game. Everybody can profit from a trade. Third, there is comparative advantage in the trade. People will exchange based on their comparative advantage. Fourth, if an individual can be better off without making another worse of, the whole society will be better off as well. Fifth, the market is so complex that no single individual can manage this complexity better than the free market mechanism itself. Sixth, there is an invisible hand in the market. This invisible hand will work forcefully, and only efficient actors will be able to stay in the market. Seventh, free competition is positive for the economy since it can force economic actors to work more efficiently (cheaper and better). Based on these assumption the fre market, not the government, will run the economy more efficiently and help the national economy to grow faster.

Obviously, there is still the government role in the free market model, but this role should be very restricted and minimal. The role of the government is to protect market mechanisms, since the market, in certain conditions, can fail. The legitimate role of the government, according to the free market supporters are: 1) to prevent monopoly, 2) to prevent the intrusion of externalities, 3) to provide public goods, 4) to enforce law and be neutral referee, and 5) to correct imperfect information. These roles should be taken by the government since no private sectors can handle such public and common interests.

The intervention of the government in the economy, outside of market failures, is wrong and misled, according to the free market principles. These are the reasons:

First, politicians in a government are self-interested and rational. The motive behind their policies is to secure their political careers and to be re-elected. These politicians may use economic policy to “buy” people’s votes. Since welfare programs are popular, for example, these politicians will distribute welfare programs and spend a lot of government money. As a result, these politicians may be re-elected but the national economy may decline. Extension of government intervention in the economy will make economic performance worse since the government may adopt bad economic policies to buy people’s or interest group’s votes. This argument is from public choice theory, which explains political behavior in democratic countries.

Second, in non-democratic countries, the behavior of politicians is worse. Since there is no public control, the predatory behavior (corruption, nepotism) spreads out. The extension of government's roles into their respective economies will create larger spaces for predatory behavior. The bigger the government is the arguments are from various literatures on rent seekers and crony capitalism.

Third, there may benevolent leaders who are interested only in great visions. These benevolent leaders are clean and smart. However, the whole economic process is too complex to be mastered and controlled by individuals. In this imperfect world they cannot have all the knowledge needed to calculate all the consequences of intervention. As results, mistaken policies due to imperfect information may be adopted. The extension of government intervention also creates the possibility of mistakes.

Based on the above principles, there are no ways to claims that the governed market is better than the free market. The concept of the superiority of the governed market is caused by mistakes in research methodology or incomplete data. Here are some examples.

Steel industries in Japan are targeted industries that get help from the government (the governed market). The growth of these industries is fast. Governed market supporters claim that this is evidence of the superiority of the governed market.

A rival explanation from the free market case can easily be given. If the government did not help, those steel industries might grow much faster. Automobiles in Japan did not get attention from the government as much as steel industries. However, the automobile industries grew very fast. The high growth of a targeted industry per se cannot be used to prove the governed market case convincingly.

MITI, said Johnson, has a strong vision to pick targeted industries to be locomotive of the economy, or to have the most added values. Shipping is an example. However, Richardson gives a different explanation. The government's help for shipping industries was given not because it was considered the most value added industry but because the government wanted te restore this industry from the losses of wartime. Contrary to being the most value added industry, shipping was a sick industry. The evidence used by supporters of the governed market is, therefore, somewhat shaky.

Which one is better?

The arguments for *the free market* and their rejection of *the governed market* are too strong to be neglected. These arguments stands upon very and tested theories such as those on the neo-classical economy, public choice theory and rent seeker concepts.

Conversely, the theory of the governed market is still new and not yet tested. Evidence to support the governed market theory is also selective and methodologically ill-defined.

If the governed market hurts economy, why do these types of policies survive and expand? The reason is politics. Governed market helps politicians to buy popularity (in democratic countries), or to serve their predatory motives (in the non-democratic world), or to apply their misunderstanding of the principles of economics (according to the neo-classical economists).

Chapter 3

Explaining the Wealth of Nations: Other Variables

Lately, in the field of Comparative Politics, two big events have been the object of many researches. First, countries in East Asia grew much faster economically than other regions in the 1970's and 1980's. Second, a wave of political and market reform has been occurring in Eastern European in the 1990's.

These two big events cannot be explained sufficiently by existing political and economic theories. Since these two events are political and economic in nature, a new theory combining both political and economic outlooks is needed. A new institutionalism is growing in response to these new phenomena. The theory of new institutionalism fits the new demands on a theory since the new institutionalism is more or less at theory of political economy.

The principles of the new institutionalism are that institutions (norms, procedures, organizations) matter in determining economic performance and political outcomes. A human being as an institutional animal and cannot be understood separately from his surrounding institutions.

Prior to new institutionalism, economic theories were dominated by the neo-classical approach, while political theories were dominated by behavioralism. Both of the above theories, neo-classical economy and behavioralism (including old institutionalism), are not adequate to explain the reality of political economy, according to the new institutionalism supporters.

Douglas North and Ronald Coase strongly criticize the neo-classical economic theory. According to North, to understand the economy we should understand not only the work of market mechanism, but also the work of states. Economic performance is also influenced by the structure of property rights imposed by the state. Those states which secure and allow personal property rights (e.g. the capitalist states) will affect the economy differently compared to the states that do not (e.g. socialist state).

In history, there are types of states. Since neo-classical economic theory is only concerned with the capitalist state (minimal state, liberal state), it cannot be used to explain economic history in its entirety. Neo-classical economic theory is good for prescription not description. Douglas North develops the new institutionalism in the economy. In his model, the role of institutions (e.g. the states) is crucial.

Ronald Coase also strongly criticizes neo-classical economic theory in another direction. According to Coase, in the real world there are costs in running the market, namely transaction costs. The price of a certain product or service is not only the cost of transformation (to produce a certain product) but also the cost of transaction (tax, litigation, bargaining, negotiation, law enforcement, monitoring). The transaction cost can be high or low. It depends on how efficient the institutions are in dealing with the transaction costs (the state, firms, and interest groups). The higher the transaction cost is, the less efficient the whole economy will be. Again, Coase underlines the importance of institutions in determining economic performance.

Political theories receive serious attacks as well. The dominant political theory at the time (1970's) was behavioralism. This theory is very strong in the methodology of research, through using new tools such as statistics and many models of quantitative analysis. However, behavioralism has very weak assumptions on human behavior. Behavioralism pays less attention to the institutions that give incentives to and put constraints on human behavior. In the real world, there are not only free individuals, but also many existing institutions. To study human behavior, one should observe not only human behavior per se but also the institutions influencing that behavior, hence the new institutionalism.

Obviously, the old institutionalism gets fundamental criticism as well. The old institutionalism pays good attention to the role of institutions. However, this old approach is too normative and narrow.

It is normative as an approach since it is framed to explain what reality should be, not what reality is. The study of constitutions, for example, is led by normative guidelines for constitutions, ignoring that, sometimes, governments do not work along the lines of the constitution's blue print. Instead of asking why this happens, the old institutionalism makes judgments on how governments should be.

It is narrow as an approach since the old institutionalism frames politics only within areas of government (legislative, judicial, executive). The old institutionalism has not yet touched political institutions outside government, such as interest groups, voluntary associations, commercial power centers and civil society. The new institutionalism has born to fill the gap.

Examples of the New Institutionalism

The literatures of new institutionalism begins by finding the important roles of the state. Skocpol and Peter Evans are the dominant figures in formulating the roles of the state in determining economic performance and political outcomes.

However, the nature of the state in new institutionalism is different from the old notion of the state framed by Marxism and Pluralism. Marxism frames the state as only a committee to serve the interest dominant class in a society (capitalist class). In this perspective, the state has no interest in itself. Pluralism frames the state as a neutral referee and as an arena in which plural interest groups in a society compete with each other to maximize their own respective interests. In the pluralist perspective, the state has no interest in itself either. Although different, Marxism and Pluralism have one thing in common: that the state is not an autonomous power.

The new institutionalism frames the state differently. Historically, the state in the third world is very strong while society is relatively weak. Because of certain setting of history, the state does not act only as a committee for a dominant class, or as a neutral referee. On the contrary, the state has an interest in itself. This perspective has been labeled "historical institutionalism" since it uses the historical perspective in theorizing about the state.

Peter Evans develops the study of the state in relation to the study of economic policy and performance. In the 1970's there big differences in economic performance among the countries of the regions of East Asia, Latin America and Africa. He elaborates why Korea (East Asia) has been growing very fast compared to Chile (Latin America) or Zaire (Africa).

Evans, then, formulates the structure of the state as an independent variable to explain economic performance.

For example, he distinguishes the developmental state from the predatory state. In both types, the role of the state in the economy is strong and interventionist. However, the result of intervention is different. In one type, the state is a solution for economic growth, and in the other the state is a problem. Since the state can be a problem or a solution for economic growth, what is it in the state that makes the difference?

Evans borrows a concept from Max Weber. The developmental state, according to Evans, is a solution because of its bureaucratic structure. In the stage of bureaucratic organization, the state is competent, efficient, ruled by impersonal order and is improved internally over time. The predatory state is a problem because it still has a pre-bureaucratic structure, and is in the patrimonial stage. As a result, the state is ruled by persons (not impersonal order), who are not competent and not efficient. Predatory behavior (corruption, nepotism) dominates state policy.

Obviously, there are many variations in formulating the role of the state in economic performance. However, historical institutionalism is well represented by Skocpol and Evans.

Another tradition in the new institutionalism is rational choice institutionalism as developed by Robert Bates. The focus of rational choice institutionalism is not the structure of the state anymore, but the role of individual politicians. Bates for example, describes these four principles in his approach: methodological individualism, the autonomy of politicians, rational agent, and that rational individual may result in irrational social outcomes.

First, methodological individualism puts the individual as the basic unit of analysis. Social outcomes are reduced to the result of the purposive action of individuals. The macrostructure as class, state, cultures and interest groups is not unimportant but it should be understood in relation to the struggles between individuals who get advantages or disadvantages from those institutions.

Second, politicians are autonomous. As in historical institutionalism, politicians are not the slaves of the dominant class or other interest groups. Politicians have their own interest to secure their political career and to stay in public office as long as possible.

Third, individuals are rational. Individuals have many purposes in their life. However, they have one thing in common. They are rational and self-interested. They have the same motivations, namely to maximize their own utility and to be better than they were. All political behavior and maneuvering should be understood within this framework.

Fourth, rational behavior of individuals can lead to irrational social outcomes. Public choice theory is in line with this principle. Politicians in public office, for example, are rational and willing to be re-elected. These politicians may distribute welfare programs to many groups of people to "buy" those people's vote. Consequently, this rational maneuvering of politicians can lead to the decline of a national economy since a huge amount of public funds is used in welfare programs.

Based on these principles, Bates explains the politics of agricultural policy in African countries. He frames the market as the political arena wherein many political groups are struggling for their own interests. The decline of agricultural production is not the result of bad climate or laziness of peasants. This decline, as framed by Bates, is the result of political struggles among the stakeholders.

"Behind the government" policies in agriculture are the self-interest of politicians. Those politicians are using government policies to strengthen their own political supporters and weaken the opposition. At the same time, those politicians force their own visions of building national industries at the expense of the agricultural sectors. The decline in economic performance is caused by rational political struggles.

In Terms of Theory

The New Institutionalism, one of the latest theories in Comparative Politics, helps in the understanding of economic performance as an outcome influenced by political institutions and political struggles. However, the dynamics of economic performance of a nation is much deeper and richer than those explained by the New Institutionalism. The roles of firms, the innovation of managers and the actions of business people are not the objects of the New Institutionalism in Comparative Politics.

Business History fills this gap. By providing various research agendas. Business History helps in the understanding of economic performance as outcomes caused by the action of the private sector (the firms, managers, and the innovation of business people). In this case, Business History and Comparative Politics (the New Institutionalism) complement each other to explain the economic performance of a nation.

The following description is about the theories (research agenda) of Business History that enriches the understanding of the economic performance of a nation.

There are many and various research agendas in the field of business history. The topics of research are diverse, from big businesses to small businesses, from the role of management to the role of government, from company profiles to the comparative study of industries. The theories, which frame the reality of business history, are also various, from the organizational analysis approach to culture, moral judgment, analytical narrative and state approaches.

However, to simplify these very rich realities, I will divide the research agenda in business history into three worlds, the era before Alfred D Chandler, the era of Alfred D Chandler, and the world outside Alfred D Chandler. The reason for this classification is that Alfred D Chandler is really an important figure in business history. His research is very influential in this field. His influence in business history may be analogue to those of Adam Smith in economics, John Locke in politics and Karl Marx in the study of ideologies.

In the era before Alfred D Chandler, the research agenda in business history was dominated by the moral judgment approach. During the 1990's, big business started to arise in the United States. Compare to previous business practices, big businesses were really "a new species". They were really big not only in terms of number of workers, amount of capital and profiles, but also in terms of power to influence society economically and politically.

Economically, big businesses were responsible for both the increase in national economic growth and also for widening the economic gap between the rich and the poor. Politically, big businesses such as Carnegie, Rockefeller and Henry Ford were also famous for their philanthropic activities and their "closeness" to some politicians for his business interest. The good and the bad sides of big businesses were bold, and deeply penetrated into public opinion. No wonder many research agendas in this era were dominated by the moral judgment approach to these big business people.

Matthew Josephson, foe example, wrote a book entitled "The Robber Barons" (1834). This book describes the nineteenth century titans (e.g. Rockefeller and Carnegie) as robbers. They were portrayed as giants who violated laws, were socially irresponsible and immoral. On the other side, Allan Nevis wrote biographies of prominent industrialists (e.g. Rockefeller and Henry Ford). He portrayed these titans as national heroes. Although Josephson and

Nevis were on opposite sides in responding to big business people, they were still on the same coin. Both of them applied the moral judgment approach to explain business history.

Obviously, there were also other research agendas in the era before Alfred D Chandler. Arthur H Cole, for example, elaborated the entrepreneurship of business history. N.S.B. Grass elaborated the evolution of individual firms. However, the moral judgment approach was more popular.

In the 1950's, Alfred D Chandler changed the field of business history and introduced different research agendas. Chandler was interested not in morally judging the phenomena of big businesses, but to explain them objectively. He was interested in knowing what, where, why, when and how big businesses arise, survive and expand in history. He compiled a large amount of data and facts. Chandler did comparative studies of firms and industries. He carefully drew scientific judgment and conclusions based on the data and facts he had.

Theoretically, Chandler developed the data driven approach to the study of business history. Chandler did not conduct his research deductively, starting with a big theory and then using that theory to frame the reality of business. On the contrary, Chandler conducted inductive research, starting from assessing research questions, collecting data and classifying data to make generalizations. From the kind of approach, he wrote the most influential books in business history: Strategy and Structure (1962), The Visible Hand (1977), and The Scale and Scope (1990).

Through these three books, Chandler emphasizes the importance of organization capabilities to increase not only the output of companies, but also the growth of national wealth. In the "Strategy and Structure", Chandler documents the innovations of managements: from centralized to decentralized management, and from single unit to diversified production. In "The Visible Hand", Chandler shows the influence of the visible hand of management, such as the role of top and middle managers and the separation between ownership and management. In "The Scale and Scope", Chandler describes the different types of capitalism and various paths of industries. His descriptions are based on a study of 200 of the largest companies in the United States, Great Britain and Germany.

Chandler applies what Galambos labels as the "organizational school of history". This school of thought assumes that the most important changes in history are the shifts from informal small-scale, locally- and regionally-oriented organizations to formal big-scale, nationally- and globally-oriented organizations. These organizational shifts happen in many fields from politics and economics to culture and business history. This approach borrows many ideas from Max Weber, especially the theory of bureaucracy. No wonder the idea of organizational capabilities from Chandler has many of the bureaucratic values of Weber, such as efficiency, impersonal order, hierarchy of authority, technical capabilities, division of labor and internal improvement.

Although Chandler is very dominant in the field of business history, many dimensions of business history are not touched appropriately by Chandler. Some of topics are elaborated outside the Chandlerian world (big businesses). Blackford, for example, wrote an important book on small businesses in the US history. Thomas K McCraw elaborates the role of government regulations in business.

Some other approaches are also strong outside the Chandlerian world. Martin Weiner explores the cultural approach to explain the decline of British business. This approach explores the role of culture (conservatism of the British upper class) as the cause of relative economic decline in Great Britain. Chalmers Johnson uses the state approach to explain the Japanese miracle. He elaborates the influence of government help (MITI) on business communities.

Blackford also applies a different approach to explain the reality of small businesses. I name his approach “analytical narrative”. This approach describes the reality of a topic in details, based on data. Analytical narrative, then, analyzes a topic by relating it to other important variables (political setting, economic environment, cultures, and historical events). Many research agendas (topics and theories) develop outside the Chandlerian world.

The above theories and topics fill a gap, because not all of them are taken by the New Institutionalism (Comparative Politics) in explaining the dynamics of the economic performance of a nation. On the level of theories and topics, business history gives a different perspective in understanding the rise of the economy (business) of a nation.

In Term of the Paths of Development

Another issue is about the path of development. The New Institutionalism has stated that political institutions matter in determining economic performance. Different political institutions, such as different state structures (e.g. the minimal state, the developmental state, and the predatory state), different cultures (e.g. liberalism, conservatism, and communalism), and different party systems (e.g. competitive, dominant, and hegemonic) all help to create different economic performances.

The study of Business History confirms the above statement by elaborating case studies of business history in the United States, Great Britain and Japan. These case studies confirm that there exist various paths to development. Modernity, industrialization and capitalism are not homogeneous, but their relations vary because of the differences of institutional arrangements.

From business history, we learn of the evolution of businesses in three important countries: the United States, Great Britain and Japan. The United States is the only super power in the world nowadays. Great Britain was the first industrialized country and nowadays her economy is in relative decline. Japan is the first non-western industrialized country and now her economics power is second only to the United States. Comparative studies of business history in these countries are interesting and important for understanding the various paths to development.

There are similarities and differences among these three countries. All of them follow Democratic Capitalism since they protect private property rights, apply market mechanisms, have democratic political institutions and affirm the superiority of the rule of law. However, they are not identical. Each of them develops its own type of capitalism. Chandler names capitalism in the United States as Competitive Managerial Capitalism, and the Great Britain as Personal Capitalism. Johnson names capitalism in Japan as State-Led Capitalism.

Capitalism in the United States is dominated by big businesses characterized by separation of management and owners. The evolution of business in the United States has passed through many stages from the 1900's to the 1970's. in the 1900's, big businesses arose through vertical integration and merger. These big businesses exploited the economies of scale and scope, research and development (R & D), big investment and mass labor.

In the 1920's, big businesses started to increase their organizational capabilities by changing their structures from centralized to decentralized management and from unit to multi-unit production. In the 1940's, post-World War II, US big businesses started going global as *multinational corporations* and exploited foreign markets. In the 1970's, small businesses revived when the United States' global competitiveness declined.

Capitalism in the Great Britain is still dominated by small businesses. The aristocratic tradition is still prevalent and so are family ties. The management of business is not predominantly left to impersonal management based on expertise and technical capabilities, but is conducted by personal management in which family ties still matter.

Capitalism in Japan is led by the direction of the state (MITI), says Chalmers Johnson. In Japan, the government plays an important role in helping industries move from light to heavy industries, and then to high-tech industries. High government officials believe that this strategy is effective in creating the highest number of value added industries. Although the roles of MITI are exaggerated in many cases, one cannot ignore that the developmental state in Japan penetrates the business world deeply.

There are some variables influencing the rise of various paths of capitalism in the United States, Great Britain and Japan. I will briefly mention three variables: historical backgrounds, political institutions, and business environment.

The historical backgrounds of the United States, Great Britain and Japan are different. Great Britain has a strong aristocratic tradition. The source of power in this tradition is land ownership. Those who are not landowners or the family of landowners are not part of the upper class. The dominant culture of this upper class is conservatism. This culture emphasizes the importance of moral order, harmony, gradual change, fine arts, family and the role of the church.

For the development of business and industries, this historical background can be a big constraint for two reasons. First, merchants, even though leading business people, were only considered to be second class citizens, inferiors to the aristocratic community, since the merchants were not landowners. Second, conservative values are not all in line with the entrepreneurship of business. Some of the driving forces of business are money-oriented behaviors and technical skills. These driving forces are not a part of conservatism. No wonder this strong aristocratic tradition is sometimes accused by some experts as the cause of incomplete industrial transformation in the Great Britain.

Japan has also s strong feudalistic tradition. Merchants in Japan, in the pre-industrial era, were also second class, inferior to the samurai, peasants and artisans. However, different from Great Britain, Japan has a strong bureaucracy which is based on merit system and technical capabilities. The positive role of government in business (MITI) is derived from this strong bureaucratic tradition.

Unlike Japan and Great Britain, the United States has no feudalistic tradition. This new nation was established by the immigrants of Europe who sought freedom in the 1500's. Capitalism came to the United States without evolving from feudalism. The merchants in the United States are first class citizens. These business people enjoy very high social privileges and on many occasions become informal leaders in their communities. From the beginning, the United States has been a land of business people. Hostility towards business is lower in the United States than in Great Britain or Japan.

The nature of political parties in the United States, Great Britain and Japan is also different. In Japan, the LDP dominated and won elections uninterruptedly for a very long time. The stable coalition between the LDP, bureaucracy and big businesses could create consistent policies in business. The dominance of the LDP is one of the reasons why the developmental state's policies (MITI) are sustainable. After the 1970's, industrial policies in Japan were slightly liberalized as a result of international pressure.

Different from Japan, political parties in Great Britain are highly competitive and ideologically divided. The Conservative Party represents the interests of business people and neo-classical economists. The Labor Party represents the interests of labor unions and welfare state economists. Conservatives support privatization (de-nationalization) while the Labor Party supports nationalization programs. Conservative and Labor parties alternate in power. As a result, there are no consistent policies toward business. This political condition is neither favorable nor stable for business. Lately, in the era of Tony Blair, the ideological gap between these two parties has become much narrower.

Parties in the United States are somewhere in between those of Japan and Britain. Unlike Japan, political parties in the US are competitive. Republican and Democrat parties are in power alternately. However, unlike in Great Britain, the ideological gap between Republican and Democrat parties is not wide. Since the era of President Carter, in the late 1970's, both parties have launched pro-business policies. For example, President Carter was committed to deregulation policies, and these policies were continued by Ronald Reagan who came from a different political party.

The last variable is the business environment. The national market in the United States is much larger and homogeneous than that of Great Britain and Japan. Since the 1900's the US government has adopt antitrust policies, such as the Sherman Act. The business environment in the United States is much more favorable for the emergence of vertical integration, hierarchical management and mass production.

US managers and owners, according to Chandler, since the 1900's have also realized the importance of increasing their organizational capabilities by investing lots of capital in production, marketing and management. No wonder big businesses arose first in the United States.

In short, the intersection between Comparative Politics (in this case, the New Institutionalism) and Business History has given a more complete picture within to explain and understand the economic performance of a nation, and the paths to capitalism, modernity and industry.

Chapter 4

Does "The Class of Civilization" Matter?

Trade in the world has grown very fast. In only ten years, from 1984 – 1993, total world exports and imports have doubled. This speed of growth is evidently more or less equal in many areas, including America, Europe and Asia.

Table 1

Total Exports

(US$ Million)

	1984	1993	1993/1984
World	1,935,165	3,632,090	187%
America			
- Developed Economies	309,769	577,041	186%
- Developing Economies	110,494	138,180	125%
Europe			
- Developed Economies	737,150	1,516,816	206%
- Eastern Europe	96,022	31,250	0,33%
Africa			
- Developing Economies	62,491	71,322	114%
Asia			
- Developed Economies	173,920	370,741	213%
- Developing Economies	320,477	773,047	241%
Oceania			
- Developed Economies	27,152	50,848	187%
- Developing Economies	1,898	4,035	212%

Source: Statistical Yearbook 1995

From 1984 to 1993, in terms of US$ Million, *world exports* increased from 1,935,165 to 3,632,090, and *world imports* increased from 1,912,570 to 3,716,705. In America, among developed economies, exports increased from 421,534 to 709,578 and among developing countries from 82,871 to 169,867. In Europe, among developed countries, exports grew from 714,272 to 1,516,816. In Asia, among developed economies, exports increased from 173,920 to 370,741, and for developing economies from 320,477 to 773,047.

The world we live in is also becoming more and more integrated and transformed into a single world market. Coca Cola, McDonalds, Levis, and Honda are common brand names tha we can find any market in the world, from Nigeria to Indonesia, from Korea to Germany. Since people all over the world can subscribe to CNN, any current political event in Washington, for example, can be viewed by people in Singapore and Berlin as fast as in Washington. A live show on HBO of Michael Jackson in New York can be watched simultaneously by anybody in the world. Because personal computers and the internet are available through out the whole world, anybody can virtually instantaneously communicate internationally using e-mail.

It is evident that world trade can transform and change not only the availability of products on the world market, but also many things that are rooted in the human mind, such as values and ways of life. The encounter of many cultures happens much more intensively and thoroughly.

How should we frame this world trade? What variables can influence this global business? What makes one country trade with a certain country and not with others? Is there a kind of law behind the pattern of world trade? What is the common ground of trading blocs that could make a group of nation states cooperate, and at the same time exclude others? What delineations could divide or integrate some nation states?

Samuel Huntington argues that the sources of grouping and conflict in this new “global” world are civilizations. The line that divides the world is not ideology anymore, as occurred in the era of the cold war nor even economic interest, but culture. Nations and societies in this new world group divide themselves through the commonalities and differences of the civilizations they belong to. A clash of civilizations, concurrent with cooperation within every civilization, dominates global politics. As a consequence, a nation tends to cooperate with other nations that share the same civilization and tends to separate itself from, and even tends to conflict with, nations that have different civilizations.

The rise of two new economic powers makes the issue of civilizations salient. First is the emergence of the European Community. This most powerful trading bloc has members (nation states) that share the same civilization – Western Christianity.

The power of European Community in international trade can be seen from the following data. Exports from the European Community in 1992 were 1,455,381 million US dollars. This volume of the European Community's exports is *higher* than that of all developing countries combined (927,432 million US dollars), 20 *times* as much as that of all developing economies combined in Africa (70,120 million US dollars), *almost* three times as much as that of developing economies in Asia (588,570 million US dollars), and five hundred times as much as that of developing economies in Oceania, which is 3,249 million US dollars.

Table 2

European Communities 1992

(US$ Million)

Total Exports	EC/Others	
European Community (EC)	1,455,381	
Eastern Europe (and Former USSR)	89,807	16.2 times
USA		
Japan	424,871	3.4 times
Developed Economies in Africa	339,651	4.3 times
Developing Economies in the Middle East	70,120	20.7 times
	116,121	12.5 times

Source: Statistical Yearbook 1995

Second is the miracle of East Asian countries. These countries that have amazing economic growth (Singapore, South Korea, Taiwan, Hong Kong and China), all share the same civilization: Confucianism. In only ten years, from 1984 to 1993, the total imports and exports of China increased by around 400%, from 27,409 to 103,881 million US dollars. Hong Kong even increased by as much as 500%, from 26,568 to 138,6587 million Us dollars, and Korea grew around 300%, from 30, 635 to 83,784 million US dollars (*Statistical Yearbook, 1995:650).*

Table 3

Confucian Countries

Total Exports

(US$ Million)

	1984	1993	1993/1984
Confucian			
China	26,143	91,737	350%
Hong Kong	28,323	135,248	477%
South Korea	29,218	82,189	281%
Singapore	24,072		307%
Western			
USA	223,976	74,773	203%
FR.	169,784	365,296	215%

Source: Statistical Yearbook 1995

Countries that share the Islamic civilization are not as bold as those of Western Christian and Confucian countries. However, there is growing cooperation between them, such as that which has occurred amongst ten non-Arab Muslim countries: Iran, Pakistan, Turkey, Azerbaijan, Kazakhstan, Kyrgyzstan, Turkmenistan, Tajikistan, Uzbekistan and Afghanistan. Other Muslim countries in Asia, such as Malaysia and Indonesia, deserve the title of high performing Asian Economies (HPAEs) from the ***World Bank***.

Some evidence of conflicts of civilizations in this new world, especially between and amongst Islamic, Confucian and Western Christian countries can be quoted from ***Huntington***. Some of these are "the confrontation at the Vienna Human Rights Conference between the West, led by U.S. Secretary of State Warren Christopher, denouncing ‘cultural relativism’, and the coalition of Islamic and Confucian states rejecting ‘western universalism’; the confrontation between China and the United States over the alleged shipment of nuclear technology to Iran; an announcement by the U.S. Defense Department of a new strategy preparing for ‘major regional conflicts’, on against North Korea, the other against Iran or Iraq”.

Culture as a Variable

It is time to put Huntington’s claim under scrutiny. Does culture matter in international trade? Can civilization dictate to a nation state or businessmen on trading? Is civilization significant for global business?

What civilization? Civilization is the highest cultural grouping and the broadest cultural identity. Civilization is created by hundreds of years of common experience in a society, from one generation to another generation that shares the same history, language, tradition, religion, beliefs, and sometimes, ethnicity. This entity grows together over time and is eventually unified as one identity.

By quoting Arnold Toynbee, Huntington assesses twenty-six major civilizations in human history. However, in this contemporary world, only six civilizations exist. These are Western, Confucian, Japanese, Islamic, Hindu and African. Western civilization is shared, for example, by all the countries in Europe such as France and Germany, also North America, such as the United States. Confucianism is practiced in East Asian countries, from China, Taiwan, Hong Kong and Thailand to Singapore. Islam is the major religion of Indonesia, Malaysia, Pakistan and many countries in the Middle East.

In this global world, according to Huntington, a nation state is less and less meaningful as a source of identity. The total encounter of many cultures makes people look inward and radicalize their own culture. As a source of collective identity, civilization is obviously the strongest since it also gives a set of values for life. A typical question in the world of the nation state is “Where are you from?”, and in the world of the economy is “How much is your salary?” or “How much profit do you want?” However, a typical question in the world of civilization is “Who are you?”. The latter is a question concerning identity. Hence, cooperation among parties from the same civilization is stronger and, at the same time, conflicts between civilizations are more difficult to negotiate since conflicts of values are deep rooted.

The address the importance of civilizations on international trade, ***two hypotheses*** can be deduced from the above questions. First, a nation state tends to trade with other nation states that share the same civilization. Second, a nation state is less and less likely to trade with nation states that have different civilizations.

The case study for this research is from the spectrum of Islamic societies. The criterion in this spectrum is the degree of Islamic values present in the public sphere as represented by the presence of Islamic political parties and Islamic state. The weakest end of the spectrum is no Islamic political parties and no Islamic state. The moderate position is the presence of Islamic political parties but no Islamic state. The strongest end is the presence of an Islamic state that applies Islamic laws as national laws and policies. This research has Indonesia before 1998 (weakest), Malaysia (moderate), and Iran (strongest) as its subjects.

I am going to elaborate the tendency of trade of the above countries toward groups of countries based on Islamic civilization, and also Western Christian civilization for the 1984 – 1995 (12 years). The IMF has recorded these directions of trade. I have just reorganized this record for my own purpose. For western civilization-based countries, I apply what the IMF labels as Industrial Countries (but I exclude Japan): USA, Canada, Australia, Belgium, Austria, New Zealand, Denmark, Finland, Franc, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom. For Islamic civilization-based countries, I use what the IMF labels as the Middle east (but I exclude Israel): Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, the Syrian Arab Republic, United Arab Emirates, the Yemen Arab Republic, and Yemen, P.D. Republic.

The purpose of this is not to claim conclusive answer, but only to act as initial research to give a strong grounding to future research.

From this study I hope to get insight into whether there is a tendency for the volume of trade (export and import) between countries sharing the same civilization to increase, and, concurrently, for the volume of trade between different civilizations to decrease.

A New Perspective

This study could possible act as an embryo study to establish a new perspective on the international economy. Through this study, I scrutinize a new variable – culture or civilization – that might influence the direction of trade among countries. Commonalities or differences of civilization might encourage or discourage trading among countries. If the above hypothesis is proven correct, the pattern of international trade and behavior of a nation state in international business can be understood in a new way.

There exist four perspectives on this subject, but none of them pays attention to civilization.

First: Liberalism. This perspective is established on an assumption that the only interest in trading is to maximize profit. The best mechanism for the realization of this interest is the free market. It gives every party an equal chance to compete and the freedom to trade. Through comparative advantage, the free market should lead every party to get maximum profits. The intervention of the government in the market should be only minimal. In the domestic economy, the government only interferes in the case of market failure, such as to prevent monopoly and intrusion of externalities. In international trade, the role of the government is only to reduce all protectionism and build an international agreement based on free trade.

Liberalism gives no space for culture. In this perspective, the commonalities or the differences of the cultures are not a problem in trading as long as the profit is there. If free trade is subordinated to politics or culture, there will be a distortion, reducing the total profit for all. Money has no country but at the same time money is the “dear friend” of any civilization.

Second: Realism. This perspective puts national interest as the highest priority. Since national interest is a matter of political judgment, politics drives business. The highest goal of realism is not how to maximize profit through free trade, but how to extend national power and wealth. The trade policy of realism is pragmatic and inconsistent. This perspective can adopt both free trade and protectionism intermittently and interchangeably, as long as it creates advantage for the national interest. Free trade will be taken if it gives profit, and if not, it will be left easily.

Realism does not give attention to civilizations either. Regardless of civilization, as long as the national interest is there, nations following realism will take any partner in trading. Indeed, realism can play on the sentiment of civilization, but this manipulation is only rhetoric to strengthen the national interest. According to realism, it is not civilization, which drives trading but national interest that drives both trading and civilizations.

Third: Marxism. This perspective is the most comprehensible frame for understanding the law of human history. More than any other perspective, Marxism puts economic interest in the highest position as the strongest driving force of human behavior. Trade, for example could not only be the subordinate of politics or civilization, but on the contrary according to Marxism, it drives politics and civilization. In classical Marxism, economic interest is an infrastructure of social construction, while politics and cultures are only supra-structures that are dependent on economic interest.

It is Lenin who made Marxism relevant for international trade. Through imperialism, according to Lenin, capitalism extends its life by exploiting to colonized world. Neo-Marxism improves an Lenin's theory by introducing the concept of unequal exchange. International trade between core countries (the western world) and the periphery (the third world) means that the resources have been sucked out without due recompense by the core countries developing, but it is only a dependent development.

In Marxism, culture is not the primary force, buy only variable that can be manipulated by economic interest. Commonalities or differences of civilizations are not a big issue. Exploitation can happen everywhere. A country in the center can easily exploit a peripheral country that shares the same civilization. This core country can also cooperate with another country that has a different civilization, to strengthen the existing system.

Fourth: Cold War Paradigm. This perspective frames trading along the lines of ideological blocs – a western bloc led by the USA and a communist bloc led by the USSR. These blocs are powerful in dividing not only the area of trading but also the mechanism of trading. In the communist bloc, for example, there are no big private companies since all important productions are owned by the government.

This perspective also does not consider civilization as an important variable. The most important variable, according to this perspective, is to hold the position of hegemonic power. It does no matter what civilization a country has, as along as that country strengthens its hegemony, it will be supported. At the same time, even though a certain shares the same civilization or even the same ideology of communism, such as China, if it challenged the hegemony of the communist bloc led by the Soviet Union, China would be excluded too.

The above four perspectives, despite large differences in assumptions and implications, share one thing in common. None of them pays attention to cultures (civilizations). This initial research, therefore, is really an attempt to build a new perspective based on culture (civilization). The result of this study will provide some directional clues.

If Huntington's framework is proven correct, it will be a serious alternative explanation (the approach of political culture) in the field international political economy. The perspective of political culture is common in other major fields, such as in explaining democratic stability (Civic culture) and the success of development in East Asia (Confucian tradition). However, international trade (in general, international political economy) has not been touched by cultural theories.

Data

Trade data (export and import) for the countries being studied is derived from "The Direction of Trade Statistics Yearbook", IMF (1991), for the years 1984 – 1989, and IMF (1996) for the years 1990 – 1995. In analyzing this data, I apply simple regression. The dependent variable is the percentage of trade volume of each country (Indonesia, Malaysia, and Iran) of those the Western Christian based and Islamic based countries. All the data and statistical models are presented in the following tables.

Table 4

Malaysia (exports)

To Western Countries

US$ Million

Year	*Whole Western World (W)*	*Industrial Countries (In.)*	*Japan (Jap.)*	*Western Countries (In. – Jap)*	*Percentage (In.-Jap)/W*	*Western Countries without USA*	*USA*	*Percentage*
1984	16563	8635	3770	4865	0.29373	2231	2634	0.159029
1985	15408	8433	3784	4649	0.30173	1970	2679	0.173871
1986	13977	8075	3257	4818	0.34471	2297	2521	0.180368
1987	17934	9726	3504	6222	0.34694	2972	3250	0.18122
1988	21109	11129	3577	7552	0.35798	3663	3889	0.184348
1989	25049	13522	4016	9506	0.37950	4684	4822	0.192503
1990	29420	14879	4506	10373	0.35258	4986	5387	0.183107
1991	34405	17516	5458	12058	0.35047	5808	6250	0.18166
1992	40709	20598	5401	15197	0.37331	7954	7243	0.177921
1993	47128	24162	6113	18049	0.38298	9580	8469	0.179702

1994	58748	29730	7010	22720	0.38674	12448	10272	0.174849

Table 5

Malaysia (imports)
From Western Countries
US$ Million

Year	*Whole World (W)*	*Industrial Countries (In.)*	*Japan (Jap.)*	*Western Countries (In. – Jap)*	*Percentage (In.-Jap)/W*	*USA*	*Western Countries without USA*	*Percentage*
1984	14057	9027	3692	5335	0.37953	2295	3040	0.216262
1985	12301	7572	2833	4739	0.38525	1881	2858	0.232339
1986	10828	6781	2221	4560	0.42113	2034	2526	0.233284
1987	12701	839	2750	5089	0.40068	2376	2713	0.213605
1988	16567	10312	3816	6496	0.3921	2925	3571	0.215549
1989	22589	14141	5438	8703	0.38528	3803	4900	0.21692
1990	29170	18557	7055	11502	0.39431	4944	6558	0.22482
1991	36749	23036	9582	13454	0.36611	5626	7828	0.121083

1992		39927	24338	10379	13959	0.34961
	6331	7628	0.191049			
1993		45616	28463	12533	15930	0.34922
	7725	8205	0.179871			
1994		59555	37951	15907	22044	0.37015
	9900	12144	0.203912			
1995		77662	50061	21211	28850	0.37148
	12691	16159	0.208068			

Table 6

Malaysia (exports) to Islamic Countries

In the Middle East

US$ Million

Year	*Whole World (W)*	*Islamic Countries in The Middle East (Ist.)*	*Percentage (Ist./W)*
1984	16563	343	0.02071
1985	15408	285	0.01850
1986	13977	217	0.01533
1987	17934	280	0.01561
1988	21096	505	0.02394
1989	25049	598	0.02387
1990	29470	735	0.02494
1991	34405	776	0.02255
1992	40709	1002	0.02461
1993	47128	1208	0.02563
1994	58748	1417	0.02412
1995	73990	1878	0.02538

Table 7

Malaysia (imports) from Islamic Countries

In the Middle East

US$ Million

Year	*Whole World (W)*	*Islamic Countries in The Middle East (Ist.)*	*Percentage (Ist./W)*
1984	14057	569	0.04048
1985	12301	475	0.03861
1986	10828	244	0.02253
1987	12701	261	0.02055
1988	16567	276	0.01666
1989	22589	229	0.01293
1990	29170	354	0.01214
1991	36749	318	0.00865
1992	39927	341	0.00854
1993	45616	431	0.00945
1994	59555	374	0.00628
1995	77662	485	0.00625

Table 8
Iran (exports)
To Western Countries
US$ Million

Year	*Whole World (W)*	*Industrial Countries (In.)*	*Japan (Jap.)*	*Western Countries (In. – Jap)*	*Percentage (In.-Jap)/W*	*USA*	*Western Countries without USA*	*Percentage*
1984	15182	10200	2605	7595	0.50026	664	6931	0.456527
1985	13727	8238	2295	5943	0.43294	693	5250	0.382458
1986	8099	4943	1281	3662	0.45215	556	3106	0.383504
1987	11049	7428	1426	6002	0.54322	4292	4410	0.399131
1988	8289	4858	1058	3800	0.45844	8	3792	0.457474
1989	13081	9206	1996	7210	0.55118	117	7093	0.542237
1990	19305	13712	3998	9714	0.50319	294	9420	0.487956
1991	18661	11470	2630	8840	0.47372	1756	7084	0.379615
1992	19868	11668	2524	9144	0.46024	2116	7028	0.353735

1993	18020	8720	2211	6509	0.36121	0	6509	0.36121
1994	17285	8037	2483	5554	0.32132	1	5533	0.321261
1995	18621	8935	2564	6371	0.34214	0	6371	0. ……..

Table 9
Iran (imports)
From Western Countries
US$ Million

Year	*Whole World (W)*	*Industrial Countries (In.)*	*Japan (Jap.)*	*Western Countries (In. – Jap)*	*Percentage (In.-Jap)/W*	*USA*	*Western Countries without USA*	*Percentage*
1984	13908	10080	1862	8218	0.59088	178	8040	0.578085
1985	10982	7222	1496	5726	0.5214	81	5645	0.514023
1986	8818	6382	1270	5112	0.57972	38	5074	0.575414
1987	8719	6237	1160	5077	0.58229	59	5018	0.575525
1988	8708	5701	888	4813	0.55271	80	4733	0.543523
1989	12807	782	973	6809	0.53166	0	6809	0.531662

1990	15903	10907	1782	9125	0.57379	140	8985	0.564988
1991	21789	15823	2724	13099	0.60117	580	12519	0.574556
1992	23106	16973	2918	14055	0.60828	822	13233	0.572708
1993	16650	10624	1606	9018	0.54162	678	8340	0.500901
1994	11628	7479	1005	6474	0.55676	362	6112	0.525628
1995	12311	6935	729	6206	0.5041	262	5944	0.48282

Table 10

Iran (exports) to Islamic Countries

In the Middle East

US$ Million

Year	*Whole World (W)*	*Islamic Countries in The Middle East (Ist.)*	*Percentage (Ist./W)*
1984	15182	930	0.06126
1985	13727	748	0.05449
1986	8099	297	0.03667
1987	11049	377	0.03412
1988	8289	206	0.02485
1989	133081	244	0.00183
1990	19305	201	0.01041
1991	18661	474	0.00254
1992	19868	466	0.02345
1993	18020	356	0.01976
1994	17285	509	0.02945
1995	18621	443	0.0237

Table 11

Iran (imports) from Islamic Countries

In the Middle East

US$ Million

Year	*Whole World (W)*	*Islamic Countries in The Middle East (Ist.)*	*Percentage (Is.t/W)*
1984	13908	209	0.01350
1985	10982	158	0.01439
1986	8818	167	0.01894
1987	8719	242	0.02776
1988	8708	294	0.03376
1989	12807	1205	0.09409
1990	15903	1310	0.08237
1991	21789	1387	0.06366
1992	23106	1729	0.07483
1993	16650	1608	0.09658
1994	11628	1341	0.11533
1995	12311	1437	0.11672

Table 12

Indonesia (exports)

To Western Countries

US$ Million

Whole *Industrial* *Western*

Western

Percentage *Countries* *Japan* *Countries* *Percentage*

USA *Countries* *Percentage*

Year *World* *(In.)* *(Jap.)* *(In. – Jap)* *(In.-Jap)/W*

without

	(W)					*USA*		
1984	21881	16532	10353	6179	0.28239	4505	1674	0.076505
1985	18597	14094	8594	5500	0.29575	4040	1460	0.078507
1986	14809	11261	6644	4617	0.31177	2902	1715	0.115808
1987	17170	12776	7393	5383	0.31351	3349	2034	0.118462
1988	19376	13860	8088	5772	0.29789	3138	2634	0.135941
1989	21941	15659	9252	6407	0.29201	3475	2932	0.133631
1990	25681	18040	10923	7117	0.27713	3365	3752	0.1461
1991	29186	18978	10767	8211	0.28133	3509	4702	0.161105
1992	33977	21235	10761	10474	0.30827	4419	6055	0.178209
1993	36843	23007	11172	11835	0.32123	5230	6605	0.179274
1994	38214	25257	11465	13792	0.36091	6179	7613	0.19922
1995	42285	29199	12908	16291	0.38527	7232	9059	0.214237

Table 13
Indonesia (imports)
From Western Countries
US$ Million

Year	*Whole Western World without USA (W)*	*Industrial Countries (In.)*	*Japan (Jap.)*	*Western Countries (In. – Jap)*	*Percentage (In.-Jap)/W*	*USA*	*Countries*	*Percentage*
1984	13880	9090	3308	5782	0.41657	2560	3222	0.232133
1985	10275	7129	2644	4485	0.4365	1721	2764	0.269002
1986	10274	7466	3128	4338	0.40451	1482	2856	0.266319
1987	12850	8630	3596	5034	0.39175	1415	3619	0.281634
1988	13489	9151	3427	5724	0.42435	1734	3990	0.295797
1989	16467	10481	3853	6649	0.40378	2216	4433	0.269205
1990	22008	14470	5455	9015	0.40962	2520	6495	0.29512
1991	25940	17042	6327	10715	0.41307	3397	7318	0.282113
1992	27283	18110	6014	12096	0.44335	3822	8274	0.303266
1993	28333	18536	6248	12288	0.4337``	3255	9033	0.318816
1994	30447	20452	8250	12202	0.40076	3424	8778	0.288304
1995	39456	26104	10966	15138	0.38367	3735	11403	0.289005

Table 14

Indonesia (exports) to Islamic Countries

In the Middle East

US$ Million

Year	*Whole World (W)*	*Islamic Countries in The Middle East (Ist.)*	*Percentage (Ist./W)*
1984	21881	179	0.00818
1985	18597	238	0.0128
1986	14809	218	0.01472
1987	17170	243	0.01415
1988	19376	432	0.0223
1989	21941	575	0.02621
1990	25681	748	0.02913
1991	29186	1068	0.03659
1992	33977	1350	0.03973
1993	36843	1443	0.03917
1994	38214	597	0.01562
1995	42285	820	0.0193

Findings and Interpretations

Whether the data confirms or disconfirms the hypothesis, depends on the pattern of the results of the T-test I use as the model for this research. The data confirms hypothesis if the pattern are as follows. The stronger the degree of Islam within a country, the less country tends to trade with Western-Christian-based countries, and the more a country tends to trade with Islamic-based countries (Middle East).

However, the T-test in tables 16 and 17 shows mixed signals. On the export side, the weakest Islamic civilization-based country, Indonesia, tends to increase her trading with the West and the Middle East concurrently. The same tendency happens to the medium Islamic civilization based country, Malaysia. The commonalities and differences of civilization do not affect the export tendencies of these countries. Indeed, the strongest Islamic-based civilization country, Iran, has a different tendency. Iran has a tendency to decrease her trading with the west significantly. However, as the data shows, if we remove the USA from the group of western countries the tendency of Iran is not significant. It seems that Iran has a problem only with the USA, not with other western countries. On the other hand, there is no indication that Iran increases her exports with the Middle East.

On the import side, the results of the test are much more inconsistent. The imports of Indonesia (the weakest) and Malaysia (medium) from the same civilization (the Middle East) tend to decrease significantly over time, not increase as I would have expected. The import tendencies of Iran, as the strongest Islamic state in this case study, from the west decrease, but not significantly, while the medium Islamic state (Malaysia) decreases significantly. This data cannot support the claim that the difference and the similarities of civilizations can change the direction of trade. Civilization is not a variable determining the direction of trade in the world.

How should this result be interpreted? There are three possibilities. First, the problem of the data. The clash of civilizations may be still in the making. As the consequence, fair judgment in attempting to verify this theory should wait much longer, at least fifteen or twenty years from now. The data at present is just not sufficient to confirm or disconfirm this process. Since this is the case, I shall replicate this research at some time in the next fifteen or twenty years, in order to correctly verify this theory.

Second: the problem of domain. The clash of civilizations might not be a theory of/for global trading, but a theory for other domains such as foreign aid, tourism, governmental conflict and cooperation, or the world of diplomacy. If this is the case, I have asked too much from this theory. Huntington might have no intention at all to expand the coverage of his theory to global trading. Fair verification of his theory, then, should perhaps be limited to non-trading domains.

Third: the theory of civilizations is indeed intended to explain and read important issues of world affairs, including global trading. The disconfirmation of this theory, therefore, is due to the weakness of the theory itself. The civilizations perspective from Huntington is based on wrong assumptions that actors (individuals, groups, and nation state) are motivated by a kind of cultural sentiment. This cultural sentiment is assumed to be strong enough to subordinate and drive other interests.

If these claims are correct and realistic, then clearly many agents in international trade world consider their cultural sentiments in conducting business. They would tend to trade with other agents that share the same cultural sentiments to strengthen their common cultures. They would frame other cultural sentiments (from other civilizations) as a threat. Many nation states from the same civilizations, then, would be unified as a single political power and trading bloc. The world would be divided along the lines of civilizations.

However, these claims are not justified. Liberalism gives rebuttal by explaining that agents are never motivated by cultural sentiment but by self-interest. Cultural sentiment can be used by any agent only if this sentiment fits his/her self-interest. Although cultural sentiments probably exist, they are not strong enough to subordinate other interests. It is difficult to force any nation state to sacrifice its national economic profit for the sake of the dignity of the civilization.

Realism gives another rebuttal by arguing that the strongest unit in international affairs is not the civilization but the nation state. A nation state will not sacrifice itself for the sake of a civilization. On the contrary, cultural sentiments, if useful, may only be manipulated for the purpose of serving the glory of the nation state. A grouping of states that share the same civilization, if it exists, cannot subordinate the sovereignty of a national state for the purpose of the glory of the civilization. On the contrary, this cluster of a civilization will be subordinated, if possible, to the interests of a nation state.

The pattern of global business, then, is not understood solely by the newcomer "theory of civilization". Thus the pattern is not determined by civilizations but, as usual, by an orchestra of the various interests of many players: from small businesses, multi-national corporations, sub-national governments, national governments and trading blocs to world organizations. Cultural sentiment, if it exists, seems to play only marginal role in this orchestra.

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17. GERAKAN MAHASISWA DAN POLITIK KAUM MUDA ERA 80-AN, Penerbit LKIS, 2006
18. ELECTION WATCH : MERETAS JALAN DEMOKRASI (Talkshow Denny J.A. di Metro TV), Penerbit Pustaka Sinar Harapan, 2006
19. PARLIAMENT WATCH : EKSPERIMEN DEMOKRASI, DILEMA INDONESIA (Talkshow Denny J.A. di Metro TV), Penerbit Pustaka Sinar Harapan, 2006
20. NAPAK TILAS REFORMASI POLITIK INDONESIA (Talkshow Denny J.A. Dalam “Dialog Aktual” Radio Delta FM), Penerbit LKIS, 2006
21. JEJAK-JEJAK PEMILU (Talkshow Denny J.A. Dalam “Dialog Aktual” Radio Delta FM), Penerbit LKIS, 2006

What is the role of government in encouraging business and economic development in pre-industrial, industrial, and post-industrial societies?

What have been the major direct and indirect roles played by government?

How and why have those roles changed over time?

How important has the role of government been in economic and business development?

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