

Building Modern States: Industrialization in Norway and Malaysia

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Abstract

This thesis sets out to apply a corrective to the views that modern state development is a result of war-making or solely a consequence of global capitalism. These and other perspectives on the state and its modern development have rarely directly engaged with industrialization as a unique form of economic change and as imperative to modern state development. Theories on the developmental state have come closest to identifying how industrialization as a process impacts upon and shapes state development. Industrialization has been the major imperative for the development of the modern Norwegian and Malaysian states in the twentieth century. Industrialization gave rise to powerful social organizations representing a range of interests. As industrial development proceeded, these organizations orientated toward the state. In turn, institutions of the modern state emerged and developed around the industrialization process and the problems and changes it produced. In both case studies, the state also managed industrialization as a political project. This project was carried out by the state attempting to variously regulate, direct or manage the key components of the industrialization process. These components included foreign investment, the banking sector and labour relations. Industrialization saw the state extend its control into areas of banking, capital flows and relations between key social groups. Modern state development in the twentieth century must be understood as a result of industrialization as an economic process *and* a political project by the state. Perspectives on modern state development must qualify accounts of war-making and capitalism to construct a more variable model. An approach that identifies key organizations as powerful social actors, must in addition understand the modern state as a powerful actor also. Industrialization builds the modern state with its many sites of power that increases regulation and management of economic processes.

Declaration of Authorship

Except where reference is made in the text of the thesis, this thesis contains no material published elsewhere or extracted in whole or in part from a thesis submitted for the award of any other degree or diploma.

No other person's work has been used without due acknowledgement in the main text of the thesis.

The thesis has not been submitted for the award of any degree or diploma in any other tertiary institution.

Several Norwegian language articles were professionally translated into English to support research.

Signed.....

May 2008

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List of Acronyms and Abbreviations

APEC- Asia Pacific Economic Cooperation
ASEAN- Association of South-East Asian Nations
BN- *Barisan Nasional*
DAP- Democratic Action Party
DNA- Norwegian Labour Party
DNU- Department for National Unity
EPU- Economic Planning Unit
FDI- Foreign Direct Investment
GDP-Gross Domestic Product
GNP-Gross National Product
HICOM- Heavy Industries Corporation of Malaysia
IMF- International Monetary Fund
ISA- Internal Security Act
KL- Kuala Lumpur
KLSE-Kuala Lumpur Stock Exchange
LO- *Landsorganisasjonen* (National Federation of Labour)
MAF- Malaysian Armed Forces
MCA-Malay Chinese Association
MIC- Malaysian Indian Congress
MTUC- Malaysian Trades Union Congress
NAF- *Norsk Arbeidsgiverforening* (Norwegian Employers Federation)
NEAC- National Economic Action Council
NEP- New Economic Policy
NIC- Newly Industrializing Country
NOC- National Operations Council
NUPW-National Union of Plantation Workers
NVE- Norwegian River and Electricity Board
OIC- Organization of Islamic Conferences
PAS- Parti Islam Se-Malaysia
PERNAS- National Corporation
PPP- People's Progressive Party
RM- Malaysian Ringgit
RTM- Radio Television Malaysia
UDA- Urban Development Authority
UEM-United Engineers Malaysia
UMNO-United Malay National Organization

A note on language and sources

Norwegian spelling is used for names and places where appropriate. These spellings use the contemporary form of *norske*. Whilst the majority of sources are in English, several Norwegian language articles were translated for the purposes of this research. Some of these older sources also use the formal *norsk* known as *bøkmål* as opposed to *nynorsk* (new norsk). For more general references, many articles from Norwegian historical journals also contain English summaries of their main points and argument. I would like to thank Veronica Eng and Maren Søreide for their translation work and guidance with the material. Whilst no Bahasa Malay language sources were used for this research, Bahasa Malay names are used where appropriate.

INTRODUCTION

Building Modern States

As the primary institution of politics, it is fitting that the state receives so much attention in scholarship. This thesis will contribute to the existing literature, providing a different perspective on old questions by exploring the state in a period of great change. The aim of this thesis is to understand how the modern state, as an organizational form, is shaped by the process of industrialization, and how in turn the state responds to the industrialization process. The problem addressed in this thesis is this: we do not have an adequate conceptual model of the modern state as it emerged and responded to the process of industrialization in the twentieth century. Specifically, this thesis asks: *how does industrialization interact with and shape the process of modern state development?*

The process of state formation has received considerable attention. From specific case studies to comparative works and to more abstract explorations in social theory, the state has remained central to the social sciences. Underpinning this vast literature are definitional debates as to what the state *actually is*. Yet despite all this work the consideration of industrialization as a key factor in modern state development has rarely been *directly* explored as the literature review will demonstrate. Numerous historical studies have approached this topic in an indirect fashion, but enhancing conceptual frameworks have not been the direct aim of many studies. This thesis will analyze the impact of industrialization on the development of the modern state with a direct focus on the relationship between economic change and modern state development. Further, it will apply these findings to the concept of the modern state.

A plausible approach to this problem resides in some traditions of historical sociology. The organizational form of the state which emerged from the seventeenth century onward in Europe was driven by a search for security. The solution to the perpetual climate of insecurity was the organization of societies along martial lines, and the key

features of the modern state, such as bureaucracies, developed as a result. Such organizations could extract treasure from the population through taxation, and conscript people for the purpose of defence. As Charles Tilly concludes: 'war made states and states went on to make war.'¹ Warfare became the driving imperative for state formation in Europe, whence it became the premier form of territorial organization because it was the best way to ensure security in an insecure world. This account is popular and its key assumptions are evident, explicitly or implicitly, in much of the literature concerning state development. Nevertheless, it needs to be reconsidered. Industrialization is a dramatic and transformative process, yet the war-making model tends to exclude it as a direct influence upon the process of state development. The war-making imperative approach is embedded in the experience of major European powers as they went about the consolidation of territorial control in the seventeenth, eighteenth and nineteenth centuries. But for small states on the periphery of major economic and political regions in the twentieth century, this model is insufficient as an explanatory framework. This is not to imply that the search for security is not of importance, but rather to suggest that industrialization must be considered as an alternative factor in modern state development.

This thesis will demonstrate how modern state development is related to the process of industrialization through an analysis of the states of Norway and Malaysia. Their political development presents challenges to existing perspectives and raises questions about the utility of the war-making paradigm of state development. The experience of these two states also challenges some existing perspectives on states and economic development.

Norway has been frequently ignored in literature concerning European economic development and politics. With a small population and located on the periphery of the European continent, Norway remained poor and isolated until the twentieth century. From independence in 1905, the Norwegian economy rapidly grew and changed from one based upon agriculture to that of industry and services. The impact industrial production had upon Norway, and the response of the state in terms of organization, will be the focus of this case study. The South East Asian state of Malaysia will be

¹ Charles Tilly, 'Reflections on the History of European State-Making', in Charles Tilly and Gabriel Ardant (eds.), *The Formation of National States in Western Europe*, Princeton University Press, Princeton, 1975, p.42.

examined as a historically subsequent case of industrialization. Malaysia lies on the periphery of the East Asia region, is small in size and its economy is heavily dependent upon trade. From the end of the 1960s Malaysia underwent a dramatic transformation of its economy, shifting into manufacturing and services. Rapid economic development impacted greatly upon Malaysian society and the institutions of the state. The purpose of examining the two case studies is to place the relationship between state development and industrialization under the microscope. It is not the primary aim of this research to develop new insights into Norwegian or Malaysian history. The findings from the evidence will rather inform an improved understanding of modern state development.

A direct comparison of Norway and Malaysia will not be undertaken initially, however, points of similarity will be discussed throughout the analysis. In presenting these particular cases it is necessary to point to some key differences and similarities now to provide a clear picture of the case studies and how they stand as an appropriate way to test the analytical approach of this thesis. The period of focus upon Norway is from 1895 to 1935. The industrialization of Malaysia will be analyzed from 1969 to 1999. Both periods have been selected because they lie in a period of great economic growth. In addition, because of significant political upheavals at the beginning and end of each respective chosen period, the case studies will permit an assessment of state development that identifies major state institutional changes over time. The time frames chosen thus make ideal entry and exit points for analysis.

Norway and Malaysia are located in different regions, making for quite different economic, cultural and geographic contexts. Norway has an ethnically homogenous population bar the small minority Sámi population in the far north. This homogeneity is reflected in a common language and an absence of cultural division. In contrast, Malaya (subsequently Malaysia), since it gained independence in 1957, has experienced considerable social and political tensions associated with relations between its three main ethnic groups. With each group having different religious faiths, social customs and economic niches, Malaysian society in the period studied is complex and diverse.

Whilst there are some key differences between the case studies they share some noteworthy similarities. Both underwent industrialization following independence gained from a colonial or occupying power. Their growth was rapid and followed a similar path in progressing from agriculture to light manufacturing and services. Both states as a consequence expanded their banking system, employment structure changed dramatically and living standards grew. Yet a major similarity that forms the basis for their utility as case studies is that inter-state war did not directly shape their territorial boundaries: rather, a process of post-colonial settlement dictated proceedings. Similarly, foreign investment from major regional economies played a crucial role in their respective economic growth. In both cases, foreign investment flowed in and had to be managed by the state in order to direct it toward profitable outcomes. It will be demonstrated that this investment, due to its rapidity and transformative effect, had a significant impact on state development in Norway and Malaysia.

The following thesis is therefore an attempt to apply a corrective to the European-derived understanding of state development. Many small and new states throughout the twentieth century did not encounter the same strategic, economic and political environment as did those of continental Europe in the seventeenth century. There are some important distinctions to be made in this respect. Many new states of the twentieth century had their boundaries determined for them by major powers and so the process by which territorial control was established did not occur in the same manner; war-making is a less significant factor in directly dictating their history. More significant as an explanatory factor is the impact of industrialization and the role such an economic process had in political change. Many small states were heavily engaged in trade and thus endured the difficulties and opportunities of exposed or open domestic economies. An additional consideration is the means by which many states sought security in the twentieth century. The twentieth century state can also be further distinguished by the possibility that development also reflects a deliberate political project on the part of certain social groups and political leaders. Industrialization, as the path to greater economic growth, can be considered as a vehicle for a project of modern state building. The case studies will demonstrate how the state, through policies and institutional development, shaped the process of industrial development.

Directly, this study addresses how the state as a bounded territorial space for social contestation and as a set of institutions has responded to and altered the economic process of industrialization. This is considered by an examination of two case studies - Norway and Malaysia - and the industrialization of their economies. This thesis suggests that industrialization, in its impact upon the state, became a political project by the state as well as an economic process. The institutions of the modern Norwegian and Malaysian states formed around the industrialization process. The state institutions then impacted upon industrialization by influencing the economic process through regulation and management of its components.

This argument will test the historical evidence of the case studies against existing concepts of state development. The case studies will provide the core of this thesis, laying the foundation for a reassessment of the concepts discussed in Part One. Theory will provide a guide to exploring history, but will itself be subjected to scrutiny by the evidence examined. By doing so, the thesis will place some important assumptions about state development under new light. The literature review in Part One will demonstrate that perspectives of the state often rest on one of two important assumptions. The first departure point for many concepts is that states are a historical consequence of various social processes. States, including their modern version, are from this perspective, organizational responses to forces and processes that occur in wider society. The state therefore, is conceived of as an arena in which social actors operate and influence political outcomes. The second view perceives states primarily as a set of institutions able to exercise control over society. Such a view, one that closely equates states with government, ascribes degrees of agency to the institutions of the state and makes their conduct the focus of analysis. Most perspectives of the state have taken one of these two directions, excluding the other to varying degrees; sometimes to the detriment of insightful analysis. To provide a basis for the literature survey that follows, a preliminary understanding of this thesis' approach to the modern state must be advanced. In this thesis, the modern state will be viewed from *both* the perspectives broadly outlined above. It is the purpose of Part One to argue why an examination of the modern state on such terms is useful. The discussion of various concepts will contribute to building a framework of analysis that incorporates these approaches. The case studies in Part Two will further demonstrate the utility of

such an approach. The historical analysis of Norway and Malaysia will show why, in the context of industrialization, perceiving the state as an arena and as a set of institutions together enhances analysis of the modern state in the context of industrialization. Such a definition, whilst it will be given further attention, is not atypical of literature on the subject, and further it is not the intention of this thesis to forward a new understanding of the state *itself*. A second and related issue to be addressed is the conceptual divide between the state and society found in much of the relevant literature. Social theory has often separated these two spheres for the sake of clarity. As Part One will discuss, such an approach has not always rendered a clear picture of the modern state and its development. Part One will suggest some ways to resolve this issue, chiefly through the development of an analytical framework that places interaction between the two spheres at its centre.

Both case studies will be handled in similar fashion. First, the industrial development of the economy is analyzed, identifying the key changes that occurred. This will set the context for an analysis of modern state development. Second, the key groups and organizations within the state will be identified and their response to industrialization analyzed. Industrialization impacted upon key social organizations such as political parties, trade unions and business organizations: the ways in which this occurred will be analyzed. Third, once the role of these groups is established, the process by which they interacted with each other and the institutions of the state in the context of industrialization will be examined. The questions asked of the case studies are: how were key social organizations within the state shaped by industrialization? How did these organizations interact with the institutions of the state during the process of industrialization? How did the state as a set of institutions respond to this dynamic? These questions will undergo refinement in Part One. The answers to these questions provided by the evidence will serve to address the central problem of this thesis.

THESIS AND ARGUMENT STRUCTURE

Part One of the thesis explores various concepts and perspectives of the state to ascertain their utility in understanding state development during industrialization. In building an approach and method, the literature will be directly engaged with to understand the state, industrialization and the relationship between the two. This part

analyzes existing concepts in order to formulate a method to approach the case studies with. Chapter One analyzes arguments that depict the state primarily as an arena and shaped by various social processes. Concepts of the state as a war-maker will be examined. It will then analyze Marxist, world systems and pluralist traditions and concepts of the state. The chapter examines perspectives of the state as an organizational form developing from the processes of war-making, capitalist production and other forms of interaction between social groups. These approaches portray the state as a consequence of these processes. Just how well these approaches consider industrialization as a factor in state development will be directly addressed. It will also address the concept of the *modern* state, to identify it as a particular form of the state. This chapter aims to build an approach to analyze the modern Norwegian and Malaysian states as arenas, as they underwent industrialization.

Chapter Two will examine contrasting perspectives that portray the state primarily as a set of institutions. Building on the approach of the previous chapter, this chapter will consider the state as a set of institutions with the ability to shape and influence society. The impact of industrialization upon the state is discussed in this light. The nature of industrialization and its unique impact upon society and the state will be discussed and incorporated into the approach. The aim of the chapter is to develop the tools by which to examine the relationship between industrialization and the institutions of the modern state. In particular, theories of the 'developmental state' will be scrutinized as these theories have come closest to exploring this relationship in ways that help address the problem of this thesis. It is necessary to canvass a wide body of literature as the context of major economic change requires an approach to the state that utilizes elements from an array of concepts. The framework developed will permit a flexible and responsive analysis of the case studies; one that understands the modern state development process as one which shapes economic outcomes, not just as an organizational response to industrialization.

Part Two of this thesis is devoted to the study of Norway and Malaysia. These case studies will serve to test the analytical framework developed from the literature review in Part One. The question 'how does industrialization interact with and shape the process of modern state development?' will be asked of the case studies. The historical studies will inform an improved understanding of the development process of the

modern state. Industrialization as an economic process will be analyzed, focussing on the ways Norway and Malaysia made a transition from labour-intensive to capital-intensive production. This part will consider the new economic sectors and their social impact. This will be followed by an analysis of the key social organizations in each state, what and who they represented, what their interests were, and how they interacted with each other. The remainder of the section examines how these organizations came to interact with the institutions of the state in the context of industrialization. How were group interests channelled or not into policy and actions? This analysis is crucial as it demonstrates important aspects of modern state development to be a result of interaction between state institutions and social and political groups. Importantly, this process of modern state development in turn had an impact on the process of industrialization. The case studies will demonstrate how economic development became a political project of state institutions and political leaders and increasingly supported by the many actors within the state arena. Chapters Three and Four examine Norway within this framework and Chapters Five and Six will treat Malaysia in the same way.

Part Three of this thesis draws conclusions from the case studies in order to make a contribution to the state development literature. The insight gained from the case studies will be used to present a conceptual picture of the relationship between modern state development and industrialization. The evidence will demonstrate that in the twentieth century an important driving imperative for the development of modern states has been industrialization. It has been the context whereby the modern state has emerged and developed. Therefore, the model of state formation based upon the war-making paradigm needs to be reconsidered in this light. Small states on the periphery of their economic regions in the twentieth century experience industrialization rather than war-making as the driving imperative in their development processes.

PART ONE

CHAPTER 1

States as a Product of History

INTRODUCTION

This chapter will discuss several key concepts and perspectives in order to provide the tools for an inquiry into the industrializing states of Norway and Malaysia. Modern economic activity in the guise of industrialization has had an enormous impact upon the organization and character of the state. The question this thesis asks is: how does industrialization impact upon the development of the modern state? This chapter will first consider concepts of the state with the aim of distinguishing the modern state from the broader concept of the state and the processes that shape it. It will do so by examining perspectives of the state that consider the state primarily as an *arena* or *space*: a bounded territory shaped by various historical forces, processes and political interactions between groups. Later, this chapter will address industrialization as a particular and unique economic process. This is important in order to develop the context for an inquiry into the modern state. In exploring these two key concepts this thesis will begin to identify connections between the two that have been discussed in existing literature. By the conclusion of this chapter, a cursory framework of inquiry will have been established to analyze the state as an arena, allowing us to understand how the states of Norway and Malaysia were shaped by industrialization.

The development of the modern state has transformed human societies. To comprehend this transformation, it is necessary to understand what the state actually is. For most straightforward definitions, the state may be considered no more than a basic centralized administrative organization controlling a defined territory. Such a Spartan definition, whilst perhaps adequate for the most basic understanding of the state as a general category, does not sufficiently illuminate the complexity of modern

states with their multitude of institutions, organs and structures. It is this very complexity of the modern state that has made a conceptual understanding difficult. Social theory is based upon a snapshot in time; therefore conceptual descriptions of the state have sometimes struggled to keep up with the rapid change and complexity of human societies in the modern era. This difficulty has played out in the many presentations of the state as derived from processes that occur separate from it. In much literature it is argued that states, as organized territories, have formed as a result of the actions of war and the process of capitalism.

The argument of this thesis is that to explore the modern state without analysing the process of industrialization is to view only a partial picture. The modern state has emerged with and as a response to industrialization, shaped by dramatic economic change. In turn, industrialization as an economic process has been shaped and directed by the social and political changes deriving from the development of the modern state. The two phenomena are intricately intertwined, both feeding and receiving sustenance from the other. It will be argued that industrialization as an economic process and the modern state have such a close relationship as to be regarded as inseparable. To comprehend modern state development in the context of industrialization, it is necessary in this chapter to explain the distinction between the modern state and the *pre-modern* state. In this chapter, the state will be approached with the following question in mind: has the modern state in its process of development, been shaped by processes and activities of which it has little direct control over? The processes of war-making and capitalist production are two primary factors considered in this chapter as shaping the development of states; the state is a *consequence* of these historical forces. These factors contribute to an understanding of the state that portrays it primarily as an organized and administered *arena*, shaped by the processes discussed, as opposed to a cluster of institutions or site of decision making, a perspective that will be considered in Chapter Two, and further developed into an analytical framework.

WAR-MAKING AND THE NEED FOR SECURITY

A broad perspective understands early modern states as an organizational development emerging from the post-medieval political morass of Western Europe.¹ As the feudal system of overlapping territorial claims and domains broke down, the centralized state developed primarily as a response to the security needs of societies. State formation was a process of territorial consolidation, as conflict between the emergent political societies solidified claims over territory. Whilst the Westphalian peace is symbolically regarded as the birth of the international state system, the gradual development of the state took place in the context of war. As the invention of gunpowder allowed a heretofore weak monarch to break the castles of the barons, the new technologies of war in turn created clear demarcations of territory, to be defended against encroachment from other emerging 'states'.² This concept emphasizes the importance of the development of boundaries or lines of territorial demarcation in state formation as the internal organization of societies followed on from this development. Increasingly defined territory and the means to defend it became the primary distinguishing features of the early modern state.

What the modern world would experience in the great inter-state wars of the twentieth century was beginning to occur in a consistent pattern. Civil wars continued to take place and indeed continue to occur to this day. But the process of war-making and state formation permitted a distinction to develop; wars increasingly became either inter-state or intra-state, with a decline in the latter as consolidation of states' territories

¹ An example of an attempt to trace a lineage from Ancient Greece to the present is Robert G Wesson, *State Systems: International Pluralism, Politics, and Culture*, Free Press, New York, 1978. Examples of an approach using early modern Europe as a foundation of the state system include Barry Buzan and Richard Little, *International Systems in World History: Remaking the Study of International Relations*, Oxford University Press, New York, 2000. Also Tilly and Ardant, (eds.) *The Formation of National States in Western Europe*; S. N. Eisenstadt and Stein Rokkan, (eds.) *Building States and Nations*, Sage Publications, Beverly Hills, 1973; Stein Rokkan, Peter Flora, et al. *State Formation, Nation-Building, and Mass Politics in Europe : The Theory of Stein Rokkan : Based on His Collected Works*, Oxford University Press, New York, 1999.

² This is the central argument of Charles Tilly. See Charles Tilly, 'War Making and State Making as Organized Crime' in *Bringing the State Back In*, P. Evans, D. Rueschemeyer and T Skocpol (eds.), Cambridge University Press, Cambridge, 1985; Charles Tilly, *Coercion, Capital, and European States, A.D. 990-1990*, Blackwell, Oxford, 1990. See also William Deane Stanley, *The Protection Racket State : Elite Politics, Military Extortion, and Civil War in El Salvador*, Temple University Press, Philadelphia, 1996. The role of new technologies is also considered as an explanatory factor in state development in, William Hardy McNeill, *The Pursuit of Power : Technology, Armed Force, and Society since A.D. 1000*, Blackwell, Oxford, 1983.

took place.³ The institutions of the early modern state and their functions were built around the need to maintain security in an insecure world. War, as a consequence of territorial conquest, led to further reinforcements of state organization.⁴

As the European political system slowly took shape from the late fifteenth century, the needs of these embryonic political societies also altered. Advances in agriculture and the economic expansion generated by trade and new technologies furthered the requirements for changes in political organization. The consolidation of territory contributed to the first functions of the modern state. States, now having a clear and delineated space, needed to protect themselves from the territorial claims of other states as well as control their own populations. It became necessary to maintain law and order through a permanent police force. The growing power of guilds and the burgeoning economic activity in towns and cities across Europe generated pressures upon the embryonic state institutions. Trade created the need for increased regulatory apparatus and an extension of law governing the growing exchange of capital, goods and people. In order to maintain armies, the nascent state (still ruled by a monarchy) sought taxation revenue for its developing legal and bureaucratic functions. Levies and duties were laid on products and traded goods. Record keeping and organizational skills, previously the sole preserve of the church, and only then maintained within monasteries, grew to be a requirement of the state. And whilst the clear divide between the ecclesiastical and secular administration still lay in the future, administration became a pressing requirement in order to structure and organize everyday society.⁵ The features of the developing state in its organizational functions and ability to manage resources were shaped primarily by the impact of war. Change

³ It is important to consider that the map of modern Europe at the end of the twentieth century is a very recent map indeed. States such as Italy only took on their current shape at the end of the nineteenth century, as conflict, or the threat of force pressured smaller kingdoms, principalities and the like to unite, join with others, or be swallowed up.

⁴ This view is well summarised with the argument that violence leads to increased organization and centralized control in Youssef Cohen, Brian Brown, A.F.K. Gorganski, 'The Paradoxical Nature of State Making: The Violent Creation of Order', *The American Political Science Review* 75:4, 1981, 901-910.

⁵ This is the foundation of Max Weber's basic argument concerning bureaucratisation. See Max Weber, *Economy and Society : An Outline of Interpretive Sociology*, University of California Press, Berkeley, 1978. A significant development of Weber's work was undertaken by Talcott Parsons who spoke of the increased array of functions and specialization occurring in modern societies. See Talcott Parsons, *The Social System*, Routledge & K. Paul, London, 1970. For a more succinct account see Talcott Parsons, 'Evolutionary Universals in Society' in *From Modernization to Globalization*, J. R. Timmons and A. Hite (eds.), Blackwell, Malden, 2000 (1964)

in the management of resources and the structure of institutions was motivated by a threat or need to maintain security.

The European experience has dominated the understanding of state development, at times to the detriment of a close understanding of non-European cases. Charles Tilly's argument that 'war made states' has been supported by other studies of European history that perceive war and territorial consolidation as the primary driver of state development.⁶ The organizational arrangements of the modern state emerged because of the need to control, organize and defend territory. This security requirement in turn impacted upon the configuration of the state. Agents of the state sought new resources to pay for security, obtaining resources and labour either through spending or force. In 'capital intensive' settings of cities and towns, resources were transformed through financial investment, giving rise to a powerful capitalist class.⁷ In more thinly populated regions of Europe, a greater dependence upon natural resources for a source of income contributed to more 'coercive' arrangements. Landlords became the most dominant group in these societies. These two variables structured the political map of early modern Europe, creating varying development trajectories. The paths taken were the result of different capacities to make war and defend against attack. Thus, as put by Tilly, war made states which went on to make further wars, driving the process on.⁸

The use of force and its central role in politics is the basis for the war-making explanation of state formation.⁹ State making was essentially a process of organizing violence and controlling it; all other activities of the state rested upon this core function. The capacity to organize the use of violence has informed popular definitions of the state, notably those of Max Weber and Anthony Giddens.¹⁰ As Weber argues, states also came to *legitimize* the use of force. States and states only could legitimately

⁶ See Bruce D. Porter, *War and the Rise of the State : The Military Foundations of Modern Politics*, Free Press, New York, 1994.

⁷ Tilly. *Coercion, Capital, and European States, A.D. 990-1990*, p.56.

⁸ Tilly 'Reflections on the History of European State-Making' in Tilly and Ardant, (eds.) *The Formation of National States in Western Europe*, p.42.

⁹ An early version of this perspective is found in Richard Bean, 'War and the Birth of the Modern Nation State' *The Journal of Economic History* 33:1, 1973, 203-201. The role of warfare as a generalized social phenomenon is discussed from an anthropological perspective in Keith Otterbein, 'Warfare: A Hitherto Unrecognized Critical Variable, *The American Behavioral Scientist*, 20:5, 1977, 693-714.

¹⁰ Weber's definition of the state is found in Weber. *Economy and Society : An Outline of Interpretive Sociology*, (v1) p.54. Anthony Giddens' understanding and theoretical contribution is fully expressed in Anthony Giddens, *The Nation-State and Violence*, Polity Press, Cambridge, 1985.

use violence for particular purposes. By the twentieth century the state had come to dominate the realm of violence and war, squeezing out non-state organizations that had also used it as a means of achieving their own ends.¹¹ This account of the modern state has therefore understood it as a history of warfare and political consolidation, permitting wars to be fought more effectively and efficiently. Modern states have been built around this requirement and the most successful war waging states became the model to be copied and adopted. Violence, it has been said, is the midwife of history - the primary motivator of political change.¹²

The process of conflict also forms the basis for accounts that explain relations between states as well as the formation of states themselves. K.J. Holsti uses 1945 as a dividing year between previous patterns of European state formation and the post World War II pattern that saw de-colonization enact a new influence upon the state formation process.¹³ Holsti's argument makes the important point that many states that emerged in the twentieth century were formed on a *conditional* basis, at the behest of the major powers.¹⁴ This consideration is significant for the case studies: both Norway and Malaysia were controlled by colonial powers before gaining independence. Yet whilst war is also the result of state breakdown and weakness in the post-colonial experience, the war-making perspective still views twentieth century state development through the context of inter-state conflict, leaving less room for the consideration of economic change as an explanatory factor. Fred Block, whilst maintaining a Marxist economic perspective, perceives war as an opportunity for the state to intrude into the economy and regulate it further.¹⁵ Even in Block's avowedly Marxist view, war is still the driving force for state formation and change. He points to National Socialist Germany as a partial exception where the state sought to control capitalists in peacetime as well as war. But the functional role of capitalists lessened as the regime sought conflict and self-destructed.¹⁶ Even when placed in the context of a rapidly changing economic

¹¹ The process of states gaining control over extraterritorial actors is examined in Janice E. Thomson *Mercenaries, Pirates, and Sovereigns : State-Building and Extraterritorial Violence in Early Modern Europe*, Princeton University Press, Princeton, 1994.

¹² Karl Marx's popular refrain was more concerned with the impulses for revolution. But the sentiment may be echoed in the war-making argument, and indeed is central to the perspective.

¹³ K. J. Holsti, *The State, War, and the State of War*, Cambridge University Press, Cambridge, 1996.

¹⁴ *Ibid.*, p.59.

¹⁵ Fred L. Block, *Revising State Theory : Essays in Politics and Postindustrialism*, Temple University Press, Philadelphia, 1988.

¹⁶ *Ibid.*, pp.88-9.

environment, inter-state war and conflict remained the primary factor in explaining state development.

In the body of literature explored, it is the political and social impact of war that provides the impetus for political change and institutional development. Preparation of defences required an organizational response that prepared societies for war. War either contributed to greater change or led to the swallowing up of territory by another aggressor state. And for a state to prepare for war by organizing themselves along martial lines deterred attack by other states. Thus, the war-making argument can help explain the formation of sovereign boundaries and the development of some basic institutions of the early modern state. The war-making thesis provides a fine macro-historical map of European state formation.¹⁷ But it is perhaps not always best suited to a detailed understanding of some cases, particularly the development of smaller or peripheral states in the twentieth century in the context of economic change. War was important in their history, but its impact was less significant than the perspective discussed suggests. It must be considered, but also qualified as a factor in developing an analytical framework.

The importance of war as a factor in explaining the development of the state is a plausible account. But mapping the European experience of state formation through this lens encounters difficulties as more cases are included in an analysis. The formation of some small peripheral states appeared to deviate from the predicted pattern; their borders were dictated by a mix of conflict, agreement and settlement.¹⁸ Stein Rokkan's extensive yet often ignored body of work understand the European process as more untidy and inconsistent than a singular war-making perspective allows for.¹⁹ Social divisions altered in response to structural changes in the economy

¹⁷ An exception to the European perspective is found in Clapham, Christopher (2000). *War and State Formation in Ethiopia and Eritrea*, La guerre entre le local et le global, Paris, University of Sussex. Also found in <http://www.theglobalsite.ac.uk/press/010clapham.htm> (accessed 23 May 2005). See also Kenneth Pomeranz, 'Two Worlds of Trade, Two Worlds of Empire' in *States and Sovereignty in the Global Economy*, D. A. Smith, , D. J. Solinger and, S. Topik (eds.), Routledge London, 1999.

¹⁸ The example of Norway that follows in Part Two is a case in point

¹⁹ See in particular, Stein Rokkan and Derek W. Urwin, et al. *Economy, Territory, Identity : Politics of West European Peripheries*, Sage Publications, London, 1983. Rokkan's work on the state was somewhat scattered across numerous works. A useful introduction to his work is Rokkan, Flora, et al. *State Formation, Nation-Building, and Mass Politics in Europe : The Theory of Stein Rokkan : Based on His Collected Works*, See also Erik Allardt, Stein Rokkan, et al. *Mass Politics : Studies in Political Sociology*, Free Press, New York, 1970; Stein Rokkan, *Citizens, Elections, Parties : Approaches to the*

and geo-politics. Rokkan's work on smaller European states suggests that war was not the only pressure shaping their development.²⁰ A criticism levelled at the war-making perspective is the materialist nature of the state formation process. Political ideas and motivations of how a state should be built play little part in the equation. As Jack Goldstone argues, the Reformation and other dramatic ideological changes in early modern European history are missing as factors in the war-making model.²¹ Changes in political and social ideas had great impact upon political organizations and policies. Indeed, the end of the early modern period in Europe, often taken to be the French Revolution of 1789, was a process shaped also by political ideas and economic changes as well as the impact of expensive wars on a bankrupt French state.²² The war-making thesis does encounter difficulties when attempting to incorporate these considerations as part of an explanatory framework of state development.²³

A preoccupation with war as the critical factor in change has driven historical accounts of what is best described as the development of the *early* modern state in Europe.²⁴ The early modern period, from approximately 1450 until the French Revolution of 1789 is a European centred epoch that considers the early beginnings of capitalist production punctuated by wars across the continent as characteristic of the process of state development and formation.²⁵ Political organization in this environment made the leap from medieval to early modern, illustrated by the establishment of territory with demarcated boundaries and the centralization of rule and basic administration. War and the maintenance of security was the business of rulers, whilst the development of guilds and early capitalist practices occurred as a result of localised factors such as new technology, transport and increased agricultural production. Because security and the conduct of war was the chief concern of rulers, an intimate connection between state

Comparative Study of the Processes of Development, McKay, New York, 1970; Rokkan, Urwin, et al. *Economy, Territory, Identity : Politics of West European Peripheries*,

²⁰ See for example Stein Rokkan, Flora, et al. *State Formation, Nation-Building, and Mass Politics in Europe : The Theory of Stein Rokkan : Based on His Collected Works*,

²¹ Jack A. Goldstone, 'States Making Wars Making States Making Wars...' *Contemporary Sociology*, 20: 2, 1991, p.178.

²² An outstanding book on the impact of ideas in instigating the French Revolution is Daniel Gordon, *Citizens without Sovereignty : Equality and Sociability in French Thought, 1670-1789*, Princeton University Press, Princeton, 1994.

²³ An example of the war-making argument and its impact upon democratic demands of populations is found in Geoff Eley, 'War and the Twentieth-Century State', *Daedalus*, 124:2, 1995, 155-175.

²⁴ A good example is M. J. Braddick, *State Formation in Early Modern England, C. 1550-1700*, Cambridge University Press, Cambridge, 2000.

²⁵ An exception to this is work on China, see for example: Li Liu and Xingcan Chen, *State Formation in Early China*, Duckworth, London, 2003; Pomeranz. 'Two Worlds of Trade, Two Worlds of Empire'.

formation and war-making became established. Economic growth and the additional revenue it generated for the early modern state was an instrument to enhance security to pay for weapons and soldiers. Therefore the war-making argument identifies a direct causal relationship between inter-state war and the development of the institutions of the state. The distinction between civil and interstate warfare became clearer as a result of states clarifying and securing their boundaries. War itself became increasingly structured upon the basis of developing state boundaries. Civil wars also became conflicts over control of the state by armed groups, with the victor gaining control over the state's territory. The mobilization of resources around the purpose of maintaining this territorial control became a key function of the developing European state. The use of Norway and Malaysia as case studies is an attempt to overcome this European-centric perspective. Norway remained on the periphery of Europe's many conflicts, whilst Malaysia's first contact with Europe arrived in the form of colonialism. The use of a peripheral European and Asian example will help to build a model removed somewhat from the Continental European-centric approach. Hendrik Spruyt offers us an alternative explanatory model of state formation, whilst still locating it in the European experience..²⁶ Exploring different forms of societal organization in the early modern era, from city-states to feudal orders, Spruyt argues that the state emerged as the primary form of organization because of a range of intersecting factors and not in a manner that suggests a single trajectory of historical change. At different periods in European history, city-states were compatible with nascent sovereign states in a way not readily identified by the war-making perspective. In short, material power or size did not always dictate relationships between different organizational units.²⁷ In this regard, it is important to acknowledge that change in the case studies may be uneven and that becoming hostage to a teleological conceptualisation of political change is a methodological risk.

The interactive relationship between war and capital has structured some historical studies into the development of the states' capacity to fight wars.²⁸ Emerging new

²⁶ See Hendrik Spruyt, *The Sovereign State and Its Competitors*, Princeton University Press, Princeton, 1994.

²⁷ Ibid, p.176.

²⁸ See for example Gautam Sen, *The Military Origins of Industrialisation and International Trade Rivalry*, Pinter, London, 1984; David Joslin and, J. M. Winter, *War and Economic Development : Essays in Memory of David Joslin*, Cambridge University Press, Cambridge, 1975.

technologies as a result of economic growth contributed to different types of warfare.²⁹ Stronger steel alloys permitted more destructive and lethal firearms and other weapons. A state that was able to utilize such technology proved the most effective at making war. The British Empire that spanned the globe in the late nineteenth century demonstrated that the successful combination of capital, modern industrial technology and the state could ensure political dominance over others.³⁰ Great Britain's global supremacy can be explained by its status as the first industrialized economy.³¹ This possibility has been explored in historical studies, but not always well translated into a conceptual map of modern state development. This thesis is seeking to develop a method to analyze and understand in detail some important features of modern states that were shaped by the industrialization process. The relationship between the industrializing economy and state development remains unclear as not all the tools are present in the war-making argument to clearly address this issue – a problem that will be addressed in this developing analysis.³²

The relationship between capital and war as key variables in determining how states develop and change is a central concern in Niall Ferguson's *The Cash Nexus*.³³ Political events, namely inter-state wars, as well as domestic disputes over resources are said to have provided the driving force for the way in which states manage and organize capital.³⁴ Such a historical perspective is essential, but the conclusions in Ferguson's study are not thoroughly developed into a conceptual map of state development. Whilst excessive determinism is criticised, it is not furthered into an understanding of how states as institutional ensembles may deliberately set out to manage economies, the context for the next chapter. What such studies demonstrate is that the impact of

²⁹ See McNeill. *The Pursuit of Power : Technology, Armed Force, and Society since A.D. 1000*. See also Jared M. Diamond *Guns, Germs, and Steel : The Fates of Human Societies*, W. W. Norton & Company, New York, 1997, Ch. 13.

³⁰ McNeill. *The Pursuit of Power : Technology, Armed Force, and Society since A.D. 1000*, p.258.

³¹ Patrick Karl O'Brien and Leandro Prados de la Escosura, *Exceptionalism and Industrialisation : Britain and Its European Rivals, 1688-1815*, Cambridge, New York, 2004.

³² War retains pride of place in many explanations. Great Britain, as the world's greatest steel producer in the nineteenth century was able to equip its armies and navy to defeat any would be challenger. The role however of the industrial revolution in explaining patterns of state development has not been extensively explored. Whilst studies of Great Britain itself do tackle this problem in a specific setting, conclusions are not often extrapolated into a conceptual map of state development. Indeed in some instances the modern (nation) state is taken as a given. For an example of this problem see Tom Kemp, *Industrialization in Nineteenth Century Europe*, Longman, London, 1969. p.19. See also Peter Mathias, *The First Industrial Nation: An Economic History of Britain 1700-1914*, Methuen, London, 1976. Ch.3.

³³ See Niall Ferguson, *The Cash Nexus : Money and Power in the Modern World, 1700-2000*, Allen Lane, London, 2001.

³⁴ *Ibid.*, p.13.

modern economic change must be a key consideration in understanding state development, even if it is secondary to political factors.

Michael Mann develops a thorough analytical and conceptual framework of state development patterns that eschews overly deterministic models.³⁵ State development has been a long historical process shaped by different forms of power. The ways in which power is exercised, be it economic, political, military or ideological, is understood as the key factor explaining political and social outcomes. This model incorporates these four considerations, allowing the different degrees of each to be identified and used to explain historical changes. No single factor is deemed to have permanent primacy over the others, addressing a problem of the war-making argument. Mann's work is important and supports the analytical approach of this thesis, namely, a recognition that multiple factors can impact upon state development. Yet the questions that arise from such a framework regard who or what exercises different types of such power and why. The next chapter, by examining the state from a quite different set of perspectives will begin to ask these important questions.

The European centred history of state development has established some plausible patterns of political change. With warfare as the primary motivator of political change, state development it is argued has been shaped by this process. State formation and development have therefore been understood in terms of how organizational responses contributed to improving security. The fundamental features of the state emerging from the early modern period were basic administrative organs, revenue collection agencies, a policing and court system to maintain internal control, and a defence force to ensure external threats were deterred. The war-making model is most useful in explaining the emergence of the *early* modern state form: the basic building blocks of a political form that was to later become universal. But the war-making model is perhaps not so successful in enhancing our understanding of the *modern* state beyond the western European experience of major powers, the modern state which has

³⁵ Michael Mann's work is extensive and offers insights on a great range of political and sociological problems. His most well known works and most relevant to this thesis are Michael Mann, *The Sources of Social Power Volume 1: A History of Power from the Beginning to A.D. 1760*. Cambridge University Press, Cambridge, 1986; Michael Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, Cambridge University Press, Cambridge, 1986. Michael Mann, 'The Autonomous Power of the State: Its Origins, Mechanisms and Results' in *States in History*, J. A. Hall (ed.), Basil Blackwell, Oxford, 1986.

emerged in the twentieth century. Different kinds of warfare in the modern era such as wars for independence, post-colonial conflicts or guerrilla insurgencies are not always easily incorporated in a European derived picture.³⁶ The pattern of conflict in the twentieth century suggests a more mixed and varied set of explanatory factors directing state development.³⁷ Examining interstate clashes as a single factor perhaps does not constitute a sufficient inquiry outside of the western European context.³⁸ What also must be considered in the case studies are the features of the modern state that developed. These include state institutions such as central banks, labour and market regulations and institutions aimed at managing the modern economy. Did they emerge just as a result of war, or were there other factors at play which contributed to these developments?³⁹ Considering industrialization an important factor will change the nature of the net cast. Approaching the case studies will therefore require a different set of analytical tools.

This discussion has proceeded from an analysis of the war-making model of state formation to models that consider economic processes as a key factor. The war-making model has tried to extrapolate a theory of how states came to emerge and why they are as they are. An alternative and important model of state development is found in the Marxist tradition. Utilizing economic relations as the key explanatory factor of state development rather than conflict and war, this tradition has dominated social and political theory. The emergence of the modern state is understood within this school as the result of economic change. We now take this path to investigate how modern states developed as they did and to establish what these understandings of state

³⁶ See for example Paul B. Rich and Richard Stubbs, *The Counter-Insurgent State : Guerrilla Warfare and State Building in the Twentieth Century*, St. Martin's Press, New York, 1997. For a recent discussion on the use of force by non-state actors and its impact upon politics see Anthony W Pereira and Diane E. Davis, *Irregular Armed Forces and Their Role in Politics and State Formation*, Cambridge University Press, Cambridge, 2003.

³⁷ Civil war is sometimes difficult to incorporate into the European derived model, a point made by Ann Hironaka, *Neverending Wars : The International Community, Weak States, and the Perpetuation of Civil War*, Harvard University Press, Cambridge, 2005, p.53. A good discussion of the consequences of civil war on the character of the state is found in Stanley. *The Protection Racket State : Elite Politics, Military Extortion, and Civil War in El Salvador*.

³⁸ Some examples of work examining state formation that emphasis the role of force outside of the European context include David Rock, *State Building and Political Movements in Argentina, 1860-1916*, Stanford University Press, Stanford, 2002.

³⁹ Hironaka hints at industrialization as an important factor in state building, but only fleetingly points to increased taxation as significant in state formation. Hironaka. *Neverending Wars : The International Community, Weak States, and the Perpetuation of Civil War*, p.58

development have to offer the investigation of Norwegian and Malaysian state development.

THE IMPACT OF CAPITALISM

There is a long scholarly tradition that identifies capitalism as the primary determining factor in the development of states. The near entirety of this tradition takes place within the Marxist school, a perspective that portrays the state as a product of capitalism. The state development process is dependent upon the process of capitalism and the arrangements within states and their relations with each other can be explained as a result of this process. In considering industrialization as the context for Part Two it is important to engage closely with this material to build a viable approach. Economic change is a critical factor in examining state development. How this factor is to be considered and what the literature in this area can offer is the subject of the following section.

The Marxist view, despite being the subject of frequent attack, has remained central. As Nicos Poulantzas writes, since Weber offered a critique of Karl Marx's approach, all discussions of the state have considered the Marxist perspective and either engaged or critiqued it.⁴⁰ Marxist accounts provide an analysis of the *capitalist* state; the political entity located within and deriving from the prevailing economic structure. The state, according to Marx, was part of the social superstructure, built upon the base economic mode of production, and thus derived from it. Marx never gave a coherent account of the state itself, his writings on the subject were scattered across many works and largely secondary to his analysis of society.⁴¹ Thus, interpreting the state has been problematic from the Marxist perspective, with contending views that though derived from an historical analysis of class relations, have often arrived at different conclusions. Marx's primary analysis concerned the capitalist mode of production; thus the state became either incidental or necessary, but never central in his analysis. The key foundation for Marxist considerations of the state has been the capitalist mode of production as described in *Kapital*. Central to the structure of capitalism is the division of society into classes, with the capitalist class – the bourgeoisie – dominating due to their control of the means of production. The bourgeoisie and the dynamics of its

⁴⁰ Nicos Ar Poulantzas, *State, Power, Socialism*, NLB, London, 1978, p.47.

⁴¹ The closest Karl Marx came to a direct exposition of the state is found in 'The Eighteenth Brumaire of Louis Bonaparte' in Karl Marx and Friedrich Engels, *The Marx-Engels Reader*, Norton, New York, 1978.

constant search for profit shape society.⁴² The state, as the universal vessel for containing human society, develops, like all other forms of social organization, from the economic base and becomes a tool of the dominant capitalist class.

INSTRUMENTALIST PERSPECTIVES OF THE STATE

Instrumentalism provides the most straightforward Marxist approach to the state. The state is an organizational form derived from the process of capitalism; it cannot be understood as an entity in its own right.⁴³ Consequently, the state reinforces and organizes itself in accordance with the economic relationships shaped within society. Such a perspective, understood by some as 'plain' Marxism, holds that the capitalist state can only be understood as an instrument of the dominant class, the bourgeoisie.⁴⁴ Ralph Miliband has written the seminal description of the state from this perspective, arguing that the bourgeoisie, as the dominant class, rule *via* the state.⁴⁵ The state and thus government is an instrument or tool to organize and rule society: its source of power derives from the ruling capitalist class.

Miliband's account of the state has an elegant simplicity that lends itself well to empirical analysis. But its very simplicity is also its most significant weakness. It separates the state from society to such a degree that the state is drained of any variation or possibility for action outside of a set of basic functions. The Norwegian and Malaysian Governments frequently came into conflict with capital interests and further, Miliband's claim that the capitalist class is homogeneous, or at least more so than, for example, the labouring classes, rests on shaky evidence.⁴⁶ The assumption that society consists of separate and defined classes that struggle against one another is the central problem encountered by this particular Marxist approach. If modern capitalist society is not so easily dissected into respective classes, the instrumentalist

⁴² Anthony Giddens, *Capitalism and Modern Social Theory : An Analysis of the Writings of Marx, Durkheim and Max Weber*, Cambridge University Press, Cambridge, 1971, p.46.

⁴³ Philip Corrigan, Harvie Ramsay & Derek Sayer, 'The State as a Relation of Production.' in Philip Corrigan (ed.), *Capitalism, State Formation and Marxist Theory*, Quartet, London, 1980, pp.8-10.

⁴⁴ Clyde W Barrow, *Critical Theories of the State : Marxist, Neo-Marxist, Post- Marxist*, University of Wisconsin Press, Madison, 1993, p.13.

⁴⁵ Ralph Miliband, *The State in Capitalist Society*, Quartet Books, London, 1973.

⁴⁶ *Ibid.*, pp.155-58.

framework becomes problematic; other contributing factors to state development can be hidden through its lens.

Ernest Mandel attempts to counter this problem by presenting a modified instrumentalist approach, incorporating the ideological strength of the bourgeoisie and how this translates and contributes to state power.⁴⁷ More generalist class approaches also owe much to the Marxist tradition, particularly the work of Claus Offe, whose analysis of the modern western capitalist state identified dominant groups in society and how they were able to translate their economic dominance into political power.⁴⁸ The state represents the formalized and centralized location of this class dominance, and as an entity itself, does not require further investigation. Such a view of the state, whilst sometimes useful for explaining why some groups have more power, is on its own, insufficient to build an analysis of the modern industrializing state. The state itself must come under scrutiny.

THE STATE AS A CAPITALIST STRUCTURE

Instrumental Marxism struggled to contend with instances where the state appeared to act contrary to the interests of the dominant capitalist class. This problem emerged when it became evident that the dominant capitalist class did not always enjoy a direct link to the mechanisms of the state. It is possible that the state may act in less direct and more informal ways to reproduce capitalism. If so, how then did the state continue to reproduce capitalism if the bourgeoisie did not directly control it?⁴⁹ A structural Marxist perspective, led by Poulantzas, argued the state functioned as a reproductive organism, and could not be claimed or 'controlled' by a ruling class.⁵⁰ The reproduction of capitalism was carried out by the state on behalf of capital itself, making the role of the bourgeoisie incidental. Neo-Marxism therefore removed the problem of social class from the state - society relationship, decoupling the state from

⁴⁷ Ernest Mandel, *Late Capitalism*, NLB, London, 1972, pp.474-499.

⁴⁸ Claus Offe, *Contradictions of the Welfare State*, Hutchinson Education, London, 1984.

⁴⁹ This debate reached its zenith with the 'Miliband-Poulantzas' debate that took place in the pages of *New Left Review*. Unfortunately, the semantic squabbling the debate succumbed to did little to further the understanding of the state, and contributed to a decline and redundancy of Marxist approaches by the end of the 1970s. See Nicos Poulantzas, 'The Problem of the Capitalist State', *New Left Review* 58:1, 1969, 67-78; Ralph Miliband, 'The Capitalist State--Reply to N. Poulantzas', *New Left Review* 59:1, 1970, 53060; Ralph Miliband, 'Poulantzas and the Capitalist State', *New Left Review* 82:2, 1973, 83-92 and finally Nicos Poulantzas, 'The Capitalist State: A Reply to Miliband and Laclau', *New Left Review* 95:1, 1976, 63-83.

⁵⁰ Poulantzas. *State, Power, Socialism*, p.37.

society to an even greater degree than instrumentalist theories. In his oft quoted remark, Poulantzas argues that 'the state maintains the cohesion of a social formation' (society).⁵¹ The structuralist critique of instrumental or 'plain' approaches is that by making the state an instrument of rule on behalf of a social class, it could potentially be controlled by another group or class. By implication, an instrumentalist approach portrays the state as potentially something other than a protector of capital: it may not be intrinsically 'capitalist' and therefore it may be claimed and controlled by another class without the need for societal transformation or revolution.⁵² Missing from this picture is the acknowledgement of the capacity for change motivated by social groups within the state arena. Such groups can act in unpredictable ways that don't necessarily accord with the dominant structure-in this instance the capitalist economy.

The state, according to Bob Jessop, is best seen as 'an institutional ensemble of forms of representation, internal organization and intervention.'⁵³ Approaching the state from this perspective allows a wide net to be cast: the various linkages between the state and other actors can be explored to a greater degree than more rigid frameworks. Seeing the state as a differentiated form and the agents of capitalist reproduction as disaggregated, whilst still maintaining a measure of coherence, also owes something to the Gramscian tradition. According to the idea of hegemony, power and control permeates not only economic and political relationships, but also perception and ideology.⁵⁴ The dominant structure manifests itself into an ideology that exercises hegemony over the subordinate classes. In this sense, the state channels this dominant experience, and reinforces it. The tool of social control (and therefore rule) lies not only at the economic level, but also at the level of societal consciousness.⁵⁵ In the analysis presented in Part Two, just how industrialization was understood by key social groups and political leaders is an important consideration. In both Norway and Malaysia,

⁵¹ Poulantzas. 'The Problem of the Capitalist State', p.73.

⁵² Bob Jessop, *State Theory : Putting the Capitalist State in Its Place*, Polity, Cambridge, 1990, p.27-8.

⁵³ Bob Jessop, *The Capitalist State : Marxist Theories and Methods*, Martin Robertson, Oxford, 1982, p.228.

⁵⁴ See Robert Cox, 'Gramsci, Hegemony and International Relations', *Millennium* 12:2, 1983, 162-175, for an excellent discussion of Gramscian thought, especially pp.163-4.

⁵⁵ See Antonio Gramsci, Quintin Hoare, et al. *Selections from the Prison Notebooks of Antonio Gramsci*. International Publishers, New York, 1972. Gramsci's ideas are the focus of several good texts. A selection includes Anne Showstack Sassoon, *Gramsci's Politics*, Croom Helm, London, 1980; Stephen Gill, *Gramsci, Historical Materialism and International Relations*, Cambridge University Press, Cambridge, 1993; Anne Showstack Sassoon, *Gramsci and Contemporary Politics : Beyond Pessimism of the Intellect*, Routledge, London, 2000.

industrial development for many social groups represented an economic process to be pursued and encouraged because it provided new jobs, wealth and improved living standards. These intentions may be present in different social groups. But as will be demonstrated, groups and their leaders sometimes disagreed greatly on the ways to achieve these aims. A common capitalist structure amidst the many groups and organizations within the state space may be difficult to empirically substantiate.

MARXISM AND THE MODERN STATE

Marxist perspectives are evident in numerous studies of the state.⁵⁶ They can be highly instructive in what they tell us about how certain interest groups or classes may seek to control the state, but some limitations of such approaches are also evident. The theoretical model, whilst elegant, can present a simplistic picture of the state arena and the society of which it is the political expression of. Even the structuralist account of the state, while expansive in scope, is limited in what conclusions it can draw from evidence. The progressive laws enacted in nineteenth century Britain for example would be understood within the Marxist paradigm as compensatory attempts by the capitalist class to insure against social breakdown and therefore disruption of production. Such a view does not always entertain other possibilities - ideas of social progress and political reform - that also contributed to these changes.⁵⁷ As the Norwegian example will demonstrate, laws protecting vulnerable workers and youth were motivated by a variety of reasons, foremost by a notion of social justice among the political leadership. Political ideas can be influential and their significance must be considered in the case studies.

SOME CONSIDERATIONS FOR THE CASE STUDIES

In the context of industrialization, a process that has often, but not exclusively stemmed from capitalism, a Marxist derived approach to state development is useful.

⁵⁶ For a select example see G. William Domhoff, *The Higher Circles : The Governing Class in America*, Random House, New York, 1970; G. William Domhoff, *Who Rules America?*, Prentice-Hall, Englewood Cliffs, 1967; Paul Marlor Sweezy, *Modern Capitalism and Other Essays*, Monthly Review Press, New York, 1972.

⁵⁷ For example, the Chartists movement had considerable impact upon political life and thought in nineteenth century Great Britain. See Asa Briggs and J. F. C. Harrison, *Chartism and the 1870 Education Act*, Educational Productions, Wakefield, 1975. Asa Briggs, *Chartism*, Sutton, Stroud, 1998.

But this approach will only complement and contribute to a more inclusive perspective. Investigating modern state development in the context of industrialization via an understanding of capitalism alone is not sufficient. It runs the risk of equating industrialization with capitalism. For the purposes of this thesis, an instrumental approach will help identify why certain groups may have greater cause than others to attempt to exercise power via the state. As the case studies will show, state power was used as a tool at times by certain groups and individuals. But their motivations did not always stem from economic interests, even when ties between political leaders and industry for example were close. Political leaders in both the case studies expressed among other things the desire to address economic inequality and modernize society in ways that could impinge upon growth. Different factors can contribute to certain political outcomes, not all of them explained by economic relationships between classes. An analytical model that accommodates the complex array of interests found among social groups in the modern industrial state will throw more light upon Norwegian and Malaysian industrialization and state development.

To suggest that the state is a part of the social superstructure, as distinct from the base in the classical Marxist sense is to depict the state as passive and devoid of agency. This generalization rings true for both instrumentalist and structuralist formulations, the state is a product of the economic base, and is bound to act within the limitations defined and dictated by the prevailing economic structure. So despite the best efforts, the conceptualization of the state is reduced to that of a reproductive mechanism of capitalist production.⁵⁸ The state remains *primarily* responsive to the capitalist mode of production.⁵⁹ In understanding the state itself, all its forms and functions can be explained as deriving from the capitalist mode of production. Structuralism is effective in revealing connections between groups, capital and the state, but it can struggle to identify different development patterns. It has a tendency to arrive at a similar explanatory conclusion regardless of the case being analyzed. Industrialization, as a process distinct from capitalism and its impact upon the state, is not clearly identified by using these approaches.

⁵⁸ Bob Jessop, *The Future of the Capitalist State*, Polity, Oxford, 2001, *passim*.

⁵⁹ Gianfranco Poggi, *The Development of the Modern State*, Hutchinson, London, 1978, p.119.

How can the processes experienced within states that are undergoing rapid and dramatic economic change, as in the case of industrialization, be better explained? The transition from an agrarian or primary production based economy to one based upon industry cannot be equated to the shift from feudal economic relations to capitalist economic relations. Whilst some of these processes of change may have similarities, to draw the same conceptual conclusions out of different historical periods can be problematic. The Marxist concepts discussed above have difficulty in explaining the political impact of the transition from early forms of capitalist production to an industrial economy: whilst surface phenomena such as governing systems and institutions may change, the base structure (the mode of production) remains unaltered and rigid. These concepts don't always identify subtle distinctions between different kinds of economic activity and variations between different capitalist states. Critically, industrialization is not necessarily preceded by capitalism. The industrialization of the Soviet Union in the twentieth century occurred outside of a capitalist framework.⁶⁰ The investment in capital, skilled labour and infrastructure was rather directed and organized by the state. Clearly understanding the state - industrialization relationship is difficult within an exclusive Marxist framework, any theoretical framework exploring the state undergoing industrialization needs to encompass additional elements of which will be further discussed here and in the next chapter.

An exclusively Marxist approach to the history of the Norwegian and Malaysian states for the purposes of this thesis is problematic. The most significant difficulty is that the political interactions contributing to state development are reduced to economic relationships. The Marxist approach cannot clearly explain variations in state development, and when it attempts to do so, these are explained away as irrelevant or only evidence of surface phenomena.⁶¹ At certain levels the state may well function as a reproductive mechanism for the capitalist mode of production. But the complexity of the modern state is not always well described by reduction to a base set of functions. This thesis is seeking to develop a more inclusive model, one that does not attempt to explain the modern state as a singular and pre-determined system, nor locking states into a path dependent framework. The modern state is unprecedented in complexity. The picture presented by Marxist accounts may well be theoretically coherent, yet can

⁶⁰ See for example R. W. Davies, *The Industrialisation of Soviet Russia*, Macmillan, London, 1979.

⁶¹ For a particularly scathing critique see Joseph R. Stromburg, 'Toward an Autopsy the Marxist Theory of the State', *Telos*, Spring:2001, 115-127, pp.115-127.

be limited in what they reveal, and are unable to account for change at anything other than the superficial (superstructure) level. For the state itself, it derives all of its power from society; it cannot be analyzed as an independent entity and is ultimately ignored in analysis.

The aim of this thesis is to identify the key characteristics of modern states and demonstrate their close relationship with industrial development. Marxist approaches to the state give great insight into how the process of capitalism shapes political interaction. Yet capitalism and industrialization describe two different processes and must be considered separately as distinct categories.⁶² The most insightful accounts of industrialization have resided in historical studies of societies undergoing the process.⁶³ As Part One will continue to demonstrate, greater interrogation of industrialization as an historical process impacting upon state development is required.⁶⁴ Industrialization is a distinct process, particularly as it often involves the large movement of capital across borders to be invested in industrial production. Industrialization required enormous coordination, organization and management of finance, raw materials and labour. This was a major feature of Norwegian and Malaysian economic development. Further, the need to entice or manage capital from overseas was critical in their industrialization processes. Placing them into a global historical perspective that can take foreign investment into account is an important advance on the previous Marxist perspectives discussed. A Marxist approach to the Norwegian and Malaysian states can reveal the interests of key groups and individuals in relation to the state, but with qualifications. To better understand the relationship between state development and industrialization Norway and Malaysia will be situated in an economic process that crossed over their borders. This factor is a particularly necessary consideration for the analysis and is the focus of the following section.

⁶² Even Michael Mann blurs the line a little between these two distinct processes. See Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, pp.724-6. See also Jerry Harris, 'Globalisation and the Technological Transformation of Capitalism', *Race and Class*, October:1998, 21-34. Perhaps the most complete account of the distinction between industrialization and other concepts is found in Herbert Blumer, David R. Maines & Thomas J. Morriane, *Industrialization as an Agent of Social Change : A Critical Analysis*, A. de Gruyter, New York, 1990, pp.16-29.

⁶³ Some excellent examples of such historical studies are Thomas Childs Cochran, *Frontiers of Change : Early Industrialism in America*, Oxford University Press, New York, 1981; Eric J Evans, *The Forging of the Modern State : Early Industrial Britain, 1783-1870*, Longman, Harlow, 2001.

⁶⁴ For an early and detailed introductory text on the process of industrialization see Walter Hoffmann, *The Growth of Industrial Economies*, Manchester University Press, Manchester, 1958.

CAPITALISM AS A WORLD SYSTEM

Capitalism is not a system that can be understood at the level of the state, argues Immanuel Wallerstein, rather, the state lies below the level of the capitalist world economy, a structure that dictates how states are shaped.⁶⁵ Building on the Marxist tradition of imperialist accounts of European expansion, relations between states are explained in the context of the economic system that emerged from Europe in the post-medieval period.⁶⁶ Capitalist expansion saw the European economic structure of the early modern period spread outward eventually encompassing the globe. It is a perspective that takes the pattern of the Marxist division of labour and places it in a global context. With such a perspective, all other political relationships below the level of the capitalist world system can be understood in terms of the global division of labour, including relations between states. The system of states in this framework is located within the world system and geographically situates states into one of three regions: the core, periphery and semi-periphery.

The core, originating in Western Europe and later incorporating North America and Japan, dominates the international system. Capital is concentrated in the core and is home to the most capital intensive forms of production. The concentration of capital is reflected in political and military power: the mercantilist power of European states in the sixteenth and seventeenth centuries developed into stable and effective state structures on the basis of economic strength.⁶⁷ Beyond the core lies the periphery, a realm that geographically encompasses much of Asia, Latin America and Africa. The

⁶⁵ Immanuel Wallerstein, *The Modern World-System*, Academic Press, New York, 1974.

⁶⁶ The classic in this tradition is Vladimir Ilich Lenin, *Imperialism, the Highest Stage of Capitalism : A Popular Outline*, Foreign Languages Press, Peking, 1965, and J. A. Hobson, *Imperialism, a Study*, Allen & Unwin, London, 1938. This tradition was continued to a degree by the dependency school that emerged from Latin America in the 1950s. See Andre Gunder Frank, 'Sociology of Development and the Underdevelopment of Sociology', in A. G. Frank (ed.), *Latin America: Underdevelopment or Revolution*. Monthly Review Press, New York, 1969; T. Dos Santos, 'The Crisis of Development Theory and the Problem of Dependence in Latin America' in H. Bernstein (ed.), *Underdevelopment and Development*, Penguin Books, Harmondsworth, 1973; Fernando Henrique Cardoso, 'The Consumption of Dependency Theory in the United States', *Latin American Research Review* 12:3, 1977, 7-24; Fernando Henrique Cardoso and Enzo Faletto, *Dependency and Development in Latin America*. University of California Press, Berkeley, 1979; Gabriel Palmer, 'Dependency and Development: A Critical Overview' in Dudley Seers, (ed.), *Dependency Theory: A Critical Reassessment*, Pinter, London, 1981. It is worth noting that Frank was American and tensions have emerged between his account of the world system and his Latin American colleagues

⁶⁷ Immanuel Wallerstein, *The Capitalist World-Economy*, Cambridge University Press, Cambridge, 1979, pp.37-48. See also Immanuel Wallerstein, 'Three Paths of National Development in Sixteenth Century Europe', *Studies in Comparative International Development* 7:2, 1972, 95-101.

periphery represents, in historical terms, those regions colonized in the wave of European expansion and conquest from the sixteenth century onwards. But independence for many new states in the post World War II era did not change economic circumstances. The colonial economic relationship was maintained, with the internal economies of peripheral states continuing to experience a 'dualist' economy, with a modern sector dominated by export orientated forms of production and a 'traditional' sector that served as a source of labour for the former.⁶⁸ The weakness of the periphery's economic position in terms of the relationship with the core is reflected in domestic politics. An assumption within this framework is that the states of peripheral economies remain weak and unable to exert influence upon prevailing economic structures or exploit them as states of the core are able to do.⁶⁹

World systems theories are an appropriate approach to explaining levels of state interdependence and began to motivate research in the 1970s.⁷⁰ As Christopher Chase-Dunn points out, any attempt to understand interdependence between states, without an appropriate structural approach, is bound to reveal little.⁷¹ Wallerstein's account of the global economic system points to the need for a greater analysis of global relations and state development in this light, in particular the capital that moves through and across states. The factor of capital shifts increased in importance in the late nineteenth century. The movement of foreign investment played a critical role in the industrialization process in many states in the twentieth century.

WORLD SYSTEMS THEORY AND STATE DEVELOPMENT

World systems approaches are sometimes accused of economic reductionism, that, like Marxist accounts of the state, they attempt to explain all political and social

⁶⁸ Christopher Chase-Dunn and Richard Robinson, 'Toward a Structural Perspective on the World System', *Politics and Society*, 7:4, 1977 453-476, p.456; also Wallerstein. *The Capitalist World-Economy*, p.123.

⁶⁹ Such a dichotomy between core and periphery is not the most empirically sensitive framework for analysis. This problem was resolved by a 'semi-periphery'. This sector of the world system houses a form of production that involves both capital and labour intensive forms of production, with capital moving both toward the centre (core) and to the periphery. It is an unstable realm, and can display conflicting and unsettled manifestations of capitalist production. See Chase-Dunn and Robinson. 'Toward a Structural Perspective on the World System', p.457.

⁷⁰ See Robert O. Keohane and Joseph S. Nye, *Power and Interdependence : World Politics in Transition*, Little Brown, Boston, 1977.

⁷¹ Chase-Dunn and Robinson, 'Toward a Structural Perspective on the World System', P.453.

relationships and institutions as a consequence of the world economic structure.⁷² Yet in developing an approach, the most significant problem with world systems analyses lies in the relationship between the world economic system and its impact upon the internal configuration and organization of the state arena. Small and peripheral states appear in world systems understandings to be powerless against the leverage of global capital movements, a conclusion not always supported by evidence. Fortunately, the most polemical contributions to the literature became less significant toward the end of the 1970s and nuance began to enter the discourse.⁷³

Taking up the challenge set by Fernando Cardoso, several scholars attempted to utilize world systems approaches in undertaking studies of states and their formation during periods of economic growth.⁷⁴ Such a direction attempted to account for different patterns of state development and change. Whilst the global economic structure remained the primary determining factor in patterns of development, other factors could be considered, even if they were less significant. Yet a problem begins to emerge when linking theories of the capitalist world system with empirical analysis of specific historical periods.⁷⁵ While maintaining a level of systemic abstraction in analysis, it was possible to argue that whilst a state was seemingly shifting its economic position *vis-a-vis* other states, the ties of dependence and capital penetration originating from the core remained intact.⁷⁶ Even inter-state conflict, traditionally seen as a reordering of power relations between states, came to be suggested as a relational consequence of

⁷² Barry Buzan, Charles A Jones and Richard Little, *The Logic of Anarchy : Neorealism to Structural Realism*, Columbia University Press, New York, 1993, pp.114-117.

⁷³ Cardoso can be credited for this intellectual sea change, arguing that dependency theory (a close relation of world systems) had to transform itself into a theoretical tool of analysis of particular economic and political relationships rather than further attempts at grand theory and a description of the overall condition of the world economy. See Cardoso and Faletto. *Dependency and Development in Latin America*.

⁷⁴ A constructive critique is found in David Ray. 'The Dependency Model of Latin American Underdevelopment: Three Basic Fallacies', *Journal of Interamerican Studies and World Affairs*, 15:1, 1973, 4-20. This edition of the *Journal of Interamerican Studies and World Affairs* contains several articles in the same vein. See especially, William G. Tyler and J. Peter Wogart, 'Economic Dependence and Marginalization: Some Empirical Evidence', *Journal of Interamerican Studies and World Affairs*, 15:1, 1973, 36-45.

⁷⁵ Gabriel Palmer engages with this problem in Gabriel Palmer, 'Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?', *World Development* 67:8, 1978, 881-924.

⁷⁶ See W. Ladd Hollist, 'Brazilian Dependence: An Evolutionary, World-System Perspective', in W. Ladd Hollist and James N. Rosenau, *World System Structure : Continuity and Change*, SAGE Publications, Beverly Hills, 1981.

the world economic structure and its resultant patterns of growth and decline.⁷⁷ To develop a clearer picture of the case studies, the assumptions of world systems analysis need to be moderated. Change and development within a state can be the result of factors other than the movement of global capital, which may be marginal or even irrelevant in certain circumstances. Making causal connections between state development and the global economic system must be undertaken with caution and a close assessment of evidence.⁷⁸

Wallerstein's attempt to synthesize a Marxist analysis of relations of production into a grand explanatory framework, while insightful, tends to selectively present historical evidence and has an inclination to dismiss contrary evidence as irrelevant or unrepresentative of a deeper, underlying logic. Economic expansion and change is portrayed as a singular product of capitalism: the wars that scarred European history throughout the eighteenth and early nineteenth century for example, are portrayed as resulting from shifts in capitalist production, a conclusion that, whilst theoretically cogent and even elegant, is problematic.⁷⁹ Historians have questioned world systems analyses for avoiding or dismissing potentially problematic evidence. Morris Janowitz for example claims Wallerstein's comparison of the seemingly disparate Chinese 'state' with Western European states, with little consideration of their respective internal configuration and arrangements, is misleading, and represents the work of an ideologue more interested in propping up a problematic theory than advancing historical analysis.⁸⁰ State development patterns that appear to deviate from the 'norm', such as the experience of Japan in the late nineteenth century, also raise questions as to the utility of the world systems model as applicable to all situations.⁸¹

Situating the state in a hierarchy that accords dominance to a higher structure lessens the need to understand different types of states and the different forms of economic

⁷⁷ See Joshua Goldstein, 'Long Waves in War, Production, Prices, and Wages: New Empirical Evidence', *Journal of Conflict Resolution* 31:4, 1987, 573-600.

⁷⁸ A good example of a considered and nuanced approach is found in Philip J. Akre, 'Industrialization in Algeria: The State and the Role of U.S. Capital, 1970-1980', *Journal of Developing Societies* 4:1, 1988, 22-37.

⁷⁹ See Goldstein, 'Long Waves in War, Production, Prices, and Wages: New Empirical Evidence', p. 379.

⁸⁰ See Morris Janowitz, 'A Sociological Perspective on Wallerstein', *American Journal of Sociology*, 82: 5, 1977, 1090-1097. See also Theda Skocpol, 'Wallerstein's World Capitalist System: A Theoretical and Historical Critique', *American Journal of Sociology*, 82:5, 1977, 1075-1090.

⁸¹ For a study of Japan's industrialization and modernization process see Johann Pall Arnason, *The Peripheral Centre: Essays on Japanese History and Civilization*. Trans Pacific Press, Rosanna, 2002.

relations that take place within them. Such an approach is problematic in that all research possibilities must be located within the broad explanatory structure, thus, 'proving' the validity of the abstract systemic account becomes an implicit aim in social inquiry, rather than the particular historical problem.⁸² Unqualified world systems approaches may experience difficulty in overcoming this problem. Central in this problem was the way in which the state was understood in terms of the economic context of other states.⁸³ Peripheral states were easily penetrated by foreign capital, their modern economic sectors dependent upon capital entering from the outside. The peripheral state was deemed to be weak and unable to effectively manage capital flows in a beneficial way. Capital flowed with ease, expropriating the surplus from the periphery. This is perhaps the strongest case that world systems theory makes. It is particularly successful in demonstrating that foreign capital frequently and profitably penetrates the peripheral regions of the world.⁸⁴ Penetration, and thus expropriation of wealth, empowered only the capitalist class in the periphery, linking them with their respective economic class in the core to a greater degree than other social classes in their own state. Class relationships could therefore transcend national borders, and be far more cohesive than the assumed ties of shared national identity. The economic elite in the periphery were therefore closely tied to the interests of capital and in terms of their economic behavior, served to propagate the status quo. As manufacturing industries in the late twentieth century shifted from the core into regions of the semi-periphery, elites in these regions became even more bound to serve the interests of foreign capital and the structural relationship was reproduced and strengthened. Those who held political power were tied to the core and sought to maintain the existing relationship.⁸⁵ The institutions and structures of the peripheral state were thus weak and enjoyed none of the power and capacity of the states of the core, nor the ability to develop. This pattern of development, while a good starting point for historical analysis, must be utilized with care and requires qualification. Modern state

⁸² This difficulty is apparent in Wallerstein, 'Three Paths of National Development in Sixteenth Century Europe'.

⁸³ Theda Skocpol provides a good analysis of this problem in Skocpol, 'Wallerstein's World Capitalist System: A Theoretical and Historical Critique', p.1084.

⁸⁴ Work on Chile and Latin America in general often demonstrates this. See Andre Gunder Frank, *Capitalism and Underdevelopment in Latin America : Historical Studies of Chile and Brazil*, Monthly Review Press, New York, 1969. For a good discussion of the Chilean economy see Henry W. Kirsch *Industrial Development in a Traditional Society : The Conflict of Entrepreneurship and Modernization in Chile*, University Presses of Florida, Gainesville, 1977.

⁸⁵ See Chase-Dunn and Robinson. 'Toward a Structural Perspective on the World System'.

development as the case studies will demonstrate has not always been directly shaped in accordance with the assumptions of the world systems model.

States in the regions of the core by contrast are deemed to be 'strong' by virtue of their position in the world economy. Core states control capital, whilst their economies are less dependent upon exports. Their state structures organize economic actors in such a way as to take advantage of world markets, further bolstering both the local economic sector and consequently the strength of the state itself. But what exactly is meant by a 'strong' state?⁸⁶ The United States in the twentieth century has been central to the world economic system, and particularly during the 1950s and 1960s was unmatched in economic and political power and size. Yet the American federal state system itself is often characterized as fragmented and enjoys none of the societal penetration and cohesiveness of for example, several western European states.⁸⁷ Some European states deemed to be less 'core' have demonstrated a far greater capacity to organize their own economies and thus exercise state 'strength' (e.g. the 'corporatist' states of Scandinavia) than the United States. The correlation between state strength as expressed by world systems theories a state's respective position in the core/semi-periphery/periphery hierarchy is not always clear.⁸⁸ As the experiences of Norway and Malaysia will show, the large influx of foreign capital did not always correlate with or contribute to a weak or fragile state. The evidence will demonstrate that foreign investment often directly promoted state institutional development that managed and controlled capital flows within the state and from foreign sources.

Structural perspectives, whilst not always clearly illuminating the behaviour and interests of states themselves, were able to paint a new and dynamic picture of economic development in the modern world. These approaches can be useful in understanding the process of industrialization and economic expansion from Great Britain from the early nineteenth century. They can help identify how industrial production shifted location and explain why manufacturing of a particular product

⁸⁶ Cal Clark and Jonathan Lemco, 'The Strong State and Development', *Journal of Developing Societies* 4:1, 1988, 1-8. The standout work that grapples with this problem is Joel Migdal, *Strong Societies and Weak States*, Princeton University Press, Princeton, 1988.

⁸⁷ See for example Daniel Judah Elazar, *Cooperation and Conflict : Readings in American Federalism*. F. E. Peacock Publishers, Itasca, 1969.

⁸⁸ See for example, Steve Chan, 'Developing Strength from Weakness: The State in Taiwan', *Journal of Developing Societies* 4:1, 1988, 38-51.

located to certain areas and not others. Traditional perspectives of economic growth and industrialization argued that underdeveloped regions were 'delinked' from the world economy and therefore unable to take advantage of economic opportunities for growth offered by trade.⁸⁹ Such a view informed early theories of economic underdevelopment, but systemic accounts turned the problem on its head, creating a distinction between pre-capitalist *undeveloped* states and the post capitalist circumstances of *underdevelopment* which were a direct consequence of capital penetration and linkage with the developed world.⁹⁰

Industrialization developed, it was argued, on the back of colonialist expansion and the exploitation of raw materials sourced from the colonized regions.⁹¹ Great Britain's industry as it advanced in the late nineteenth century saw certain economic sectors decline, particularly labour intensive production which became replaced by capital intensive production. This shift was indicative of the expanding global economic system that shifted production to new locations irrespective of individual state's policies. The great expansion in industrial production encouraged further linkages between capital, industry and the state, particularly in the European states often referred to as 'late developers', in particular Germany and Russia.⁹²

Alexander Gerschenkron's work on industrializing Tsarist Russia points to the importance of understanding the interaction between foreign and domestic capital investment, and the economic circumstances of a society. The shortage of domestic capital acts as a spur to greater investment by the state. The need to accumulate capital to initiate industrialization was apparent since the industrial revolution. Nevertheless, the source of such investment, and the means by which it is directed, be it market

⁸⁹ See Hans Wolfgang Singer, *The Strategy of International Development: Essays in the Economics of Backwardness*, International Arts and Sciences Press, White Plains, 1975; Hans Wolfgang Singer, 'Dualism Revisited: A New Approach to the Problems of the Dual Society in Developing Countries', *Journal of Development Studies*, 7:1, 1970, 60-75.

⁹⁰ Andre Gunder Frank is the best known proponent of this argument see Frank, 'Sociology of Development and the Underdevelopment of Sociology' see also Henry Bernstein, 'Sociology of Underdevelopment Vs. Sociology of Development?' in *Development Theory: Four Critical Studies*, D Lehmann (ed.), Frank Cass, London, 1979.

⁹¹ The classic text in this regard is Hobson. *Imperialism, a Study*. See also the chapters in Edward Owen, John Roger and Robert B. Sutcliffe (eds.), *Studies in the Theory of Imperialism*, Longman, London, 1972.

⁹² See Alexander Gerschenkron, *Economic Backwardness in Historical Perspective, a Book of Essays*, Belknap Press of Harvard University Press, Cambridge, 1962. A good account of Russian state development is found in Martin McCauley and Peter Waldron (eds.), *The Emergence of the Modern Russian State 1855-81*, Macmillan, Basingstoke, 1987.

forces or the hand of the state, is the area of uncertainty in explaining the interaction between political and economic change. Gerschenkron's approach goes a long way towards identifying how the condition of 'economic backwardness' (both real and imagined) can dictate quite different policy responses by the state and the form that industrialization took.⁹³ States committed to 'catching up' sought to facilitate and hasten economic growth through greater state management of capital, a practice that was later taken up in the twentieth century with gusto, not only by the centrally controlled economies of the Eastern Bloc states, but by capitalist states of Latin America and Africa following independence. Sheltering national economies from global trade and price fluctuations became the common policy response to the difficulties of engaging successfully in international trade. The dependency scholars of Latin America were especially influential in the development of economic policies in the region from the 1950s onward.⁹⁴ Yet world systems theory suggests a state's interventionist policies operate largely in vain; capital is still able to penetrate the peripheral state, regardless of the shifts in production that may transform a region at the expense of another. State responses take place below the level of the capitalist world economy. These shifts in production are system maintaining, not altering.

Wallerstein's most significant legacy was to put the concept of the state as a closed economic system to rest. He introduced into analysis greater consideration of external factors, in particular foreign capital, influencing the state. That world systems theory according dominance to the largest possible closed system exposed it to criticism but a new spirit of enquiry was generated, supporting Wallerstein's belief that it is only through a polemical approach that social theory can develop.⁹⁵ The state is not a closed system; typical assumptions of sovereignty must be viewed with a critical eye; and the notion of a secure border must be counterbalanced by acknowledging the state is porous and can be penetrated and influenced by capital as well as ideas and armies. Both Norway and Malaysia were heavily dependent upon foreign capital investment in the beginnings of their industrial growth. A world systems perspective highlights the impact of this investment. But the impact of foreign capital did not always result in predictable patterns of state development. Both cases will demonstrate that foreign

⁹³ See Gerschenkron, *Economic Backwardness in Historical Perspective*, chapters one and six especially.

⁹⁴ Raúl Prebisch, *The Economic Development of Latin America and Its Principal Problems*, United Nations Dept. of Economic Affairs, Lake Success, 1950, was the most notable of these influential studies.

⁹⁵ See Wallerstein. *The Capitalist World-Economy*, p.x

investment can also promote the ability of the state to manage such capital for a variety of political aims.

INDUSTRIALIZATION: A UNIQUE PROCESS

Whilst the assessment presented does abbreviate world systems theory, the problems outlined remain evident. A difficulty with using the world systems approach as outlined above lies in understanding capitalism as it changed in form from the eighteenth century to the twentieth century. As Skocpol argues, changes and differences in how capital is used and managed are not always well understood or clarified using world systems approaches as a template without qualification.⁹⁶ This is demonstrated when making distinctions between capitalism and industrialization. As discussed, industrialization is a particular process of production and economic relations and to understand it as equivalent to capitalism precludes a deeper understanding of the process.⁹⁷ Weber clearly distinguishes between the two phenomena, arguing that industrial production is a particular expression of modern capitalism.⁹⁸ In line with this distinction, industrialization needs to be understood as a unique form of economic activity that has developed dramatically in the twentieth century. Industrial production is a process that first emerged in Great Britain in the late eighteenth century. Involving a dramatic division of labour, it was linked to advances in technology, particularly those involving mechanization and steam power. While industrialization can be understood as possible consequence of capitalism in many cases, there are counter examples as the case of the Soviet Union demonstrates. Industrialization may also be distinguished from capitalism in terms of its dependence on large-scale capital investment and the way both business and labour are organized around it to garner the greatest possible return on its use. The manufacturing of goods and the provision of the many services subsequently required resulted in different forms of business organization and consequently large amounts of capital necessary to pay for the process. Capitalism, Barry Turner argues, is dependent to a degree upon plunder and must be understood as a previous stage before industrialization, which in

⁹⁶ See Skocpol. "Wallerstein's World Capitalist System: A Theoretical and Historical Critique." pp.1078-9.

⁹⁷ See Barry A. Turner, *Industrialism*, Longman, London, 1975. pp. 35-8, for an excellent discussion of Weber's fundamental distinction. See also Blumer, Maines, et al. *Industrialization as an Agent of Social Change : A Critical Analysis*, Chapter 1.

⁹⁸ Turner. *Industrialism*, p.36.

contrast accumulates wealth from increased production.⁹⁹ As historical examples demonstrate, industrialization is not necessarily preceded by capitalism.¹⁰⁰

Harold Blumer's detailed and rigorous account of industrialization is especially helpful and merits incorporation into our analytical framework.¹⁰¹ By placing manufacturing at the heart of the industrialization process, Blumer shows that industrialization is a distinctive system of production, with mechanized production at the centre. Indeed, the mechanized production of goods may be deemed the essence of industrialization. This centre of production has attached to it a network of procurement and is supported by a service structure of banking, financial services, insurance and communications.¹⁰² It is closely related to advances in technology including the steam powered engine, the harnessing of electricity and the production of steel as opposed to the weaker iron. In short, industrialization, as an economic and social phenomenon was, for states and societies, a major break with the past.¹⁰³ For the purposes of this thesis, it is the dramatically increased and changed economic, social and political interaction generated by industrialization that is the most significant consequence of its emergence. The process changed states and the way in which they were organized. Blumer's definition has great clarity and is adaptable as an analytical tool, making it a sound basis upon which to approach the case studies. The industrialization context for state development is therefore complex with analysis required at different levels of social organization. It is necessary to examine the types of societal interaction emerging with industrialization and their frequency to glean the nature of its impact. World systems analysis provides an insightful macro-historical perspective for this thesis and will be utilized in order to assess the impact of foreign investment upon the state. But to examine particular details of state development requires a different perspective, particularly one that views groups and other forms of social organization as important characters in the state arena.

⁹⁹ Ibid., p.38.

¹⁰⁰ Anthony Giddens also touches upon this distinction, albeit from a different angle by pointing out the looseness by which the term 'industrial society' is used to describe both capitalist and socialist states. Giddens, *Capitalism and Modern Social Theory : An Analysis of the Writings of Marx, Durkheim and Max Weber*, p.246.

¹⁰¹ Blumer, Maines & Morriane, *Industrialization as an Agent of Social Change : A Critical Analysis*, p.32.

¹⁰² Ibid., pp.32-3.

¹⁰³ David Brown and Michael J. Harrison, *A Sociology of Industrialisation: An Introduction*, Macmillan, London, 1978, p.14.

We leave world systems theory with these considerations in mind. All groups within a state are subject to pressures and forces, many stemming from economic relationships. The tendency in the surveyed literature has been to analyze the structural pressures in order to understand why organizations and groups respond and change. But key social organizations themselves - those that emerge as a result of industrialization - also require examination in their own right. Such organizations, in both the case studies, were key players in a process of interaction with the institutions of the state.¹⁰⁴ During the process of industrialization, such interaction was fundamental to influencing how the modern state developed. Why did these organizations emerge as they did and what important social and political roles did they play? The structural perspectives examined are not necessarily the best way to understand social organizations and the different motivations they have in responding to economic change. To address this problem the next section takes up an alternative path to approaching the modern state.

THE PLURALIST MODERN STATE

According to the pluralist perspective, modern states are shaped by the many groupings of people that themselves represent a countless array of interests. Perspectives on the state that incorporate analysis of organizations such as trade unions, business organizations and lobby groups may help better comprehend the characteristics of the modern state. How the state as a governing system responds or is impacted by these many groups is a central issue in such an approach and the subject of this section.

Robert Dahl, in an attempt to discover where social power lies asks the straightforward question: who governs?¹⁰⁵ Unlike the previously discussed formulations that identify economic relationships as the central explanatory factor in state development, the pluralist response attempts to understand state development via political processes

¹⁰⁴ Blumer describes the state as 'the target of pressure' from these groups due to industrialization. Blumer, Maines & Morrione, *Industrialization as an Agent of Social Change : A Critical Analysis*, p.45

¹⁰⁵ Robert A. Dahl, *Who Governs? Democracy and Power in an American City*, Yale University Press, New Haven, 1961.

and interactions between social groups.¹⁰⁶ Society in a modern *democratic* state involves a contest between groups, each vying for power. Pluralist views of the state are often associated with political liberalism. This factor and that many of its adherents hailed from the United States, presented it as an alternative to European perspectives. Thus, pluralism is an analysis of the *liberal-democratic* state, rather than the capitalist, according greater emphasis to the political characteristics of the state rather than economic structures. Dahl's approach represented an important step forward in analysis, by no longer attempting to reduce state - society interaction to a base set of economic relationships.

According to the pluralist view, society consists of groups and organizations, power being dispersed among them. The power wielded by any varies depending on the nature of the political contest and the issue at hand. While the perspective does not accord permanent dominance to a particular group or class, what did it have to say about the state? David Truman's *The Governmental Process* asked this question.¹⁰⁷ In his formulation '...government[s] are centers of interest-based power'.¹⁰⁸ The state, closely associated with government, is described as a contested arena, and control of its institutions become the goal for groups attempting to influence politics. Such an approach to the state has lent itself to large empirical studies of groups, actors and their relationships.¹⁰⁹ Government represents a central, neutral place where groups congregate and compete for in order to exercise power. Power therefore remains in the hands of designated societal groups; the state only comes to legitimize and channel this power into policy. The state conveys the *interests* of the dominant group holding power at that time but the state has no interests of its own. With this perspective the state becomes characterized as a neutral arena, with modern democratic systems

¹⁰⁶ The classic exponent of this perspective is Harold Laski. See Harold Laski, *Authority in the Modern State*, Yale University Press, New Haven, 1919. For a good discussion of pluralist political ideas see David Nicholls, *The Pluralist State*, Macmillan, London, 1975.

¹⁰⁷ David B. Truman, *The Governmental Process: Political Interests and Public Opinion*, Alfred A. Knopf, New York, 1965.

¹⁰⁸ *Ibid.*, p.506.

¹⁰⁹ A series of massive studies were conducted by the Social Sciences Research School led by Gabriel Almond and others who were also closely affiliated with modernization ideas. See Gabriel Almond and Sidney Verba, *The Civic Culture*, Princeton University Press, Princeton, 1963; Gabriel Almond and, James Smoot Coleman, *The Politics of the Developing Areas*, Princeton University Press, Princeton, 1960; Gabriel Almond and G. Bingham Powell, *Comparative Politics : A Developmental Approach*, Little Brown, Boston, 1966. The leading proponent of modernization ideas is Samuel Huntington. See Samuel P. Huntington, *Political Order in Changing Societies*, Yale University Press, New Haven, 1968. This text was a book length follow up to the classic article, Samuel P. Huntington, 'Political Development and Political Decay', *World Politics*, 17, 1965, 386-430.

(particularly that of the United States) being the procedural means to facilitate the process of political contestation between societal groups. This approach shares something with the instrumentalist perspective of the state discussed previously. What differentiates it is the possibility that different groups may claim control of the state. Power is dispersed across society and classes and is thus shared, albeit unequally. Further, power is not only derived from economic position, i.e. control of capital. Power may be wielded by different groups, via different means with different motivations. What is important in the pluralist argument is that the state remains an institutional ensemble responsive to social forces and unable to influence them in turn with any great degree of agency.¹¹⁰

Pluralism invites the possibility that more than one social class or group (or indeed individual) can gain access to the state apparatus. More recent variations of pluralism present a more refined perspective that identifies important differences in power between groups.¹¹¹ Contest between groups is not a clash of equals as it can be demonstrated that some groups have greater power by virtue of certain economic and political structures.¹¹² Neo-pluralism or later variations attempt to synthesize a more coherent model, according qualified dominance to particular groups in society by virtue of certain prevailing social structures.¹¹³ In addition, pluralism came to be a characteristic of societal groups and the form of power that they wielded. The state could thus reflect and channel other forms of power; its many functions could not be reduced to those reproducing the capitalist mode of production. In interpreting the state as such, forms of power that encompassed military coercion, political ideology

¹¹⁰ Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, p.47.

¹¹¹ See Charles E. Lindblom, *Democracy and the Market System*, Norwegian University Press, Oslo, 1988, esp. chapter 7. Other 'neo-pluralist' accounts argue that only certain groups, by virtue of their functions or positions within a loose social structure have greater access to political power. See for example Theodore J. Lowi and Benjamin Ginsberg, *American Government: Freedom and Power*, Norton, New York, 1990.

¹¹² A recent and novel example of work that adopts a pluralist perspective is that of Leonard Seabrook. *The Social Sources of Financial Power* explores how social groups, in particular those less economically advantaged, may lend legitimacy to certain financial institutions and arrangements within the state. Such legitimacy can, it is argued, lead to greater financial power in an international setting. See Leonard Seabrook, *The Social Sources of Financial Power*, Cornell University Press, Ithaca, 2006.

¹¹³ An article by Almond argues that the pluralist tradition has often identified more powerful groups, and that the state itself may also come to have autonomous power. Almond puts forth a convincing response to the critique often mounted by the 'statist' school in Gabriel Almond, 'The Return to the State'. *The American Political Science Review*, 82:3, 1988, 853-874.

and social cohesion could be channelled by the state. Further, such actions could be unrelated to the reproduction of capitalism and carried out for a variety of reasons.

Among the most significant groups identified by a pluralist analysis are political parties. Emerging in their contemporary form in nineteenth century Europe, the modern political party is the social organization closest to the state in that it typically seeks to gain power.¹¹⁴ This is the case in both democratic systems of government whereby parties may participate in elections and non-democratic arrangements that have historically encouraged the formation of parties that resist the existing political order.¹¹⁵ In Norway and Malaysia, political parties will be closely examined in two ways: first, how they were shaped and influenced by industrialization and second, how they interacted with institutions of the state. Analytical approaches to political parties have focussed upon their make up and the ways in which they influence power. The emphasis has often been upon the emergence of systems which place parties centre stage and analyze them as reflective of social change.¹¹⁶ An exclusive focus upon political parties at the centre of the modern state is, however, limiting. Political parties are not closed organizations; their membership is fluid and their nature can be dramatically altered by macro-changes such as industrial development or by a minor amendment to electoral laws.

THE PLURALIST APPROACH TO THE MODERN STATE

Within a pluralist framework the state remains a secondary consideration of analysis after society. The state derives its power *from* society, reducing the unit of power to that of the individual or group. Analysis of the state from the pluralist perspective rests upon this assumption: the state becomes, as within Marxist explanations, a

¹¹⁴ The classic investigation into political parties is Maurice Duverger, *Political Parties, Their Organization and Activity in the Modern State*, Wiley, New York, 1963. See also Richard L. McCormick (ed.), *Political Parties and the Modern State*, Rutgers University Press, New Brunswick, 1984.

¹¹⁵ The European liberal model and its development are the subject of Andrew Gould, *Origins of Liberal Dominance : State, Church, and Party in Nineteenth-Century Europe*, University of Michigan Press, Ann Arbor, 1999.

¹¹⁶ See Pradeep K. Chhibber and Ken Kollman, *The Formation of National Party Systems : Federalism and Party Competition in Canada, Great Britain, India, and the United States*, Princeton University Press, Princeton, 2004, pp.9-21., for a good overview of approaches to political parties and their place in modern society.

consequence of particular social actions.¹¹⁷ But an assumption that causality travels in one direction is a problem that will be addressed in this thesis. An insightful analysis of the modern state must entertain the possibility that institutions of the state may be more active than the pluralist perspectives discussed have permitted. A pluralist view allows the analysis of important social groups. But to address the case studies it will also be important to identify why structural change, namely industrialization, influenced power relationships. In the context of an industrializing economy, a pluralist perspective will help analysis of organizations such as labour unions, business organizations, political parties and their leaders. A pluralist perspective of the case studies will demonstrate how, in the context of an industrializing economy, these groups developed, changed and interacted with each other. Most importantly, how the modern state, considered as a cluster of institutions responded to this dynamic is central in the approach to the cases studies. Developing a viable approach to this problem is the subject of the next chapter.

According to the perspectives discussed, the 'state' may be imagined as a neutral arena of societal organization where social groups interact. Plurality has been applied to society in order to understand where power lies. The state however remains a singular and powerless entity, an organization to be controlled by society or particular social groups.¹¹⁸ What is less certain in these approaches is how social groups come to have power and where power derives from. The Marxist perspectives discussed earlier are useful in finding answers to such questions. A viable approach to the modern industrializing state must consider groups as important social and political actors. But the processes that build these groups and provide them with political power must also be understood. As the case studies will demonstrate, industrialization was a process that directly contributed to the development of important and powerful social groups in Norway and Malaysia. How this power was exercised and channelled requires investigation with a view that employs the structural considerations of a Marxist perspective with a social group analysis that pluralist approaches provide.

¹¹⁷ For a good discussion of this problem see Robert R. Alford and Roger Friedland, *Powers of Theory: Capitalism, the State, and Democracy*, Cambridge University Press, Cambridge, 1985, pp.35-41.

¹¹⁸ That pluralist views are reductionist, or curtail the ability to analyse the state itself may suggest more of a difficulty with pluralism as an applied method rather than the conclusions it draws. How it is applied and what the subject it is used upon as an analytical device are more significant bones of contention.

In the pluralist literature discussed the state has been characterized as a neutral space that reflects the interests of social power in the form of social organizations. Whilst powerful groups may emerge in modern societies, the state is set aside and explained as a secondary social phenomenon. Perhaps most significantly for theorizing, the state becomes neatly separated from society with a set of clear linkages that are easily identified. A clear line of demarcation exists with the territorial space of the state divided into two spheres of the state and society. Interaction is limited, and power resides *within* society, only being channelled to the state *by* society. This approach shares something with the rational choice school which argues outcomes are the result of a combination of individual actions motivated by self-interest.¹¹⁹

STATE, SOCIETY AND INDUSTRIALIZATION

Plurality is identifiable as a characteristic of society, whilst the state in the literature reviewed remains singular. Yet in the twentieth century modern state development is not sufficiently explained as either a reproductive structure of capitalism or as a passive centre for channelling social contests without significant qualification. Whilst singular structuralist accounts of the state may reflect realities at a certain level, they need to be qualified to aid understanding of the modern state as an extraordinarily complex form of social and political organization. In the twentieth century, the modern version of the state has assumed a growing number of functions and range of roles: the post-World War II expansion of the welfare state in the Western world is a recent example of this phenomenon. Structuralists argue that the ever expanding activities and roles of the state are reflective of the increasing contradictions inherent in capitalist production.¹²⁰ This claim, however, reinforces an existing perspective rather than generating new insights into the modern state. Whilst the capitalist state may well act to reproduce the mode of production, the modern state is engaged in a vast array of activities involving social conflict but in contrast to the classical structuralist

¹¹⁹ A classic rational choice text is George Caspar Homans, *Social Behaviour : Its Elementary Forms*, Routledge & K. Paul, London, 1961. A good overview is found in J. Scott, 'Rational Choice Theory' in Gary K. Browning, Frank Webster and Abigail Halcli, *Understanding Contemporary Society : Theories of the Present*. Sage, Thousand Oaks, 2000.

¹²⁰ This is a somewhat weak refute of the Marxist claim, however attempts to link the expanding actions of the state, i.e. support of cultural activities and the construction of certain types of infrastructure with the base requirement to reproduce capitalism almost appear desperate at times. See Jessop. *The Future of the Capitalist State*, pp.275-6.

view such activities may also increase social cohesion, alter the makeup of social organizations and mobilize resources. It is apparent that the state cannot be understood as a singular entity or viewed as a mere consequence of processes occurring in society. In the modern industrialized context, the state encompasses many structures and organizations with a variety of functions and different purposes. The modern state is characterized by a complex web or network of institutions that may not always demonstrate unity. Indeed, if institutions of the state do exhibit points of tension or desegregation, the concept of plurality can safely be applied to the state itself.¹²¹ Such a view also begins to take account of the blurred line that separates the society and the state, making the area of interaction between the two the subject of analysis. In addressing the complexities discussed thus far, interaction between the state and society will become a focal point of the analysis developed in this study.

The concepts examined have presented the state variously as an organized arena shaped by war, the capitalist mode of production or contests between social groups. The modern state has been depicted as an organizational response to forces and processes beyond its control or influence, which if taken at face value suggest that the modern state, as an institutional entity, is extremely limited or constrained in influencing economic activity and social groups. Capitalism and war have represented the most powerful of these forces, impacting upon states and shaping them throughout their history. States, it may be said, are a product of these historical forces. In addressing the case studies the following considerations, based upon the findings of this chapter, will inform the analysis:

- Economic change, specifically, industrialization, is a key structural factor in understanding modern state development.
- Marxist and structuralist perspectives offer useful approaches to understanding industrialization as an economic process and its impact upon society. These approaches identify the considerable impact of foreign capital as factor in the industrialization of Norway and Malaysia. Nevertheless, they must be qualified and utilized as a complement to a flexible analytical framework

¹²¹ Stephen Skowronek's landmark work pointed to examples of such disaggregation. See Stephen Skowronek, *Building a New American State: The Expansion of Administrative Capacities 1877-1920*, Cambridge University Press, Cambridge, 1982.

- Industrialization and its critical component of investment capital must be understood as transcending state boundaries: a consideration that world systems literature has addressed.
- In analysing this process, the social impact of economic change must be assessed. Pluralist considerations of group formation offer an approach that considers the social impact of industrialization by examining organizational change in the state arena.

The issue that remains at the end of this chapter concerns the role of state institutions and their relationship with industrialization and society. Whilst some conceptual frameworks of the state have incorporated industrialization as a factor, it has sometimes proven difficult to directly connect the economic process to the complexity of modern states and the many interactions between the state and social organizations in the industrial age. While industrialization may have given rise to important and organized social groups, the complexities of the modern state cannot be clearly understood by regarding it simply as a *consequence* of industrialization. The approach to Norwegian and Malaysian modern state development in the twentieth century thus far includes the consideration of foreign investment as central to industrialization. This developing approach will incorporate social group analysis in building a picture of the modern state arena. Considering how organizations change and respond to the industrialization process will be an important aspect of the developing analysis. Further, it will identify what type of organizations developed in the industrial age and how they became important. The developing framework currently incorporates industrialization's impact upon the state by examining industrialization itself, and takes a perspective of the state that considers it an arena that includes important social organizations and investment capital as key components in the process of modern state development.

An inclusive approach to the case studies that addresses the problem of modern state development cannot ignore state institutions as an agent of change. The next chapter will examine concepts that address state institutions and their actions as a factor in explaining social and economic change. If the state does have agency then it is necessary first to establish who or what in the state possesses such agency. This will lead to a second area of inquiry: the nature of the modern state itself. Is the modern

state a group of identifiable people, an institutional ensemble, a bureaucracy, or a combination of these things? The key assertion of the next chapter is that societies can be altered or changed by the action of the state. Industrialization as an economic process may thus be considered a process initiated and managed, to varying degrees, by the state itself.

CHAPTER 2

States as Makers of History

INTRODUCTION

Part One of this thesis has begun developing an approach to the modern state. In order to advance this framework, this chapter will consider concepts of the state that regard it a set of institutions with the capacity to influence and change the economy. Such a perspective is critical to understand the modern state as it developed in the twentieth century. The context of industrialization and its impact upon society were the subject of the first chapter. By situating states in processes that shaped and altered them in the previous chapter, the state was characterized as an arena. The focus now turns to the institutions of the state, those that are shaped by the industrialization process and can in response influence the process. This chapter will complete an analytical framework to apply to Norway and Malaysia in Part Two.

By making the state an agent, the state, considered as a cluster of institutions, needs to be interrogated as a key variable in understanding political change. This consideration raises questions of power; in particular who or what holds power to influence change. This chapter will explore the state as an institutional set by examining it through the elitist and 'statist' concepts of the state and bureaucracy. Elitist understandings emphasize the role of government and individuals that hold power within the state. Statist views have a similar perspective but emphasize the ability of states, as institutional ensembles with their own interests, to shape and influence the society in which they are located. The rise of large bureaucracies as a key feature of the modern state will then be examined. The bureaucratic perspective of the state is connected to the 'developmental state' tradition. This approach places the state squarely in the context of industrialization, fittingly for the investigation of Norway and Malaysia in Part Two. The rapid industrialization experience of several East Asian states has informed the 'developmental state' view: that the state, via a modern bureaucracy, may

directly influence industrial development. How each of these perspectives can contribute to an analysis of Norway and Malaysia will be discussed in detail. The primary question of this thesis will be addressed with an emphasis upon how modern state development can respond to and shape the industrialization process. This chapter will conclude by establishing the analytical framework to apply to of Norway and Malaysia.

The perspectives utilized have both merit and problems. The task of this chapter is to find the conceptual tools to approach the problem of modern state development in the context of industrialization. This chapter examines perspectives of the state that understand it primarily as a cluster of institutions able to shape and influence society. Such a view often equates the state with government and the institutions that govern the territorial space of the state.¹ In doing so this chapter will ask whether the state can effect change and make the transition from the pre-industrial state to the industrial state. The case studies which follow in Part Two will examine the state undergoing this transition in the context of industrialization.

THE ELITE LED STATE

The accounts of the state discussed portray the state as derivative and secondary to other processes and groups. The state has been presented as a passive structure or set of institutions responsive to pressures from groups and processes in society. Yet when perceived from the 'outside', in the context of other states, such views of the state can change. In literature on the state from an international relations perspective, states can appear more powerful and regarded as the dominant actors in global politics.²

The statist view often examines the state in terms of its actions in relation to other states. It perceives the state as a particular type of organization led by an elite group of citizens, usually the executive government, senior bureaucrats and military officials.

¹ This equation of state with government is a particular feature of American perspectives. See Christopher Morris, *An Essay on the Modern State*, Cambridge University Press, Cambridge, 1998, pp.20-1.

² The classical realist tradition is founded upon this assumption. The most prominent classical realist examples include Hans Joachim Morgenthau, *Politics among Nations : The Struggle for Power and Peace*. Knopf, New York, 1960; Edward Hallett Carr, *The Twenty Years' Crisis, 1919-1939 : An Introduction to the Study of International Relations*, Harper Torchbook, New York, 1964.

This approach is exemplified in Stephen Krasner's *Defending the National Interest*.³ States, he argues, have 'peculiar drives, compulsions, and aims of their own that are separate and distinct from the interests of any particular social group.'⁴ This argument contrasts with the concepts discussed in the previous chapter; that the state is only reflective of particular interests originating from society. It is argued that the state, as a set of institutions controlled by a select group of people, may be able to shape and control resources in ways of their own choosing. Whilst Krasner discusses how United States' foreign policy was involved in maintaining the supply of raw materials to industry, his argument can be extrapolated into a more general view of foreign policy. Whilst the actions of a state in its relations with other states may be partially reflective of the interests of particular powerful groups, elite individuals with major political power, may act of their own accord, motivated by not only economic self-interest, but with political and ideological intentions. Thus, the modern state is led by an elite group of officials that carry out the aims of the state. In addition, Krasner's argument maintains that these groups are insulated to a large degree from societal pressure groups.⁵ The decision makers in the area of foreign policy (e.g. the executive, senior bureaucrats and military officers) can be regarded as having a high level of independence and separation from domestic considerations.⁶ It is therefore possible that this group may form policies that conflict with the interests of particular societal groups, even the most powerful ones. This can be contrasted with Marxist and pluralist views that argue certain groups, by virtue of their economic or social status, control the state.

Classical or realist theories of international relations often portray the state as a self interested entity.⁷ In conditions of anarchy, the state must pursue survival at all costs. In such a competitive environment, the self-interested and power seeking state is a rational one.⁸ Realist accounts of the state rest upon this foundational assumption.

³ Stephen Krasner, *Defending the National Interest*, Princeton University Press, Princeton, 1978.

⁴ Ibid., p.10.

⁵ Ibid., p.332.

⁶ John Spanier, *Games Nations Play*, Praeger, New York, 1972, pp.40-1.

⁷ Classic examples of the realist tradition include Hans Joachim Morgenthau, *Politics among Nations : The Struggle for Power and Peace*, Knopf, New York, 1967; Stanley Hoffmann, *The State of War: Essays on the Theory and Practice of International Politics*, Praeger, New York, 1965.

⁸ The concept of anarchy is well discussed in the classic Hedley Bull, *The Anarchical Society : A Study of Order in World Politics*, Macmillan, London, 1977. See also Richard Ashley, 'Untying the Sovereign State: A Double Reading of the Anarchy Problematique', *Millennium* 17:2, 1988, 227-262. The concept

The state's interests and aims are pursued by people acting on its behalf, in isolation from domestic considerations. Sovereignty thus provides a conceptual barrier, but also makes itself useful for the state organizational apparatus; which can insulate the practice of ensuring security from question by other social groups.⁹

Relations between states are not always best explained in terms of sovereign cohesive units interacting in an anarchic realm theoretically as equals. This is an assumption of traditional international relations theories, yet it is questionable whether it is a close approximation of reality, or rather serves to buttress an abstraction that attempts to exclude potential aberrations. In the context of this inquiry, that of twentieth century industrialization, it is clear that approaching the state from this perspective is problematic. To understand the impact of industrialization - as a regional and global process of economic change and transformation that crosses borders - requires an approach to the state that qualifies such a traditional concept of sovereignty. Industrialization in the twentieth century has seen capital, goods and technology move in and out of states with great speed and unpredictability, suggesting that understanding modern states as sealed 'containers' is not the best way to understand them.¹⁰

The elitist perspective is best supported by examining the state from the outside.¹¹ Traditionally in external relations the state has no equal; more recently, scholars have begun to invite the possibility that there may be other actors on the world stage able to exercise a great degree of influence on political affairs.¹² It is unusual then that

of rationality is central to the neo-realist arguments of Kenneth Waltz. See Kenneth Waltz, *Theory of International Politics*, Addison-Wesley, Reading, 1979.

⁹ For a good discussion of 'state autonomy' see Stephan Krasner, 'Approaches to the State: Alternative Conceptions and Historical Dynamics', *Comparative Politics* 1, 1984, 223-246. See also Eric A. Nordlinger, *On the Autonomy of the Democratic State*, Harvard University Press, Cambridge, 1981. One of the best discussions of sovereignty as both a conceptual idea and a research tool is found in Janice Thomson, 'State Sovereignty in International Relations: Bridging the Gap between Theory and Research', *International Studies Quarterly* 39, 1995, 213-233. A discussion that attempts to substantiate sovereignty from an institutional and legal perspective is found in Ryan Goodman and Derek Jinks, 'Toward an Institutional Theory of Sovereignty', *Stanford Law Review* 55, 2003, 1749-1788.

¹⁰ An excellent overview of the concept of the state as a container of territory is found in Peter J. Taylor, 'The State as Container: Territoriality in the Modern World System' in N. Brenner, B. Jessop, M. Jones and G. MacLeod (eds.), *State/Space: A Reader*, Blackwell, Malden, 2003.

¹¹ Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, p.49.

¹² The classic early version of this approach is Keohane and Nye. *Power and Interdependence: World Politics in Transition*, which introduced the possibility of forms of non state power having an influence

perspectives of the state that view it from within so often describe the state as variously weak, fragmented or subject to special interests. Why should a state have agency as the primary 'actor' in the world polity, yet not be accorded the same privileged position within its own territory? Classical international relations approaches do not always pay a great deal of attention to the internal characteristics of the state. Such traditional descriptions of the state rely implicitly upon sovereignty as a barrier to outside pressures to inform their logic. A problem with such an assumption lies in understanding the relationship between the state and society. Fortunately, within a historical scholarly tradition, the issue of whether states themselves can change the societies they operate in has been addressed. In periods of great social change such as revolutions, some have identified how the state itself may be effecting change – an important step forward in this analysis. If states are, as the following section argues, able to implement such dramatic change, they may also be able to influence and shape an industrial revolution.

STATISM

It is a small leap from a view of the state an independent variable in the analysis of social change to so called 'statist' approaches. In contrast to pluralist and structuralist approaches that portray the state solely as an arena or space for social contests, this perspective accords a significant degree of power to the state itself, through its institutions. The analysis Theda Skocpol presents of the French, Russian and Chinese revolutions was not itself groundbreaking, but what does represent a significant analytical advance are the questions she asked and the emphasis her work accords to the way states, regarded as autonomous entities, manage the process of social change.¹³ Revolutionary change in all of the three countries had previously been portrayed as a dramatic social reordering that reshaped the state itself. 'Bringing the state back in' as a concept allowed Skocpol's and several other works to gain prominence.¹⁴ The modern state according to Skocpol is 'a structure with a logic and interests of its own

upon states. See also Susan Strange, *The Retreat of the State : The Diffusion of Power in the World Economy*, Cambridge University Press, New York, 1996.

¹³ Theda Skocpol, *States and Social Revolutions : A Comparative Analysis of France, Russia, and China*. Cambridge University Press, Cambridge, 1979.

¹⁴ This is a hackneyed term yet it does have a resonance that is useful in demonstrating the analytical shift that took place. See Peter B. Evans, Dietrich Rueschemeyer and Theda Skocpol (eds.), *Bringing the State Back In*, Cambridge University Press, Cambridge, 1985.

not necessarily equivalent to, or fused with, the interests of the dominant class in society or the full set of member groups in the polity.¹⁵ The state as an independent variable became central in analyses of social change.¹⁶

Skocpol was cautious in her work, after all, is it possible for a structure, as opposed to an agent, to have interests? Skocpol was tentative on this point, but the breach in conventional wisdom permitted a shift in thinking. The state could return to the fold of the legitimate social sciences and be considered an agent, with interests, in its own right. These ideas drew upon the Weberian tradition: the modern capitalist state is characterized by an organizational apparatus that increasingly claims more power unto itself and forces change upon society in its own interests. Separated from society, the state is able, by virtue of its administrative and policing powers, to extract the resources it requires from society to maintain its position of power over society. Further, the view that maintenance of such a position is possible is advanced by the suggestion that the state apparatus can reshape and transform social relations.¹⁷ Yet such an analysis invites questions concerning the origin of such interests. Who carries out the interests of the state and are such interests always consistent? It is also difficult to clearly identify the interests of an institutional ensemble without closely analyzing groups within the bureaucracy and individuals such as political leaders who implement policy.

Ellen Trimberger's analysis of the revolutions that took place in Japan and Turkey also make the state the central participant in dramatic political change.¹⁸ Unlike the conventional account of revolutions as a class struggle from below, these two cases demonstrated that a particular group in society, namely the military and bureaucratic class, by enjoying a large degree of separation or autonomy from society, was able to effect major transformations of both society and the state. Ataturk's Turkey and Japan

¹⁵ Skocpol, *States and Social Revolutions : A Comparative Analysis of France, Russia, and China*, p.27.

¹⁶ An article that foreshadowed this movement is J. P. Nettl, 'The State as a Conceptual Variable', *World Politics* 20, 1968.

¹⁷ See the chapters in Evans, Rueschemeyer and Skocpol, *Bringing the State Back In*, especially Skocpol, Theda. 'Bringing the State Back In: Strategies of Analysis in Current Research'; Charles Tilly, 'War Making and State Making as Organized Crime'; Peter Evans, 'Transnational Linkages and the Role of the State: An Analysis of Developing and Industrialized Nations in the Post-World War II Period' and Peter Katzenstein, 'Small Nations in an Open International Economy: The Converging Balance of State and Society in Switzerland and Austria'.

¹⁸ Ellen Kay Trimberger, *Revolution from Above: Military Bureaucrats and Development in Japan, Turkey, Egypt, and Peru*, Transaction Books, New Brunswick, 1978.

following the Meiji Restoration were reshaped by the actions of a small group deemed to be a part of the state organization that was able to overthrow the old regime and instill a newly centralized and modernized state apparatus.¹⁹ This argument supports the argument that the developing modern state undergoes a centralization of power, as organizational, military and policing institutions of the state are built. A conclusion that may be drawn from this perspective is that the modern state has the capacity to undertake a project of societal transformation, independent of the interests of particular classes and social groups. The question arises that will be asked of the case studies: whose interests is such a project reflecting? The motivations of political leaders in particular require consideration as well as their supporters in business and other social organizations. The pluralist perspective discussed in the previous chapter shares some similarities with the statist perspective. Yet not all states experience revolutions. It may not require a violent process to demonstrate that states have the capacity to act independently of social pressures and group demands.

Industrialization provides a context that can demonstrate the impact of modern state institutions on society. In both Turkey and Japan as Trimberger showed, economic development brought social change in a more gradual and less violent way than that of the revolutions of Russia and France. Norwegian and Malaysian societies too underwent economic change that dramatically reconfigured their societies. How their state institutions shaped this process is a focus that must be modified by also considering how modern state institutions were built and influenced by industrialization. Causality in this developing framework must be understood as traveling in both directions. Economic and social change impacted upon state institutions, yet by developing, state institutions were able to influence social and economic activity.

An approach that focuses upon the interaction between social organizations and the institutions of the state will prove central to the analysis in Part Two. Eric Nordlinger and Stephen Skowronek emphasize the modern version of the state not as solely responsive to the whims and pressures of social groups, but as a self interested and

¹⁹ For a good account of Ataturk's Turkey see, Ali Kazancigil and Ergun Özbudun (eds.), *Ataturk : Founder of a Modern State*, Hurst, London, 1997. For an account of Japan's modernization experience see Michio Umegaki, *After the Restoration : The Beginning of Japan's Modern State*, New York University Press, New York, 1988.

autonomous creature in peace as well as in times of conflict.²⁰ Skowronek's depiction of the American state is that of an institutional cluster going about a building process: one carried out by a bureaucratic and government elite.²¹ This feature is what gives insight into the modern state's character. The conceptual problems that emerge with these claims are twofold. First, can the state, if autonomous, be regarded as a singular entity as so much of the statist literature asserts? Second, and somewhat related: is the explicit theoretical divide between the state and society both an accurate depiction of reality and a useful analytical tool for social analysis? Interaction between the modern state and social groups is difficult to clearly identify with such a rigid demarcation of space. Blurring the divide, by examining interaction between the modern state through its institutions and social groups is a central element of Part Two.

The difficulty in describing the state as an organization with a singular logic or a unified set of institutions has remained in some of the literature. As Trimberger's work demonstrates, one arm of the Turkish state, in the military administrative form, overthrew those deemed to hold executive power. Both arms of the state apparatus, according to statist accounts, should have had a harmonized set of interests in accordance with its 'singular logic'.²² Yet the modern states presented in the case studies are not singular entities with a unifying logic. State institutions conflicted and disagreed on direction and policy. The modern state as it develops needs to be considered in a plural fashion in order to more fully understand its characteristics and the way it is shaped by industrialization.

THE MODERN STATE

It is the nature of the modern state that is a central consideration of this thesis. What exactly makes a state modern? The understanding that has guided much literature is the idea that the modern state differs from the pre-modern version by virtue of its bounded territory and the way the governing system has dominance over the entire

²⁰ Nordlinger. *On the Autonomy of the Democratic State*, , Skowronek. *Building a New American State: The Expansion of Administrative Capacities 1877-1920.*,

²¹ Skowronek. *Building a New American State: The Expansion of Administrative Capacities 1877-1920.*, pp.12-13.

²² The term 'logic' was central in Skocpol's description, for which she was criticized. See, for example, a critique of the statist perspective in Almond. "The Return to the State." pp. 869-70.

territory.²³ Its characteristics distinguish it from the pre-modern state: the difficulty is that many perspectives of the state don't always provide detail to support this definition. In providing such clarity the statist view may not be much different from the view that the state is an institution controlled by elite individuals in power. Whilst Louis XIV may have equated the state with himself, the modern state that has emerged since the industrial revolution and particularly in the twentieth century comprises a multiplicity of institutions, organizations, laws and agents who carry out (or do not) a vast array of activities. For this thesis it is held that the modern state is exceedingly more complex compared to the pre-modern state and that great regulatory power is centralized in its institutions.²⁴ What must be interrogated, and this is the essential subject of this thesis, is how industrialization contributes to and shapes the institutions that exemplify the modern state. An analysis of the political and social interaction that led to particular types of institutional development requires tools beyond a mere basic definition of the modern state.²⁵ The modern state is indeed complex; but just how complex and why needs to be explored.

Particularly pertinent are the complex organizational, extractive and redistributive roles the modern state assumes through its bureaucratic institutions. Understanding such characteristics requires an examination of Norway and Malaysia's institutional developments in detail. Arms of the state all have limited resources and tensions can arise between administrative organs over their respective levels of socially extracted resources. Groups within institutions of the state may wrest control from others: power may be transferred from the executive to a specialist bureaucratic institution, for example. During banking crises in both Norway and Malaysia, dedicated bureaucracies were established by the state to deal with the problems, wresting power away from government and causing considerable political friction in the process as they began to regulate previously untouched economic activities. How these disputes played out often dictated the shape of state institutions established to settle such conflicts and manage the banking system. Where state power shifted to and changed

²³ An excellent discussion from the perspective of political philosophy is found in chapter two of Morris, *An Essay on the Modern State*,

²⁴ This point is at the centre of Michael Mann's argument in Mann, 'The Autonomous Power of the State: Its Origins, Mechanisms and Results'.

²⁵ Detailed work on the modern state and views of its different origins can be found in H. Kenneth & F. Dyson, *The State Tradition in Western Europe : A Study of an Idea and Institution*, Martin Robertson, Oxford, 1980.

will be revealed by analysis of conflict between state institutions and social organizations which will also serve to highlight their complexity.

In the most extreme cases such as a coup, some state agencies may seek to undermine or overthrow another group who may also said to be part of the state. If conflict is severe, can the state be understood as representing a singular 'thing' or interest?²⁶ Conflicts within the institutions of the state do take place, often reflecting conflicts that occur between social groups. This leads to an additional problem, the analytical dichotomy between the state and the society it coexists with. Such a division makes analysis easier; dividing up the characters becomes a manageable task when they have clear categories to fit in. Yet the consequences for research using such an approach can create problems.²⁷ States as well as society are made up of people and groups, who can also be regarded as part of society as a whole. Where cross-over between the two categories takes place is uncertain. When does a senior bureaucrat assume the role of state agent and when does she or he become a member of 'society' deemed to be outside the sphere of what is formally understood as the state? Ultimately, such a problem may be irresolvable, but accepting an analytical grey area could be a helpful way to look at interaction between the state and society. This problem takes us into some murky terrain, but certain accounts of the state - society relationship during dramatic social change do point in some helpful directions toward identifying the modern state's particular features. Alfred Stepan's attempt to synthesis polemical Marxist and pluralist explanations takes up an 'organic-statist' position that goes some way toward breaking down this problematic divide.²⁸ Stepan does acknowledge his organic view of the state is heavily embedded in a normative approach, yet he still manages to develop an abstract model of government.²⁹ What his study of Peru demonstrates is the importance of ideology and what the state represents as an agent that can bring about social change.

²⁶ This question also leads to the problem of state 'personality'. Are states to be regarded as a 'thing', or can they be understood as an entity with a will? For a recent discussion of this problem in IR theory see Alexander Wendt, 'The State as Person in International Theory', *Review of International Studies* 30, 2004, 289-316. See also Patrick Thaddeus Jackson, "Hegel's House, or 'People Are States Too'", *Review of International Studies* 30, 2004, 281-287.

²⁷ John Hobson makes the good point that bringing the state in cannot be usefully accomplished by kicking out society. See John M. Hobson *The Wealth of States: A Comparative Sociology of International Economic and Political Change*, Cambridge University Press, New York, 1997, p.230.

²⁸ Alfred C. Stepan, *The State and Society : Peru in Comparative Perspective*, Princeton University Press, Princeton, 1978.

²⁹ Ibid., p.46

The desire by those in positions of political power to progress along the path of industrialization represents a normative factor of importance. As Marx himself remarked, 'The country that is more developed industrially only shows, to the less developed, the image of its own future.'³⁰ Turkey and Japan modernized their economies through the leadership of an elite group or class dragging and cajoling the rest of society with them.³¹ The need to catch up economically with the industrialized West was central in the minds of Turkish and Japanese policy makers; turning a political aim into direct actions and effective policies was their primary challenge. The policies and ideas of political leaders need to be considered as important. How they had an impact and in what context they were able to effectively implement policies require an analysis of the policy environment. How industrialization shaped this environment, and the way it enhanced or changed the power of some social organizations may generate a more complex picture of the modern state; one that ameliorates some of the problems outlined in this literature review.

In this thesis, the place of government policy will play a role in understanding modern states and the political response to industrialization. The political desire for a late developer to 'catch up' can influence the interaction between social actors and the state. In this tradition, the focus has fallen upon the institutions of the state and the way they may generate economic change through policy. The institutions most closely associated with the modern state have been the administrative organizations of bureaucracy. Economic change resulted in the need to organize resources and create laws, regulations, common measurements and currencies. The process of industrialization developed this process in the most dramatic and rapid way. The more complex economic interactions in society, the more administration and organization required. Yet this administrative development cannot always be perceived as purely responsive to social processes. In Part Two the modern state is to be understood by examining the institutional features that regulate, manage and direct resources according to policies and not solely responding to social pressures. By developing such a perspective, Part Two will be able to closely examine several key

³⁰ Karl Marx and Ben Fowkes (translator), *Capital : Volume 1 : A Critique of Political Economy*. Penguin, London, 1976. p.8.

³¹ Turkey and Japan are standout cases of state-led modernization. T. Hayashi makes the point in a comparison that neither Japan nor Turkey experienced modernization as a process forced upon them from the outside. See T. Hayashi, 'The Modernisation of Japan and Turkey' in Kazancigil and Özbudun, (eds.) *Ataturk : Founder of a Modern State*,

institutional developments in the case studies. It will permit an analysis of the actions of bureaucracies and motivations behind them.

BUREAUCRACIES AND THE MODERN STATE

The analysis of the organizational forms of states and societies can be regarded as the institutional perspective, deriving from the works of Weber.³² The state according to Weber is a structure consisting of various institutions dedicated to particular tasks.³³ Weber did not approach the state head-on by analyzing it directly, but his description of modern society and its characteristics made the state significant, even implicitly central, in his work. What characterized the modern state was the range of roles it adopted; it became the dominant organizational form for human societies. According to Weber, the state could not be understood by identifying an *end*.³⁴ The functions of an organization were the only way by which to analyze them, in the case of the state, these were primarily the use of force and the managerial roles undertaken. What set the *modern* state apart is the *means* by which the modern state organizes and controls its territory and economy. At a basic level, the state alone has the ability to legitimize the use of violence, and thus a monopoly on the legitimate use of force, yet this definition on its own is only of limited utility when examining the modern state.

What characterizes the modern state's role is ever growing *specialization*. Agents of the state become increasingly involved in specific organizational tasks in a process understood as *bureaucratization*.³⁵ According to Weber, the modern state is synonymous with the *rational* and *bureaucratic* state. The modern bureaucracy is rational and formal in its approach to organizing society, making it distinct from the pre-modern forms of social organization. This applies to the way the bureaucracy goes about its business and the way the institutions of the bureaucracy are organized. In the modern state, the bureaucracy takes on responsibility to organize societal relations;

³² Max Weber's major work concerning the state is found in Weber. *Economy and Society : An Outline of Interpretive Sociology*. See also Max Weber and Max Rheinstein, *Max Weber on Law in Economy and Society*, Simon and Schuster, New York, 1967 and David Beetham, *Max Weber and the Theory of Modern Politics*, Allen & Unwin, London, 1974.

³³ Weber. *Economy and Society : An Outline of Interpretive Sociology*, p.55 Weber's classic definition of the state is: 'A compulsory political organization with continuous operations...successfully upholds the claim to the monopoly of the legitimate use of physical force in the enforcement of its order.'

³⁴ Ibid., p.55.

³⁵ Ibid., p.223.

sometimes this power is granted by government but it also may grow in a manner unplanned. Weber's understanding, unlike the pluralist conceptualizations previously discussed, is that social power is located, concentrated and maintained in particular institutions of the state. This increasing and specifically institutionalized power was characteristic of modern social and economic organizational needs, a trend that was continued by those who held positions within bureaucracies and sought to increase their power.³⁶ The process of bureaucratization therefore gained a momentum of its own.

Depicting and analyzing the modern state as a set of institutions in Weber's terms is a great advance on previous conceptualizations. It permits an approach to the state that allows insight into its great complexity - a key characteristic of the modern version. Whilst a unifying structure may be identifiable at some levels, the modern state may develop as a result of factors more mixed and varied than solely the capitalist mode of production. Institutions can respond to different kinds of pressures from different groups, individuals and processes. And importantly, the institutions of the modern state may also initiate actions of their own doing. The understanding of social power therefore, cannot be reduced to either a singular phenomena or one way process. The analysis of the modern state in Part Two of this thesis must not regard it only as a secondary, derivative entity, dependent upon the whims of a social action or particular class, but as an organizational form comprising of agencies and individuals with the capacity to undertake independent action. Weber's analysis succeeded in distinguishing the state as a broad category from the modern, bureaucratic and rational state. It is the institutions of the modern state that can reveal much about the state itself and the way it behaves.

If the modern state is primarily characterized as a regime of institutions, the understanding of the relationship between the state and society is changed significantly. The power of the state over society is influenced by the power held by the bureaucracy itself, and also by the level of *penetration* the state has into society.³⁷

³⁶ Beetham. *Max Weber and the Theory of Modern Politics*, pp.72-9.

³⁷ It is this factor that is described by Michael Mann as *infrastructural* power. See Mann. 'The Autonomous Power of the State: Its Origins, Mechanisms and Results'. This point was later developed and expanded in Mann, *The Sources of Social Power Volume 1: A History of Power from the Beginning to A.D. 1760*, pp.59-63.

Interaction between the state and society is now an important area of analysis. Modern states consist of a cluster of institutions, and these institutions are staffed by people who are also members of society at the same time. And as the institutions of the modern state emerged, they held and retained increasing levels of power; they could be regarded as having autonomy from and power over society.³⁸ Most importantly, the institutions of the modern state are not always best described as components of a singular, unifying structure. A central bank may disagree with government over economic policies and a defence bureaucracy may experience fractious internal relations trying to satisfy all its funding recipients. Plurality can be a condition of the state when it is understood in institutional terms. The institutions of the state may conflict with one another, as well as with key groups in greater society; our approach to the cases must consider these issues. Disputes and agreements can occur between individuals and groups over a range of issues. How these are resolved can often shape future organization. Movement between groups is also an important consideration. Public officials may move into the private sector, and business people and union officials may become politicians. This interaction needs to be considered by examining its institutional consequences. The case studies of Norway and Malaysia will make such interaction between social groups and state institutions central to analysis. Industrialization created a context in both the states for major upheavals and disputes that caused serious rifts in society and the institutions of the state. The consequences of interaction will help to identify how their modern states developed.

This approach represents an attempt to transcend the perceived barrier that lies between the state and society. Not only has the barrier been conceptually necessary in the literature thus far but the concepts considered have reinforced the significance of the divide. Contrastingly, the analysis of Part Two will take a different approach. Power is unevenly dispersed across the territory of the state and located variously within groups, organizations and individuals. According to the Weberian tradition, power in its various forms becomes centralized and consolidated within state

³⁸ This concept of autonomy of the state from society is well discussed in Peter Evans, *Embedded Autonomy: States and Industrial Transformation*, Princeton University Press, Princeton, 1995. For an East Asian context see Hee-Yeon Cho and Eun Mee Kim, 'State Autonomy and Its Social Conditions for Economic Development in South Korea and Taiwan' in Eun Mee Kim (ed.), *The Four Asian Tigers: Economic Development and the Global Political Economy*, Academic Press, San Diego, 1998

institutions, an important example of modernization.³⁹ This has proceeded in an evolutionary fashion, with the modern state adopting a set of features that differentiate it from the feudal state or the empire. The modern state, as a result of this process, can become distributive, extractive, and promotional. It is important to qualify such a consideration with the caveat that such descriptors of the modern state are at best, a heuristic tool to invite questions of its features. What is necessary for our inquiry is to ask how certain institutions come to obtain power that is distributive, extractive and promotional. What are the processes of interaction between society and the state that contributed to modern state development in the case studies? It is essential that such claims are substantiated by historical evidence.

The literature reviewed in the previous chapter presented a perspective of the state as primarily an arena for social contest. The institutions of the state in this light are responsive to social and economic forces and processes and are unable to act of their own volition. With the elite-led, statist and bureaucratic concepts of the state, the state can be considered as a set of institutions-a place of social action. In order to better understand the modern incarnation of the state, it may be considered as both an arena and as a set of institutions simultaneously. Michael Mann argues that the state by virtue of being a centre for social contestation is what gives it considerable autonomy.⁴⁰ This idea goes a considerable way to understanding the state in such dualist terms. Another approach to this problem is to characterize the modern state as a web, incorporating institutions and structures which display evidence of unity at some levels whilst displaying disaggregated behaviour and even outright conflict at others.⁴¹ The web model can help identify the connections and relationships between state institutions and society. Such approaches call into question the utility of unifying theories or the claim that state development is primarily dependent upon war or capital relations between classes. Mixed accounts are sometimes described as 'organized chaos' or what Mann calls 'muddling through' or 'cock-up' theory.⁴²

³⁹ Beetham. *Max Weber and the Theory of Modern Politics*, p.79.

⁴⁰ Mann, 'The Autonomous Power of the State: Its Origins, Mechanisms and Results', p.112.

⁴¹ Japan's post World War II political-economic system has been characterized as a web with various centres of control. See Bruce Cumings, 'Webs with No Spiders, Spiders with No Webs: The Genealogy of the Developmental State' in Meredith Woo-Cumings (ed.), *The Developmental State*, Cornell University Press, Ithaca, 1999. See also Dirk Messner, *The Network Society: Economic Development and International Competitiveness as Problems of Social Governance*, Frank Cass, London, 1997.

⁴² Mann. *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914.*, pp.53-4.

Political outcomes may be explained by considering a variety of factors. Approaching the state in this way widens the net cast however it can make theorizing problematic. The institutional complexity of the modern state also has made it difficult to conceptually separate important groups from one another and what is considered the state itself, be it an arena or a set of institutions. Analysis of political interaction that considers the state as both these things may prove a useful path to pursue provided the analytical tools are clear and what is being sought with these tools is identified.

The primary concern of this thesis is the need to identify which processes influence the development of *modern* states. An organizational response to security requirements in the context of war has garnered much attention as a possible answer. This has resulted in the concept of sovereignty and the territorial border being central to understanding what constitutes the state. Indeed it has provided the central assumptions for understanding the modern state and differentiating it from pre-modern versions. An analysis of social and political organization that occurs within the state is conceptually dependent upon these features. But a deeper understanding of modern state development in the twentieth century may be hindered if these assumptions continue to be made. The approaches surveyed are insufficiently attentive to the factor of industrialization in explaining the process of modern state development, particularly modern state institutions. As pointed out in the previous chapter, capital frequently crosses borders, suggesting that the sovereign border may not function as is sometimes depicted. The process of industrial development as opposed to international war represents an alternative setting in which to examine modern state development in the twentieth century.

The next section analyzes perspectives that the state can - and indeed has been able to - transform an agricultural economy into a modern industrial economy. It considers approaches addressing rapid and dramatic economic change that locate the state at the centre of analysis. Dragging societies into the modern industrial era became, according to some of the perspectives to be discussed, a political aim of the state, implemented through policy. The responsibility for this task fell to the organizations that Weber identified as key to comprehending the modern state. Bureaucracies, in many of the cases analyzed, were at the vanguard of the industrialization process.

STATE-LED DEVELOPMENT

Whilst much research concerning the state in the 1970s considered the possibility of social change and transformation in the abstract, at the same time, several state economies were undergoing economic transformations in reality. The post-war industrialization of Japan, followed by South Korea, Taiwan, Singapore and Hong Kong was astounding. While Japan, recovering from the devastation of WWII had experienced a significant degree of industrial development prior to the war, the likes of Korea and Taiwan in the late 1940s had largely subsistence based agricultural economies and low living standards.⁴³ What made their meteoric rise even more astonishing was its unexpectedness. Economists in the early 1950s had expressed few hopes for the region, with optimism for rapid industrial development in the economies of Latin America.⁴⁴

Studies of industrialization in East Asia were first conducted by economists; chiefly with a distinctive neo-classical bent.⁴⁵ Explanations of rapid economic growth in the region emphasized the importance of export orientation, an economic structure receptive to open competition and foreign investment, and a domestic economy largely free of political interference. The East Asian economies had followed all the rules as dictated by the neo-classical school; they were proof, not only of the importance of trade, but also the redundancy of the critical, world systems and dependency perspectives.⁴⁶

Neo-classical economics with the individual as its base unit of analysis draws on the classical tradition (albeit heavily modified) of Ricardo and Smith: that the 'economic'

⁴³ South Korea will be hereafter referred to as Korea unless otherwise stated.

⁴⁴ A pessimistic appraisal of South East Asia's potential for development can be found in Myint Hla and Asian Development Bank, *Southeast Asia's Economy: Development Policies in the 1970's*, Penguin Books, Harmondsworth, 1972. Development economics of the period did have a great focus upon Latin America and Africa. The Latin American question was also brought to the fore by the important work carried out by Raul Prebisch and the United Nations Department for Economic Affairs. See Prebisch, *The Economic Development of Latin America and Its Principal Problems*.

⁴⁵ See for example Bela A. Balassa, 'Trade Policies in Developing Countries', *American Economic Review* 61, 1971, 178-187; Bela A. Balassa, *The Newly Industrializing Countries in the World Economy*, Pergamon Press, New York, 1981. For a critique of state led development planning see Peter T. Bauer, *Dissent on Development : Studies and Debates in Development Economics*, Weidenfeld and Nicolson, London, 1971; Robert H. Bates, *Markets and States in Tropical Africa : The Political Basis of Agricultural Policies*, University of California Press, Berkeley, 1981.

⁴⁶ See Bela A. Balassa, *Development Strategies in Semi-Industrial Economies*, Johns Hopkins University Press, Baltimore, 1982.

sphere of life is filled with rational individuals, all seeking to materially improve themselves.⁴⁷ The emphasis accorded to norms, institutions and structures is minimal, and in the most extreme versions of this perspective, non-existent.⁴⁸ Whilst there is not the space to delve deeper into such an approach, it is important to acknowledge the dominance of the neo-classical perspective as an explanation of economic growth and change. Only by doing so can the revisionist perspective, known as 'developmental state' theory, be portrayed as denoting a radical shift that took place in the social sciences.

THE DEVELOPMENTAL STATE

Developmental state literature argued that East Asian industrial transformation did not occur because the states of the region embraced free market doctrine inspired policies.⁴⁹ Nor, contrary to dependency and world systems theory that dominated the academy of the 1970s and early 1980s, was the economic expansion entirely the result of shifting production away from the former manufacturing centres of North America and Western Europe. Rather, what had underpinned industrial revolution in the region was a powerful state led form of capitalism, involving a close relationship between the private sector and state, led by a centralized and largely autonomous (from certain sections of society) bureaucracy. Chalmers Johnson's historical study of the Japanese Ministry of International Trade and Industry was an attempt to demonstrate that state intervention via well-planned industrial policy directly influenced the path the Japanese industrial sector took from the mid 1920s.⁵⁰ Johnson's thesis, with its conclusions frequently misunderstood or exaggerated, was portrayed in

⁴⁷ For an account of the shift from heterodox Keynesian approaches to the neo-classical theories of economics see Harry G. Johnson, 'The Keynesian Revolution and the Monetarist Counter-Revolution', *The American Economic Review*, 61:2, 1971, 1-14. See also John Toye, *Dilemmas of Development*, Basil Blackwell, Oxford, 1987, especially chapters two and three.

⁴⁸ This perhaps does set up neo-classical economic models as a something of a straw man. For the standout and most influential works of this school, see Anne O. Krueger, 'The Political Economy of the Rent Seeking Society', *American Economic Review*, 64:2, 1974, 291-303. Deepak Lal, *The Poverty Of "Development Economics"*, Institute of Economic Affairs, London, 1983. For an early critique of foreign aid see the essay by Peter Bauer 'Foreign Aid: An Instrument for Progress?' in Barbara Ward and Peter Bauer, *Two Views on Aid to Developing Countries*, Institute of Economic Affairs, London, 1966.

⁴⁹ See for example Behzad Yaghmaian, 'An Empirical Investigation of Exports, Development and Growth in Developing Countries: Challenging the Neoclassical Theory of Export-Led Growth', *World Development*, 22:12, 1994, 1977-1995.

⁵⁰ See Chalmers A. Johnson, *MITI and the Japanese Miracle : The Growth of Industrial Policy, 1925-1975*, Stanford University Press, Stanford, 1982.

some circles as a heresy of sorts.⁵¹ Whilst Japan's rapid rise could be traced to its pre war history, the experiences of South Korea and Taiwan were more unexpected. Taking on a political structure claimed to be 'developmental' in orientation, the state and market cooperative venture pursued economic growth via an export orientated industrialization approach, in contrast to the direction taken in Latin America.⁵² A question emerging, as the economies of East Asia grew rapidly, concerned the place of the state in this economic process. How were these states structured and how did their interactions with society lead to such economic outcomes, namely industrial transformation? The relationship between the institutions of the state and particular groups in society became central to the analysis of state development.

What was characterized as unique about the high growth economies of the region was the way they were organized and structured. Rather than being directly controlled by the state, the economy was rather 'governed' or guided.⁵³ Both the Japanese and Korean bureaucracies were able to 'pick winners' and channeled finance and support to chosen areas of industry. The structure of the domestic economies, particularly in Japan, and later Korea, lent themselves to high credit availability, with banks and manufacturing industries centralized into several large industrial conglomerates. Vertically integrated industrialization, whilst lessening competition among some sectors, kept many extraneous costs down. Further, state support of industries such as steel and building products - commodities with high input and output characteristics - was aimed at enhancing growth rather than the protection of inefficient industries.⁵⁴

⁵¹It is important not to overstate this point. *MITI and the Japanese Miracle* was initially not widely reviewed in academic circles, tending to rate mentions in such magazines as *Fortune* (see reviews *Fortune*, Sept. 6, vol. 106, p.131 1982. and August 8, vol.108, p.113, 1983). As Johnson later remarked, his central argument had been misunderstood in the US (see Chalmers A. Johnson, *Japan: Who Governs?*, W.W. Norton & Company, New York, 1995.) Where *MITI...* did make a major impact was in business and management circles, many of whom advocated a similar approach to industrial policy by the US who were in the early 1980s struggling to compete with the Japanese manufacturing sector. Some groups also suggested that the Japanese business culture was a key to their success and that the US should adopt similar practices. Within popular culture, the reason for the economic rise of Japan was interpreted in more mysterious terms. Michael Crichton's 1993 novel *Rising Sun* is a good example of this phenomenon.

⁵²See Gary Gereffi and Donald L. Wyman, *Manufacturing Miracles : Paths of Industrialization in Latin America and East Asia*, Princeton University Press, Princeton, 1990.

⁵³ Robert Wade, *Governing the Market : Economic Theory and the Role of Government in East Asian Industrialization*, Princeton University Press, Princeton, 1990.

⁵⁴ The account of Pohang Steel works in Korea is especially pertinent here, as representative of the state supporting an industry against the recommendations of Anglo-American economists. For the key study of the Korean steel industry see Alice H. Amsden, *Asia's Next Giant : South Korea and Late Industrialization*. Oxford University Press, New York, 1989, chapter 12. See also Meredith Woo-

Both the Taiwanese and Korean states directed their greatest support to industries that exported goods.⁵⁵ Through tax concessions and supply of cheap credit, these industries, in taking the greater risk of selling offshore, were aided and rewarded for their efforts.

The developmental state fitted into a typology that has emerged with the wider literature on states and economic development.⁵⁶ Western industrialized states are deemed to be *regulatory*; their state apparatus ideally function as a platform for the economy, providing stability and predictability. Thus, the state functions as the basis for a semblance of order and control; whilst economic shifts and changes are instigated through market actors freely interacting with each other. *Predatory* states, as described by Peter Evans, are organizations that extract the maximum possible resources from society, but return little in terms of economic growth and opportunity.⁵⁷ They represent the most polemic example of the state and society divide: the state functions as a separate entity, only interacting with society for the purposes of extraction and domination. States such as Zaire under the Mobutu regime, and to a lesser degree Indonesia under Soeharto, are deemed to have fitted into this category.⁵⁸ Another state type frequently referred to is identified as the *corporatist* state, commonly associated with the economies of Scandinavia and some continental European states.⁵⁹ Through cooperation, state and market interests converge around a negotiated set of policies leading to economically beneficial outcomes. This state form has also been associated

Cumings, *Race to the Swift : State and Finance in Korean Industrialization*, Columbia University Press, New York, 1991.

⁵⁵ For the foremost discussions on Taiwan's economic development see Stephan Haggard, *Pathways from the Periphery : The Politics of Growth in the Newly Industrializing Countries*, Cornell University Press, Ithaca, 1990; Alice H. Amsden, 'Taiwan's Economic History: A Case of *Estatism* and a Challenge to Dependency Theory', *Modern China* 5, 1979, 341-380; Chan, 'Developing Strength from Weakness: The State in Taiwan'; Henry Y. Wan and Erik Thorbecke, *Taiwan's Development Experience : Lessons on Roles of Government and Market*, Kluwer Academic, Boston, 1999.

⁵⁶ The number of analytical categories proposed for states numbers almost as many actual states to analyse. A recent expansion of categories concerns the discussion around so called 'failed states', typically concerned with examples from Africa and the South Pacific. See for example Robert I. Rotberg (ed.), *State Failure and State Weakness in a Time of Terror*, World Peace Foundation, Brookings Institution Press, Cambridge, 2003; Hank Nelson, 'Governments, States and Lables', *State, Society and Governance in Melanesia*, Discussion Paper 2006:1:2006; Carnegie Endowment for International Peace, 'The Failed States Index', *Foreign Policy* 154:May-June, 2006.

⁵⁷ Peter Evans, 'Predatory, Developmental and Other Apparatuses' in A. D. Kincaid and A. Portes (eds.), *Comparative National Development: Society and Economy in the New Global Order*, University of North Carolina Press, Chapel Hill, 1994.

⁵⁸ Evans, *Embedded Autonomy: States and Industrial Transformation*, p.53. See also Evans, 'Predatory, Developmental and Other Apparatuses', pp.92-3.

⁵⁹ See Peter J. Katzenstein, *Small States in World Markets : Industrial Policy in Europe*, Cornell University Press, Ithaca, 1985.

with fascist states, when corporate and state interests, at least in theory become unified, typically at the expense of civil society.⁶⁰ The developmental state idea depicts a structure that appears even more convergent with close ties developing between the state and the capitalist class. As the experiences of Norway and Malaysia will demonstrate, such cooperation was a feature of their industrial development. Conflict over different priorities and directions also patterned their development, a consideration that perspectives of the 'developmental state' do not always reveal. Industrialization is easy to explain as an economic process in itself. Yet to explain it as a causal result of certain types of political interaction is much more difficult. This is a challenge of the case studies, and thus the approach must give conflict and disagreement due weight.

Accounts of East Asian growth have constructed a model representative of a Weberian ideal type: a professional and highly trained bureaucracy, enjoying a high degree of separation from groups with vested economic interests. As power was concentrated within these institutions, the state was able to plan the trajectory of various economic sectors. Many studies of the region have been devoted to considering the type of supportive industrial policies that aided industries as they progressed from initially textiles and footwear, followed by light manufacturing and finally to the emergence of a heavy industry and high technology sector.⁶¹ The role of bureaucracies can be examined at various stages of industrial development. Norwegian industrialization progressed from shipping and food production to manufacture of chemicals and metals. The level of state interaction with society changed depending on the industrial context. A model that considers how different stages of the industrialization process influence state development will throw new light on the Malaysian experience - how light manufacturing made a transition to heavy industries such as cars and machinery. The Malaysian state's role in this process will need to be considered in this light.

Descriptions of the East Asian experience sensitive to historical and international factors have pointed to the role the United States played in the region. Rather than

⁶⁰ The outstanding example is that of Germany under the Nazi regime. See Maxine Bernard Yapple Sweezy Woolston, *The Structure of the Nazi Economy*, Russell & Russell, New York, 1968.

⁶¹ A good overview of the developmental state concept is found in Yilmaz Akyüz, Ha-Joon Chang and Richard Kozul-Wright, 'New Perspectives on East Asian Development' *Journal of Development Studies*, 34:6, 1988, 4-36.

highlighting particular domestic arrangements between the state and industry, one view regards the East Asian miracle as the result of American protection and military spending in the region, particularly throughout the period of the Vietnam War.⁶² Further, Korea and Taiwan were able to take advantage of manufacturing industries shifting offshore from Japan as production costs increased. The East Asian Newly Industrializing Countries (NICs) were able to offer low labour costs, whilst still providing advanced infrastructure and a skilled labour force to growing industries. These factors combined fortuitously to give the Asian NICs the best possible platform to industrialize. That East Asian states were in the right place at the right time represents a view closer to that of the dependency school previously discussed. But such an argument lessens focus upon industrial policies and particular state - society interactions as an important factor in economic change. Further, and most importantly for this thesis, the literature discussed above does not always closely examine the impact industrialization had upon the development of the modern state in return. Modern state institutions in some literature are taken as already existing. By examining the way economic change shaped institutions a more sophisticated picture of state and society interaction can be produced.

RETHINKING THE DEVELOPMENTAL STATE MODEL

The developmental state model has come to represent an account of East Asian economic growth, combining a Weberian ideal type bureaucracy with a trained and educated workforce and the production of goods primarily intended for export. Competitive industries were built through a combination of these factors. This perspective accords explanatory emphasis to the strength of the state apparatus; it is a powerfully Weberian perspective, with great political power located in a core of bureaucracies and executive leadership. It is these groups and the relationship they have with chosen sections of society that is deemed to result in rapid economic growth.

The developmental state model can become a selective account of economic policy, rather than an evidence based investigation into relationships between state

⁶² See Richard Stubbs, *Rethinking Asia's Economic Miracle : The Political Economy of War, Prosperity, and Crisis*, Palgrave Macmillan, New York, 2005. See also John A. Hall and Ding-Xin Zhao, 'State Power and Patterns of Late Development: Resolving the Crisis of the Sociology of Development', *Sociology*, 28:1, 1994, pp.211-229, p.218.

institutions, groups and economic processes. Analyzing the nature of the linkages between bureaucrats and industry is a challenging area of study. With at times selective evidence, economic outcomes are deemed to have been 'caused' by certain actions of the state.⁶³ Industrial policy in South Korea and Taiwan was well directed and planned in instances, yet many East Asian bureaucracies have suffered from corruption and waste, suggesting that the model of the ideal type bureaucracy only represents a partial picture. Some investigations reveal that East Asian political economies suffered from inefficiencies and impediments like many economies of Latin America in the post WW II period.⁶⁴ The developmental state has seemingly become a refreshed account of economic growth rather than an original conceptual perspective of the state.⁶⁵ A state is deemed 'developmental' because of economic growth whilst the beneficial contributing linkages between the state and industry remain mysterious or difficult to substantiate.⁶⁶ Actually identifying these connections on their own can be difficult, whilst connecting them to economic growth can be even more problematic. Clearly identifying the structures and networks of these high-growth states remains difficult, without retreating into a mysterious Hegelian concept of the state.⁶⁷ A detailed examination of historical examples must include a focus upon the impact of industrialization upon bureaucracies. For example, a report into economic problems in a given sector may heavily influence the organization of a central bank. How the intricacies of disagreement and cooperation shape state development must be approached with care. The drawing of broader conclusions from such details can only be done from a careful analysis of historical patterns.

Making generalizations from the few East Asian experiences can be problematic. Whilst Korea and Taiwan shared much with Japan in generating endogenous growth

⁶³ See Vivek Chibber, 'Building a Development State: The Korean Case Reconsidered', *Politics and Society* 27:3, 1999, 309-346. For an alternative account of Korea that suggests industry interests had considerable power over the actions of the state. See also Lim, Timothy C. "Power, Capitalism and the Authoritarian State in South Korea." *Journal of Contemporary Asia* 28 4:1998, 457-483.

⁶⁴ Timothy Lindsey and H. W. Dick, *Corruption in Asia: Rethinking the Good Governance Paradigm*. Federation Press, Annandale, 2002. See also the chapter by Abhijit Banerjee in J. Malcolm Dowling and M. G. Quibria, *Current Issues in Economic Development: An Asian Perspective*, Oxford University Press, Hong Kong, 1996.

⁶⁵ Bob Jessop mounts a fine critique of the developmental state argument in Bob Jessop, 'A Regulationist and State-Theoretical Analysis' in R. Boyd and T.-W. Ngo (eds.), *Asian States: Beyond the Developmental Perspective*. RoutledgeCurzon, New York, 2005.

⁶⁶ Leftwich, Adrian. "Bringing Politics Back In: Towards a Model of the Developmental State." *Journal of Development Studies* 31:3, 1995, 400-427, p.409.

⁶⁷ See for example Shlomo Avineri, *Hegel's Theory of the Modern State*, University Press, Cambridge, 1972.

via selective state intervention, the city state of Hong Kong is frequently portrayed as the exemplary model of the minimal state.⁶⁸ Singapore, the fourth member of the NICs embraced foreign investment to a great degree, leading to questions as to its long term economic stability and viability.⁶⁹ The differences between the four 'Asian Tigers' are great and extrapolating different patterns into a general theory of state function in regard to its economy is a fraught process. Much of the literature that implicitly advocated the policy direction taken in 'developmental states' has, since 1997, also been reassessed in the wake of the region's economic problems.⁷⁰

EXTENDING THE DEVELOPMENTAL STATE ANALYSIS

A central problem that has emerged in the developmental state literature is the portrayal of the state itself. The modern state consists of more than a core bureaucracy directing economic traffic. Further, many accounts within the developmental state paradigm emphasize the role of specific goal-orientated bureaucracies that are depicted as unified, rational and centrally organized. The developmental state idea may be closer to a theory of economic policy than a theory of the state. The resulting analysis can be problematic as modern states are not always unitary actors and the modern state, even in its most pared-down form suffers from internal contradictions and conflicts like any organization. Tensions and friction between institutions are important. The reasons for such conflicts and how they play out can tell us much about the character of the modern state.

So whilst the perspectives discussed have been centered upon the institution of the state, there has been less space for a more nuanced analysis of how political interactions influence and respond to economic change and come to form institutions. Economic growth has not simply been the result of a set of 'rational' decisions by a

⁶⁸ For histories of Hong Kong and its economic development see for example Michael J. Enright, Edith E. Scott and David Dodwell, *The Hong Kong Advantage*, Oxford University Press, Hong Kong, 1997; Tak-Wing Ngo, *Hong Kong's History : State and Society under Colonial Rule*, Routledge, London, 1999.

⁶⁹ See Kunio Yoshihara, *The Rise of Ersatz Capitalism in South-East Asia*, Oxford University Press, Singapore, 1988.

⁷⁰ See for example Eul-Soo Pang, 'The Financial Crisis of 1997-98 and the End of the Asian Developmental State', *Contemporary Southeast Asia* 22:3, 2000, 570-589. Steve, Chan, Cal Clark and Danny Lam, *Beyond the Developmental State: East Asia's Political Economies Reconsidered*, MacMillan Press, Houndmills, 1998; Joseph E. Stiglitz and Shahid Yusuf (eds.), *Rethinking the East Asian Miracle*, Oxford University Press/World Bank, New York, 2001.

powerful arm of the state. Indeed, East Asian states have experienced conflict and problems like many other countries. Cooperation between the state and industry did not take place in a political and social vacuum.⁷¹ Further, and most significantly for this thesis, analysis of institutional formation with regards to its historical context is sometimes neglected. State institutions do not just emerge from the ether; they are the result of political and social actions based upon a variety of motivations and norms. Analysis of Norwegian and Malaysian state development will examine how important institutions of the modern state developed. What social and political interactions shaped the development of modern state institutions is a central question asked of the case studies. In addressing this, the role of foreign capital and imported technology is included. Norway and Malaysia's proximity to major economic centres in Western Europe and Japan made them major recipients of foreign investment.

The impact of foreign investment and technology is not always accounted for in developmental state literature; presenting a picture that can be isolated from its historical and political context.⁷² An analytical model that makes out the state to be unresponsive or immune to social and economic pressures lessens the need to consider how industrialization impacts upon the state. To address these shortcomings, an approach that considers these factors will require a historical perspective that can incorporate day to day political machinations. How these interactions, in the context of an industrializing economy shaped state development will contribute to a more complex understanding that is lacking in some of the developmental state literature.

An additional difficulty found in the development state approach is the conceptual dichotomy between state and society, a recurring theme throughout much of the literature on the state.⁷³ Clear analytical categories may make conceptualizations more coherent, yet a rigid approach can fail to capture the complexity of state - society interaction. Not only is the state described as a unified actor, but significant social

⁷¹ Wade point this out as 'thin' politics in Robert Wade, 'Industrial Policy in East Asia: Does It Lead or Follow the Market?' in G. Gereffi and D.L. Wyman (eds.), *Manufacturing Miracles*. Princeton University Press Princeton, 1990 p.87.

⁷² Several accounts of East Asian transformation do acknowledge the role of the Japanese colonial presence in constructing the building blocks of state infrastructure in the region. An excellent edited collection of the colonial role of Japan in Korea is found in Michael Edson Robinson and Gi-Wook Shin (eds.), *Colonial Modernity in Korea*, Harvard East Asian Monographs: 184, Harvard University Asia Center, Cambridge, 1999.

⁷³ Chung-In Moon and Rashmi Prasad, 'Networks, Politics and Institutions' in Chan, Clark, and Lam (eds.), *Beyond the Developmental State*, p.18.

organizations are portrayed as passive or compliant to the directives issued by the state. While the suppression of unions and other forms of organized labour was a factor in East Asian growth, major industrial groups were not always obedient to the whims and dictates of the bureaucracy either. The automotive group Honda were defiant toward the Japanese Ministry of International Trade and Industry in many of their activities and often eschewed state support, yet went on to become a major business success, raising a question of the apparent state-corporate policy consensus.⁷⁴ Making direct causal linkages between the intentions of government and economic outcomes is a difficult undertaking at the best of times. Economic outcomes are subject to a variety of factors, with industrial policy representing just one aspect of this process. Arguing that state intervention and management is *necessary* for economic growth, as the developmental state thesis implies, is a claim that, like the neo-classical model it critiques, ignores or plays down other plausible explanations.⁷⁵ The work of T.J. Pempel attempts to resolve this problem by taking the concept of the developmental state and fully immersing it in historical context.⁷⁶ The resulting picture of Japan - and the 'regime shift' that occurred in the late twentieth century - is illuminating, demonstrating how structures and actors both influence and respond to change. It is essential to consider the state - society relationship as a more organic and flexible process of societal interaction. The challenge in such an approach lies in generating a coherent concept of the state.

The developmental state argument shares similarities with the corporatist state analysis of some Western European states.⁷⁷ Close linkages between the state and leading industries and organized labour, with economic policy forming around a consensual set of national economic goals is deemed to be central to explaining the economic development of several European states such as Sweden and Austria.⁷⁸ Like

⁷⁴ See for example Richard Pascale, 'The Honda Effect', *California Management Review*, 38:4, 1996, for a discussion of Honda and its planning and strategies.

⁷⁵ Moon and Prasad, 'Networks, Politics and Institutions', p.14.

⁷⁶ T. J. Pempel, *Regime Shift : Comparative Dynamics of the Japanese Political Economy*, Cornell University Press, Ithaca, 1998.

⁷⁷ Bruce Cumings, 'Webs with No Spiders, Spiders with No Webs: The Genealogy of the Developmental State' in, M. Woo-Cumings (ed.), *The Developmental State*, p.62.

⁷⁸ See Dieter Senghaas, *The European Experience : A Historical Critique of Development Theory*, Berg, Leamington Spa, 1985. See also Peter J. Katzenstein, *Corporatism and Change : Austria, Switzerland, and the Politics of Industry*, Cornell University Press, Ithaca, 1984; Martin Schnitzer, *The Economy of Sweden : A Study of the Modern Welfare State*, Praeger, New York, 1970; Jukka Pekkarinen, Matti Pohjola, Bob Rowthorn, *Social Corporatism : A Superior Economic System?*, Clarendon Press, New York, 1992.

the East Asian examples, these economies have limited scope for expansion within their territory as their populations are too small to exploit economies of scale. They have therefore generated highly competitive export - orientated industries in several sectors. With state support that has encouraged entrepreneurship and export industries, relatively small state economies have managed to survive in an increasingly competitive world economy.⁷⁹ In this sense, the developmental state perspective alludes to the idea that industrialization may be regarded as a project of social modernization undertaken by institutions of the state as much as an economic process that shapes the state.

This view of economic development has a long genealogy, with the idea of economic nationalism proposed by the German economist Friedrich List in the late nineteenth century.⁸⁰ The idea of economic nationalism merging with a project of state modernization, as found in some states of Western Europe, also finds a telling example in Japan following the Meiji Restoration of 1863.⁸¹ In contrast to classical economic theory, a nationalist approach makes the state central to domestic industrial growth, supporting and protecting them in their embryonic phase. The possibility that industrialization may be considered a political project on the part of the state is difficult to integrate into conceptual frameworks that emphasize the importance of structural imperatives. Yet in the context of the twentieth century such an approach must be considered. Developmental state theory addressed this closer than other perspectives, yet now needs to be modified to address its shortcomings in order to enhance the understanding of how modern states develop.

Part One of this thesis has examined relevant concepts of the state in an effort to build a viable approach to the modern state development of Norway and Malaysia. Industrialization, despite being a dramatic process of economic change, has not always been clearly linked to many explanatory accounts of state development. Most conceptions of the state have emphasized other factors as contributive to state development and as a result have sometimes neglected industrialization as an

⁷⁹ See Juhana Vartiainen, 'The Economics of Successful State Intervention in Industrial Transformation' in M. Woo-Cumings (ed.), *The Developmental State*.

⁸⁰ Friedrich List, *The National System of Political Economy*, A.M. Kelley, Fairfield, 1991 (1885).

⁸¹ See Umegaki. *After the Restoration : The Beginning of Japan's Modern State*; W. G. Beasley, *The Rise of Modern Japan*, Weidenfeld & Nicolson, London, 2000.

important factor. Approaches that have come closest to an analysis of the state that addresses this thesis question - those of the developmental state literature - have revealed the importance of interaction between the state and other social actors in understanding the impact of industrial development. It is evident that further questions must be asked of the historical case studies. The analysis of Norwegian and Malaysian industrialization that is to follow will examine their historical processes with a refined set of tools. To conclude this chapter, an assessment of the previous considerations will be summarized and the framework for analyzing the development of the modern Norwegian and Malaysian states will be laid out.

IMPLICATIONS FOR THE CASE STUDIES

In the twentieth century, states as political entities are located in the context of a global economy. They are also important economic actors, in that their capacity to mobilize and organize resources can profoundly influence economic outcomes.⁸² The industrialization of the case studies is characterized by growing capital flows in the form of investment moving across their state borders. In both cases, considering such capital movement is essential to understanding the nature of their industrialization experiences as well as how their modern state development was shaped by foreign investment. It is the international dimension of twentieth century industrialization that is so important in providing the setting and context for the analysis of Part Two.

This thesis seeks to identify the *modern* state as something unique, thus a working definition must be established. The modern state is not, as some neo-liberal economists assume, just a territory populated by self-maximizing individuals. In this thesis, the modern state is to be approached and analyzed as both an arena for social contestation and a cluster of institutions with the ability to wield a degree of autonomous power. The state is an organized and bounded arena for social organization between groups, organizations and individuals. This concept of sovereign bounded territory can be

⁸² An important discussion of this problem, or rather the Polanyi argument that economies are embedded in their social contexts is found in Bernard Barber, 'All Economies Are "Embedded": The Career of a Concept, and Beyond', *Social Research* 62:2, 1995, 387-414. See also Karl Polanyi, 'The Economy as Instituted Process', in R. Sewedburg and M. Granovetter (eds.), *The Sociology of Economic Life*, Westview Boulder, 1992. Polanyi's most well known work is Karl Polanyi, *The Great Transformation*, Beacon Press, Boston, 1957.

understood as emerging from European political consolidation that took place in the early modern period. War was critical in creating the conditions for the establishment of sovereign boundaries, providing the first building block of the modern state. Within this designated territory, a complex centralized system of rule developed, with the state assuming roles such as law and order, a defence force, and record keeping. Collecting taxes to pay for the defence of the territory became an important role of the state institutions that slowly developed. These organizations made up the institutional set of the state. Both of these spheres of the state will be considered and analyzed in the context of industrialization. The interaction between the two will form the crux of the analysis.

It is at this point that the concern with institutions arises. Institutions best reflect what is perceived as the modern state form, with enormous capacity for organization, control and coercion through their many arms and networks. The Weberian tradition has best identified such characteristics, notably bureaucracies that are tasked with a wide variety of managerial and regulatory roles, along with police, judicial and organized military forces. In this context, a centralized, elaborate, and regulated banking system and complex administrative organizations such as statistical collection agencies may be said to be distinguishing features of the modern state. It is these regulatory and managerial institutions that may be understood as the essential building blocks of the modern state and mark the distinction between it and the pre-modern state form. Such institutions administer the flow of capital and shape and influence the interaction between social organizations. The modern state is uniquely organized by virtue of its reach and complexity and may be distinguished therefore from the more general category of the state in that it has significant regulatory and managerial control over planning and organisational structures generally, and in relation to the economy in particular. In addition, identifying what shapes the interests of modern state institutions, namely the role of individuals as political leaders will also be considered in the case studies.

The state as a cluster of institutions is led and represented by the executive, judicial and bureaucratic apparatus, whilst society, with its multiplicity of groups and individuals populate the arena of the state. It is at this point that tidy approaches dividing the state and society relationship can stumble. As this chapter has stressed,

clearly distinguishing the state from society can hinder rather than aid social inquiry. State institutions are embedded in and are a part of society and the economy; indeed, if they channel and modify human activity, then discussing them in isolation from their social context creates limitations of inquiry. What will be the subject of this inquiry is the nature of the linkages between state institutions and important social organizations. This thesis is seeking to understand the relationship between the groups that pluralist views of the state identified so well with the structures that Marxist influenced perspectives emphasize. In turn, the institutions of the modern state need to be understood as unique and subject to influences and pressures as well as wielding power themselves as they develop. This approach attempts to account for interaction between social organizations and the institutions of the state and understand how this dynamic shapes modern state development.⁸³ Industrialization, and the social organizations that emerged or changed as a result of it, interacted in ways that created conflict or problems.⁸⁴ Industrialization in the cases provides for a series of significant periods of interaction that were critical in shaping the modern state. These episodes will be analyzed to identify the points at which institutions of the state developed as a result of societal interaction in the context of industrialization.

The developmental state literature perhaps most directly addressed the question: what sort of state and society arrangements influenced the industrialization process? The answers this body of literature presented were limited by the net cast and the shortcomings identified previously. Where are organized labour, business groups, political parties and other significant societal actors located in this framework as active societal participants? Such social organizations emerged during the industrialization process in both Norway and Malaysia as analysis of Part Two will demonstrate. Economic change made many of these organizations politically powerful as they influenced and shaped the key components of the industrial economy. It is the interaction between these organizations and state institutions that will be analyzed in Part Two. The picture this thesis paints of modern state development is one which highlights the far-reaching reorganization of societal arrangements. Therefore the

⁸³ This is a key point made by Timothy Lim in his study of Korea. See Lim. "Power, Capitalism and the Authoritarian State in South Korea."

⁸⁴ An excellent collection that considers industrial problems such as corporate collapses and their effects on state policy is Kenneth H. F. Dyson and, Stephen Wilks (eds.), *Industrial Crisis : A Comparative Study of the State and Industry*, Robertson, Oxford, 1983.

patterns of social change that occurred during industrialization will be *directly* linked with the modern state development process. As discussed in the previous chapter, the typical model of state formation and development is derived from the continental European experience and is shaped by an emphasis of territorial security in the early modern period. There is a gap in the literature and our understanding between the experience of the major European powers and the process by which states in other parts of the world have more recently undergone their development process. The industrialization process makes for a dynamic context of rapid change in which to explore the reorganization of the state and its modern development. The social and economic impact of industrialization will be directly connected to modern state development by examining change in several key state institutions and their roles. In an advance on the existing literature, the evidence of the case studies will also demonstrate how state institutional development shaped industrialization in return. An important caveat to highlight in addressing the case studies are that this thesis is not seeking to establish whether industrialization preceded modern state development or vice versa. Rather, industrialization and modern state development will be shown to be mutually dependent processes.

THE CASE STUDIES

The case studies to which the analytical framework will be applied present challenges to the existing literature on state development. Norway and Malaysia are relatively small in terms of population and economic size. Both began to industrialize shortly after gaining independence. Both were previously colonies of major or regional powers and thus their history was shaped by this experience. Neither state achieved independence through violent means, although conflict was sometimes a possibility in their respective independence processes. And neither was a direct participant in major international wars in the formative years after independence. Norway, in the period between 1895 and 1935 underwent a dramatic economic, social and political transformation. Norway in the early twentieth century powered an industrial revolution through the implementation of hydroelectric schemes. Independence from Sweden was achieved in 1905 and Norway enjoyed strong growth until the 1930s when

the Great Depression hit Europe. In little more than a generation, the Norwegian economic landscape was transformed. The social and political impact was profound. The second case study is the South East Asian state of Malaysia. The 1969 inter-ethnic riots in the capital Kuala Lumpur is the departure point for an analysis of Malaysian industrialization. It is the period from 1969 to the immediate aftermath of the 1997 Asian economic collapse that will fall under the spotlight. In this period, the Malaysian economy changed dramatically, from a poor subsistence based agricultural economy to a rapidly developing economy with an emerging manufacturing and services sector. The period also marks a time of considerable upheaval in Malaysian society and politics marked by a recalibration of the relationship between the state as an institutional ensemble on the one hand and an arena in which competing political actors jostle for position and leverage.. Malaysia's most recent history following the 'reformasi' period of the late 1990s and early 2000s, whilst important, will not be discussed. It is necessary to state that Part Two does not seek to bring to light new information on the historical experience of either country during the period of industrialization . In this sense, the overriding aim of this thesis is not *primarily* historical. Rather, the historical experience of each country is reviewed, in the light of existing historical accounts, as a way of identifying with greater conceptual clarity the societal interactions that shaped the functions and modalities of the modern state in relation to industrialization.

Both states make ideal case studies to ask questions of modern state development during industrialization. Norway has received limited scholarly attention despite its rapid industrial development from a low base and difficult circumstances. In Malaysia's case, though its history has received greater coverage, much of the existing literature does not explicitly connect modern state development with the form or processes of industrialization. Whilst indirectly involved in conflict, war did not greatly influence their development patterns, suggesting the need to consider other factors. What both states share in these respective periods is the rapid industrialization of their economies generated by the expansion of manufacturing and trade. In the same period, major developments occurred in social and political organization. It is the challenge of Part Two to identify how these two processes were related. Both Norway and Malaysia are situated on the economic peripheries of Europe and Asia respectively and found it necessary to open their economies to foreign capital and

technology. The evidence will demonstrate that foreign direct investment played a central role in contributing to their industrial transformation. Yet the predictions of world systems theory applied to the impact of foreign investment in Norway and Malaysia does not conform with the evidence. Embracing open markets did not however result in a *laissez-faire* approach to economic or industrial policy. Both states exercised considerable control on the influx of foreign capital and indeed domestic investment, especially when it pertained to selected industries. Patterns of state intervention are not easily established though use of an unmodified world system approach, nor is intervention predictable without strong consideration of domestic pressures. Part Two will attempt to identify the types of interaction that connect the state with the different arms of the industrial economy. It will also highlight the events and processes that instigated them. Complementing this investigation will be an assessment of how state intervention and development shaped the emerging industrial economy in each of our two case studies.

The aim in presenting these two case studies is not to *directly* compare them for points of commonality. Indeed each case may be distinguished from the other by their very different histories and experiences. Their utility is that they will allow an analysis of how the process of industrialization in the twentieth century impacted upon modern state development. Both case studies will serve as tests of the analytical framework developed. Further, and importantly, neither of the cases are judged to be a 'success' or upheld as examples of how an industrialization process 'should' occur. Indeed, what a historical approach can show us is that any two states, whilst sharing similarities, are never exactly alike, and each must be considered in their own historical and regional contexts. What this thesis will demonstrate is how certain patterns of state development were influenced by the same factors. This will in turn reconfigure the understanding of more general patterns of modern state development.

Industrialization as a *political project* is evident in both Norway and Malaysia. Who or what part of the state sought to industrialize the economy is a consideration of Part Two. In Norway, the desire to ensure that economic change served certain political objectives is evident in the pronouncements and policies of leading politicians. In the Malaysian industrialization process, the role of the state as the agent for economic change is clearly apparent. The state established companies aimed at building

industries that were progressively sold and moved into the private sector. The shift from industrialization as an implicit political aim in Norway to a vehicle for an explicit set of political goals in Malaysia is an important one. The process whereby this occurred, and the interaction between economic process and political project, is a consideration in analyzing and contrasting the cases. How industrialization shaped the state, and how the state responded in turn varied in both the cases. But in both examples similar patterns are discernable.

The discussion so far has outlined the conceptual tools to be applied to the case studies. A gap in the existing literature has been demonstrated in addressing the following question: how does state development occur as a response to the industrialization process? The following four chapters will analyze Norwegian and Malaysian industrialization and its impact upon their state development processes. Industrialization occurred rapidly and resulted in a dramatic reorganization of society. In both cases, it had an equally significant or greater impact upon state and society than either international or civil war. Each respective period also witnessed major developments for the state; the central questions posed by this thesis are: how were processes of modern state development shaped by industrialization, and, how was industrialization influenced by the expanding and changing organization of the state?

THE DIMENSIONS OF CHANGE IN THE ANALYSIS

In approaching the case studies this thesis will first analyze the economic transformation of each. Industrialization which was rapid and dramatic in both Norway and Malaysia is explored with a view to identifying the key industrial sectors that developed and explaining their importance. As discussed in Chapter One, industrialization represents a major break with previous forms of economic activity. Production, with manufacturing at its core, requires inputs of skilled labour, the borrowing of capital on a large scale and new support services. Such an investigation is essential to identifying the context of industrialization, its social impact and the pivotal role of foreign investment in the process. The approach that has been developed, drawing on world systems perspectives of the state, will highlight the role of foreign investment in shaping the domestic economy and society. Second, the key

groups and organizations within the state arena will be identified and the change they underwent analyzed. The case studies will demonstrate how industrialization impacted upon these organizations. Industrialization proved immensely influential in the creation and subsequent change of political parties, trade unions and business organizations. An investigation of interest groups derived from pluralist perspectives of the state is employed in this section. It will demonstrate how these organizations became connected to the industrialization process or formed as a consequence of its impact. Such organizations became politically powerful because they were able to influence key components of the industrialization process, namely capital investment and the supply of labour. Third, once the roles and interests of these organizations are identified, the process by which they interacted with each other and the institutions of the state will be examined. To do so, this thesis examines a series of significant interactions between the state and the industrialization process involving foreign investment, organized labour, business groups, economically marginalized ethnic groups and the banking system. The way in which the interactive relationship changed will be an indicator of the nature and function of modern state development. In the light of the available evidence, this thesis will argue that such interaction, propelled by certain mode of production and distribution, namely industrialization, has been central to the evolution of the modern state.

The interaction between the state and the key components of industrialization is analyzed in chapters four and six, considering Norway and Malaysia respectively. Each case will analyze three instances of interaction between the state and these components. Such an approach seeks to address the conceptual division between state and society by examining the interaction between them. As will be demonstrated, the industrialization process resulted in increased interaction and often conflict between social organizations and state institutions over the issues and problems caused by economic change. The questions asked of the case studies are: how did industrialization shape and impact the development of key social organizations within the state arena? How did key social organizations increasingly formalise their interaction with and relationship to the institutions of the state in the context of industrialization? How did state institutions respond to this interaction and influence the industrialization process through increased regulation and management of its components? The third question is critical in that it addresses how industrialization

may be understood as both an economic process and as a political project driven by the state.

Part Two will demonstrate that industrialization was a key factor shaping the development of the modern Norwegian and Malaysian states in the periods studied. As discussed, an approach that seeks to understand the development of state institutions embedded in the state arena promises a way forward from the shortcomings identified in the previous chapters. The modern states of Norway and Malaysia developed as a response to the industrialization process. In doing so, the institutions to manage and regulate the key organizations and components of the industrialization process developed in an attempt to manage industrialization as a political project. This is the third and key variable addressed in this thesis. Part Two details the momentous change to Norway and Malaysia that occurred in the context of industrialization.

PART TWO

CHAPTER THREE

The Industrialization of Norway: From Independence to the Great Depression

INTRODUCTION

When Sam Eyde and his engineering associate Kristian Birkeland gained permission to build a hydro-electric scheme in the mountains of central Norway, he probably did not anticipate that Norsk Hydro, as the company became, would a century later be the largest industrial group in Norway, and one of the world's biggest energy and aluminum conglomerates, employing over 50,000 people worldwide. Norsk Hydro's development reflects a broad picture of Norwegian industrialization; the story of a small society modernizing against the odds.¹ The years between 1895 and the beginning of WWII saw the development of some key industrial sectors in Norway and the decline of its traditional economic activities. This chapter will analyze the new economy that emerged in Norway following independence. The development of an industrial economy and the central role of foreign investment in the process had a tremendous impact upon Norwegian society and the way it was organized. Our approach to the modern state requires analysis of the economic and social changes wrought by industrialization. This chapter will show how industrialization and the mobilization of foreign and domestic investment capital impacted upon the arena of the state populated by groups, organizations and individuals.

This chapter will then analyze the key groups in Norwegian social and political life in the period, these being political parties, organized labour and business organizations. This will be done by utilizing the framework established in Part One that emphasizes the role of the identified organizations as politically significant. The purpose of this section is to examine how industrial development affected key social organizations and

¹ Francis Sejersted, 'Science and Industry: Modernisation Strategies in Norway 1900-1940' in F. Caron (ed.), *Innovations in the European Economy between the Wars*, de Gruyter Berlin, 1995, pp.255-6



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changed them. Because of industrialization these organizations became politically powerful as they influenced the supply of capital and labour. And as the groups that emerged became powerful, they increased their interaction with the institutions of the Norwegian state and in the process provided an important stimulus for institutional change. The questions shaping this chapter are: how did industrialization shape and impact the development of key social organizations within the state arena? How did key social organizations increasingly formalize their interaction with institutions of the state in the context of industrialization? These findings will be followed in Chapter Four by an analysis of interaction between the key social organizations identified and the state over the issues emerging from the industrialization process. In so doing, the study will address the key question that lays at the heart of the thesis, namely, the relationship between industrialization as economic and social process, and the state as an arena and a set of institutions. This story begins with an examination of the pre-industrial economy to provide background to the great transformation that occurred in the early twentieth century.

THE PRE-INDUSTRIAL ECONOMY

Norway was among the poorest European countries in the late nineteenth century.² Across an array of economic criteria, Norway lagged behind its European neighbours in manufacturing, industry and lacked the financial capacity to invest in indigenous industrial production.³ Yet the Norwegian economy was extraordinarily dependent upon foreign trade, with the exchange of goods and service growing from an already high level during the inter-war period.⁴ In the 1880s Norway's key economic sectors were in the old world form of fishing, timber and shipping, mostly powered by sail. The fishing sector employed a large percentage of the population, yet few employees were fulltime, the majority being casual and seasonally employed. Whilst records in

² Povl Drachmann and Harald Ludwig Westegaard, *The Industrial Development and Commercial Policies of the Three Scandinavian Countries*, Clarendon Press, Oxford, 1915, p.85.

³ Hodne points out that Norway experienced only 1.2 per cent GDP growth between 1870 and 1910, compared to Sweden (2.1) and Denmark (1.9). Fritz Hodne, *The Norwegian Economy, 1920-1980*, Croom Helm, London, 1983. See also Lennart Jörborg, 'The Industrial Revolution in Scandinavia 1850-1914' in C. Cipolla (ed.), *The Fontana Economic History of Europe*, Fontana, London, 1970, p.377.

⁴ Hodne, *The Norwegian Economy, 1920-1980*, p.10. This placed Norway in the top sector of states most dependent upon trade in the late nineteenth century. Such exposure to world markets created opportunities to grow but also the risk of exposure to slumps in overseas demand. This problem became especially apparent later in the 1930s when the world-wide Great Depression stalled some of the industrial growth that had occurred in Norway in the early twentieth century.

this industry only extend back to 1913, in that year only twenty-five per cent of fishing personal were engaged on a full time basis.⁵ Yet this also contributed to the robustness of the sector. Many fishermen worked in the summer months and returned to rural activities during winter. Such flexibility of employment resulted in low labour costs, allowing the sector to respond to changing prices and conditions. The industry compared to those of other European states, was fragmented and diversified in ownership. There were no large firms controlling fleets of vessels, most of which significantly, were aging, small and open decked. In addition much of the catch was netted in Norwegian waters, with vessels only venturing further afield in the 1920s. Yet despite apparent backwardness the sector proved adept at utilizing new technology. As canning and preservation techniques improved, exports grew too, beginning to link into the greater demand for preserved and canned fish in continental Europe.⁶

The timber trade also remained devoted to and dependent upon exports. A traditional industry, timber as the primary building product of ships and housing grew rapidly in the nineteenth century as demand from the newly settled United States grew. Forestry, like fishing, was an industry that engaged many people, often on a part time or casual basis, and it too was not controlled by a few commercial interests; rather, it remained small scale in terms of ownership.⁷

Whilst only some three per cent of Norwegian land is arable, this did not prevent the agricultural sector remaining the largest employer in the nineteenth century and into the early twentieth.⁸ The continental European model of industrialization has emphasized the importance of such factors as land enclosure and secure land title in stimulating savings and investment. Improved productivity contributed to an economic surplus that permitted investment in new sectors. But Norway in the late

⁵ Statistik Sentralbyrå, *Statistisk Oversikter*, 1948, p.96. Unless otherwise stated, all statistical information from the period in question is sourced from this extensive collected volume. The 1948 edition was the first issued to assemble key statistical information of the preceeding 50+ years, and its utility has been proven in the literature of the period. It was the only publication up to 1948 that compiled previous years in tables, permitting comparisons to be made across numerous economic indicators.

⁶ The canning industry, based in the southern city of Stavanger became an important industry in the inter-war years. The standout brand was 'King Oscar's' sardines, a brand name that survives to this day.

⁷ For an in depth discussion of the timber industry in the mid nineteenth century see Francis Sejersted, 'Aspects of the Norwegian Timber Trade 1840s-1850s', *The Scandinavian Economic History Review*, 16, 1968, 137-154.

⁸ Statistik Sentralbyrå, *Oversikter*, p.36.

nineteenth century did not experience these factors in the same way.⁹ In particular, the ownership structure of the agricultural sector did not reflect continental European countries. Close to ninety per cent of the farming land was owned by its occupiers, unlike the land ownership system in much of Western Europe.¹⁰ Farming remained until the turn of the century a small scale activity, directed toward self sufficiency and agriculture took on varied and diverse directions.¹¹ Large scale production was rare, because of small land holdings and low demand. Farmers therefore tended toward traditional styles of farming, in that several crops were grown, an array of animals kept, and parts of land were kept wooded and uncleared. Many farmers frequently engaged in tree felling and fox hunting to supplement their incomes. For a long period, Norway was a major producer of fox pelts. Silver foxes, valued for their furs, made up a key sub-sector, particularly during times of economic downturn. Unskilled rural workers faced with declining job prospects, were able to engage in fur production with little difficulty. Because of these factors, surplus capital was not generated through increased agricultural production.¹² Local investment was limited, and not on the scale sufficient to support the development of industry. In addition, there was a large labour pool in rural Norway that was less tied to the land because of the small scale of production.¹³ The backwardness of the Norwegian agricultural economy in this context proved advantageous to future industrial developments as labour was freer to move. This necessitated the need for foreign investment to support the industrial development of the twentieth century, a major difference from the experience of major European states that had industrialized on the basis of indigenous investment.

Mechanization came extremely late to Norwegian agriculture; the first motorized tractor did not arrive until 1908, previously the horse drawn plough had provided the

⁹ This has been disputed in Francis Sejersted, 'The Industrial Revolution in Norway', *The Scandinavian Economic History Review*, 1, 1966, 153-164, which points out that there was an enclosure shift in the mid nineteenth century. But the size of plots owned remained small in size.

¹⁰ Royal Institute of International Affairs, *The Scandinavian States and Finland : A Political and Economic Survey*, London, 1951, p.209. A good text on the history of European agriculture is B. H. Slicher van Bath, *The Agrarian History of Western Europe, A.D. 500-1850*, E. Arnold, London, 1963.

¹¹ Royal Institute of International Affairs. *The Scandinavian States and Finland : A Political and Economic Survey*, p.210.

¹² See Lennart Jörborg, 'The Industrial Revolution in Norway', *The Scandinavian Economic History Review* 1, 1966, 165-170, p.167.

¹³ Statistics are problematic in this regard. But it is possible to deduce that around a third of the rural population were gainfully employed. The remaining two thirds were either partially employed, self-sufficient or transient in the late nineteenth century. Statistik Sentralbyrå, *Oversikter*, pp.34-6.

muscle for tilling fields.¹⁴ Agriculture however, despite its importance, remained a small scale pursuit, and declined in the early twentieth century, as people departed the land for the employment of coastal towns and cities as industrialization offered new jobs.¹⁵ Cooperation that eschewed concentrated ownership was a unique factor due to geographical isolation and the small size of villages and towns.¹⁶ . This feature, whilst holding back mass agricultural production in the late nineteenth century, also had positive ramifications in the early twentieth century. As industrialization began to develop, labour left the land; the already transient nature of many agricultural workers exacerbated the shift. The traditional sectors of Norway continued on into the twentieth century. But they were not able to generate a platform for industrial development by producing the income surplus that had stimulated the industrialization of Great Britain and other European countries.¹⁷ The Norwegian experience demonstrates industrialization in the twentieth century as a particular process; one that was shaped by foreign capital and new technology that emerged quickly and rapidly developed the economy.

THE TRANSITION TO INDUSTRY

Norway's traditional economy suffered from a lack of indigenous capital, small scale ownership of production and the limited use of modern technology. Yet Norway had two niche economic sectors that made a transition from traditional processes to modern industrial practice. They are important because they were industries that developed linkages into modern manufacturing and services, creating modern economic networks in Norway aimed at exports. Further, they demonstrate how industrialization is a unique process that engages an array of economic activities with each other in the production of a single good or service. Such niche industries provided a stepping stone to the large scale industry that took hold in Norway. An

¹⁴ T.K. Derry, *A History of Modern Norway 1814-1972*, Clarendon Press, Oxford, 1973, p.185.

¹⁵ The ideal of the Norwegian farmer, self-sufficient and self-reliant, has been central in Norwegian folklore. This reputation is nevertheless often supported by evidence. The extensive common ownership of land, where all had the right to use, generated cooperative approaches to agriculture. See Sima Lieberman, *The Industrialization of Norway, 1800-1920*, Universitetsforlaget, Oslo, 1970, p.67. This tradition is maintained today, with the concept of 'allmansland' permitting all Norwegian people to pass through otherwise privately owned rural land. This qualification of private property is an important consideration in understanding the development of such social cooperation in Norway.

¹⁶ Ibid., pp.58-9, 67.

¹⁷ Kemp, *Industrialization in Nineteenth Century Europe*, pp.34-51.

open economy and dependence upon trade are characteristics of both Norway and Malaysia, one that places them squarely in the context of the world economy and its fluctuations. Both shipping and whaling were industries that made a transition to a modern industrial sector while greatly exposed to international trade.

SHIPPING

The shipping industry contributed significantly to the economic expansion of Norway.¹⁸ Blessed with an enormous coastline and a surplus of deep-water ports, the Norwegian shipping industry held a position of traditional importance and generated the greatest foreign currency earnings. Following the lifting of the British Navigation Acts in 1849 and with a ready product in coniferous timber to export, Norwegian vessels began to ply their trade to the United States and Canada, which still lacked the infrastructure to cheaply exploit their own timber resources.¹⁹ With the growing European trade economy, Norwegian ships began to transport timber from Sweden and Russia to western European countries and later in the century carried coal from Great Britain. The aging and small ownership scale of the sector created intense competition. Norwegian sailor's wages were poor and with smaller sail powered vessels, overheads were also low compared to the newer generation of steam power ships.²⁰ Cargo, such as timber and coal was non-perishable and cost little to handle. Whilst some captains transported goods as fruit, ice and people, the majority of the fleet continued to carrying cargos with low overheads and a minimum of attention required from the sailors. Further, the costs of maintenance and repairs were carried out in poorly equipped Norwegian ports, keeping costs down.²¹

The Norwegian fleet was almost entirely powered by sail until the turn of the century, placing it technologically behind other major seafaring nations.²² Contributing to this

¹⁸ For a general history of shipping in Norway see Kaare Petersen, *The Saga of Norwegian Shipping : An Outline of the History, Growth and Development of a Modern Merchant Marine*, Dreyer, Oslo, 1955.

¹⁹ Fritz Hodne, 'Growth in a Dual Economy- the Norwegian Experience 1814-1914', *Economy and History* 16, 1973, pp.81-110, p.97.

²⁰ Lewis R. Ficsher and Helge Nordvik, 'From Namsos to Halden: Myths and Realities in the History of Norwegian Seamen's Wages 1850-1914', *The Scandinavian Economic History Review* 35:1, 1987, 41-66.

²¹ Fritz Hodne, *An Economic History of Norway 1815-1970*, Tapir, Oslo, 1975, p.103.

²² By 1890 the Norwegian fleet, whilst consisting of over 14 per cent of world tonnage, had under 2 per cent of the world's tonnage in steam powered vessels. See Petersen. *The Saga of Norwegian Shipping : An Outline of the History, Growth and Development of a Modern Merchant Marine*, p.44.

feature was the lack of an indigenous coal supply for the new steam vessels.²³ The Norwegian economy lacked large scale capital to build or purchase newer ships. But while these factors were in some respects a disadvantage, they served to keep costs down and to employ many more sailors on the labour intensive sailing ships. This worked to the industry's advantage toward the end of the nineteenth century as the Norwegian timber trade began to decline. Increasingly, the growing fleet engaged in the transport of foreign goods.²⁴ Trade with the United States and Canada also allowed captains to carry a profitable cargo in both directions across the Atlantic. Timber, animal skins and the like were carried to Europe, whilst many of the industrial goods required for building railways and other modern constructions were exported from the continent. At the turn of the century, the shipping industry was bringing in valuable foreign earnings that covered Norway's import costs. The importance of the shipping industry was enhanced because of this foreign income earning capability.²⁵

The transition to modern steam and motorized vessels began in the early twentieth century when capital began to consolidate in the industry and the incentive to carry larger cargos evolved.²⁶ With an increasingly modernized fleet, the industry earned itself a reputation of reliability and courage throughout the first decade of the century.²⁷ Motorized vessels grew in use and increasing specialization occurred, particularly for the emerging world trade in crude oil and petroleum products.²⁸

The growth of the shipping fleet from a small-scale sector to a fully modernized merchant marine represents an important locally driven development of the inter-war economy in Norway and exemplifies industrialization as a major break with traditional

²³ Hodne. *An Economic History of Norway 1815-1970*, p.253.

²⁴ Hodne, 'Growth in a Dual Economy- the Norwegian Experience 1814-1914', p.99.

²⁵ Almost half of the income of the shipping industry was in overseas earnings in 1900, dropping only to 30 per cent during WWI. Statistik Sentralbyrå, *Oversikter*, p.227.

²⁶ See Ole Gjølberg, 'The Substitution of Steam for Sail in Norwegian Ocean Shipping,' *The Scandinavian Economic History Review* 28 2:1980, 135-146, for a technical account of this development.

²⁷ It was during WWI that the industry suffered enormous losses. During the war, Norwegian vessels were instrumental in the carriage of goods for the war effort, mostly British. This practice earned the merchant fleet the wrath of the German navy, who, via attacks by U-boats managed to sink almost half of the Norwegian merchant fleet at the cost of over 2000 sailors' lives. The losses were grievous, and left the fleet severely depleted at war's end. During a period in 1917 when the German naval attacks were at their height, the Norwegian fleet was suffering 2 ship losses a day; by the armistice, 1.23 million tons of Norwegian shipping had been sunk or destroyed, the greatest percentage loss of any state involved in the European conflict.

²⁸ Steam vessels had surpassed sail in kroner earnings by 1895. See Gjølberg, "The Substitution of Steam for Sail in Norwegian Ocean Shipping." p.141. The figures suggest that steam surpassed sail in earnings in 1897. See Statistik Sentralbyrå, *Oversikter*, p.277.

economic activity. Shipping maintained its economic position and became even more important into the 1920s and 1930s as prices fell for other Norwegian exports. Concentration of ownership occurred and growing levels of indigenous capital began to invest in the sector. This resulted in the growth of the many support networks required to serve a modern shipping industry. Insurance for merchant vessels was vital but in the late nineteenth century Norway lacked large scale insurance providers. Rather than seek foreign insurance, a cooperative system was developed that integrated the sector and allowed for lower insurance premiums.²⁹ These factors contributed to ship owners becoming a powerful collective political force in the inter-war years. By the 1930s, the Norwegian shipping industry had modernized its fleet and operations. As exports of industrial products increased from Norway, there was a shipping sector able to provide transport, ensuring more foreign earnings remained in Norway. Adding to shipping's prominence was several leading politicians with business interests in the industry. Indeed the push for independence at the turn of the century was motivated in part by the wish by to have full diplomatic representation abroad for the shipping fleet.³⁰ Christian Michelsen and Gunnar Knudsen who both served as Prime Ministers and were major political leaders in the early twentieth century were both shipping magnates with considerable financial interests in the sector.³¹

WHALING

The hunting of whales, whilst initially declining in the mid nineteenth century, grew rapidly until the mid twentieth century when the industry became almost extinct (along with the whales). The industry expanded following the inventive efforts of Svend Foyn who patented the first explosive harpoon in 1870.³² This technology

²⁹ For an excellent discussion of this cooperative nature of the Norwegian shipping sector see Håkon With Anderson, 'Producing Producers: Shippers, Shipyards and the Cooperative Infrastructure of the Norwegian Maritime Complex since 1850' in C. F. Sabel and, J. Zeitlin (eds.), *World of Possibilities*, Cambridge University Press, Cambridge, 1997.

³⁰ The process of gaining independence from Sweden is covered in more detail in Chapter four.

³¹ Michelsen was Prime Minister from 1905-07, Knudsen, who consolidated the left wing of the *Storting* in 1908 was PM for two periods, 1908-10 and 1913-20. Knudsen was the first steamship owner in eastern Norway, whilst Michelsen's major shipping interests were based in Bergen, to which he returned to after leaving politics. Derry, *A History of Modern Norway 1814-1972*, p.173.

³² For an extensive discussion of the development of this technology see J.N. Tønnessen and A.O. Johnson, *The History of Modern Whaling*, Hurst & Co, London, 1982, pp.16-25. For a reproduction of Sven Foyn's patent for the explosive harpoon see Hodne, *An Economic History of Norway 1815-1970*, p.286.

allowed for the hunting of baleen whales such as the blue and humpback, no longer restricting the industry to coastal hunting of small species. As coastal resources declined in the late nineteenth century, Norwegian whalers began to look further a field, both toward the Arctic and to the southern seas. The logistical problems of such a venture were overcome in 1905 when the first modern industrial factory ship, the *Admiralen* was launched. Its builder Chr. Christensen constructed a vessel equipped with on board boilers for processing the whale oil. The ship, accompanied by small hunting boats, allowed the catch to be processed at sea, harkening the modern era of industrial whaling. Further technological developments increased efficiency even further.³³ The slipway at the rear of a factory ship, developed in the 1920s, allowed production to occur entirely at sea, permitting major increases in production, and allowing vessels to travel further a field, frequently deep into Antarctic waters.³⁴ These three key technological developments, all Norwegian, saw the industry become both a major employer and a large earner of foreign income.³⁵ Norway became the dominant world power in whaling. From the first production records in 1909 to the end of the 1930s, Norway was responsible for never less than twenty-eight per cent of world production, and for a period between 1910 and 1917 produced between fifty-four and seventy-seven per cent of whale oil in the world.³⁶ The Norwegian whaling sector demonstrates how a unique industry was able to develop new technology and techniques, and create a pool of skilled engineers, sailors and factory workers to meet increasing world demand. The industry linked engineers, ship builders and many other services to each other through demand. The manufacture of whale oil into various products drew a multitude of secondary industries into cooperation with each other, the fundamental characteristic of industrialization defined in Part One.

³³ Bjørn Basberg, 'Technological Transformation in the Norwegian Whaling Industry in the Inter-War Period' *The Scandinavian Economic History Review*, 32:2, 1985, 83-107, p.101.

³⁴ The factory ship, whilst originally developed for whaling, has since become the giant of the fishing industry in the late twentieth century and into the 21st. Of course, whaling has since become unviable, yet during Norway's period of rapid growth, it represented much of the pioneer spirit that is central to Norwegian folklore. This sentimentalism is also however based on some truths. Modern whaling was largely a Norwegian creation, and these techniques were adapted by other states, particularly the Japanese, during the 1930s and later in the post WWII era. Limited whale culling continues to this day.

³⁵ See Basberg, 'Technological Transformation in the Norwegian Whaling Industry in the Inter-War Period'. For a first hand account of whaling in this period see Alan John Villiers, *Whaling in the Frozen South : Being the Story of the 1923-24 Norwegian Whaling Expedition to the Antarctic*, Hurst & Blackett, London, 1925.

³⁶ Statistik Sentralbyrå, *Oversikter*, p.105.

Yet whilst shipping, whaling and the timber trade all generated major export earnings, these sectors, whilst dynamic, were localised and their impact across Norway was limited. Shipping was a traditional industry that transformed and modernized itself, taking advantage of changing economic conditions. Whaling too made the leap from a traditional economic activity to a modernized, industrial sector, developing the factory ship and industrial processing of the whale catch. But mass scale industrialization in Norway was primarily built around new economic sectors that emerged rapidly and suddenly. The driving forces for these new sectors were the increasing demand for electricity in industry, the influx of foreign capital and new technology. These developments were to have the greatest impact on the economy and were fundamental in reshaping Norwegian society and the state.

ELECTRIFICATION OF THE ECONOMY

Trained as an engineer in Berlin, Sam Eyde recognised a business opportunity in Norway's waterfalls and he began the construction of the first major hydroelectric scheme at Rjukan in 1907. It was only by the late nineteenth century that metal alloys with the required strength were developed to construct turbine blades allowing Eyde to exploit the many waterfalls. This proliferation of waterfalls in Norway presented enormous potential for the production of electricity. But such potential alone could not provide sufficient motivation to produce electricity. What was required was sufficient demand. In the early twentieth century, many domestic electric devices emerging in Western Europe were almost unheard of in Norway.³⁷ Apart from the lighting of homes, demand for such goods was low.³⁸ Further compounding the problem was the Norwegian landscape as a barrier to the easy construction of powerlines.³⁹ Building the infrastructure to distribute power to often isolated communities was a long-term project, far beyond the scope of a single private

³⁷ For a discussion of the development of energy infrastructure in Europe see Robert Millward, 'European Governments and the Infrastructure Industries, C. 1840-1914', *European Review of Economic History*, 8: 1, 2004.

³⁸ Electric lighting was recognised as a useful technology in the far north of Norway where the winter brought several months of darkness. The far northern town of Hammerfest installed its first electric lights in 1890. Derry, *A History of Modern Norway 1814-1972*, p.192.

³⁹ It was easier to construct powerlines than transport other fuels such as coal and oil. This is an important consideration. The backwardness of Norway technologically meant that it 'leapfrogged' some forms of technology and developed an electricity sector quickly. *Ibid.*, pp.191-2.

company. Without a major buyer for electricity, an industrial economy in Norway was unlikely to take hold.

Eyde's project carried great financial risks, for unless power hungry industry took up the opportunity, the project could prove a disaster. Fortunately, the changing global economy provided the required demand. Agriculture in the nineteenth century was using growing quantities of nitrogen based fertilizer, sourced from the enormous deposits of saltpetre in Chile and Peru; deposits that were beginning to run low.⁴⁰ Eyde, with associate Kristian Birkeland, developed a technique for producing nitrogen oxides that utilized an electric furnace. With the newly developed method and the potential offered by hydro-electric power, Eyde founded Norsk Hydro, and construction of the first power plant at the waterfall of Rjukan was completed in 1911.⁴¹

With the Birkeland-Eyde furnace perfected, Norsk Hydro began to produce nitrogen fertilizers and other chemicals, in particular ammonium nitrates, used for fertilizer and explosives. The world demand for these new chemicals led to continued expansion of Norsk Hydro and other new companies, all requiring the continued construction of hydroelectric plants that could supply the high power demands of the electro-chemical industry. Cheap electricity was to provide the basic resource for twentieth century industry in Norway and the vehicle for transformation of the economy.

Electricity was the new steam power and its mass production invited an array of industrial possibilities. Hydroelectric power production also had important input and output consequences for the wider economy and employment. Large projects required skilled engineers and workers to maintain complex equipment. The industry therefore created a demand on training and education as well as many support services. With a plentiful supply of cheap electrical power, modern industry was able to obtain its most important resource at a very low, almost negligible cost. Such was the rapidity of hydroelectric development that by 1920, Norway was producing among the highest

⁴⁰ See Paul Gootenberg, *Imagining Development : Economic Ideas in Peru's "Fictitious Prosperity" Of Guano, 1840-1880*, University of California Press, Berkeley, 1993, for a history of the industry in Peru.

⁴¹ The power station at Vemork was when built the largest power station in the world and continued producing electricity until 1971. It was also the site of the famous German attempt to produce heavy water during WWII, necessary for the production of an atomic bomb. The site was attacked several times during the war, most notably by Norwegian led saboteurs in a night time raid. This episode later became the subject of the film 'The Heroes of Telemark' (1965, Director: Anthony Mann).

per-capita output of electrical power in the world.⁴² For industry, the sudden increase in power made for a tempting commercial opportunity, at a time where new industries such as aluminium smelting were emerging that required electricity in large quantities. Electricity, more than any other factor, was the primary factor in the development of Norwegian industry.⁴³ Foreign companies and investors elsewhere in Europe now saw great opportunities for growth.

THE ROLE OF FOREIGN INVESTMENT

As new investments began to flow into nascent industries, traditional agriculture and primary production became linked to the emerging industrial sectors. The forestry sector became connected to paper and pulp manufacturing, whilst fishing and shipping were able to adapt and change also through canning, processing and the expansion of trade. The new industries that shaped the economic landscape of Norway built upon some old sectors, and developed in new directions, pushed by cheap power and foreign investment.⁴⁴ What is significant for Norway is that growth occurred with greater pace than previously in continental Europe and was heavily dependent upon overseas investment. This was to impact upon the state in a dramatic way and lead to new ways of regulating capital.

Large industrial projects were made possible with the input of foreign capital. Sam Eyde's first hydro electric schemes were heavily financed by British, Swedish and German interests.⁴⁵ There was little local venture capital and the commercial banking sector was only in an embryonic form. The sole major bank was the state controlled *Norges Bank* (Central Bank), which alone was able to issue legal notes.⁴⁶ The sectors

⁴² Lieberman. *The Industrialization of Norway, 1800-1920*, p.138.

⁴³ Ibid., p.138.

⁴⁴ A useful general overview of the Norwegian inter-war economy is found in Jonathon W. Moses, *Norwegian Catch-Up: Development and Globalization before WWII*, Ashgate, Aldershot, 2005.

⁴⁵ The primary text on foreign investment in Norway during the inter-war period is, oddly, written by an English economist. See Arthur Stonehill, *Foreign Ownership in Norwegian Enterprises*, Statistisk Sentralbyrå, Oslo, 1965.

⁴⁶ See Åsmund Egge, 'Transformation of Bank Structures in the Industrial Period: The Case of Norway 1830-1914', *Journal of European Economic History*, 32:2, 1983, 271-294; Helge Nordvik, 'The Banking System, Industrialization and Economic Growth in Norway 1850-1914', *The Scandinavian Economic History Review*, 41:1, 1993, 51-72; Helge Nordvik, 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective' in C. H. Feinstein (ed.), *Banking, Currency, and Finance in Europe between the Wars*, Clarendon Press, Oxford, 1995.

with the greatest demand for capital, namely the shipping industry and its related activities made alternative arrangements, often utilizing cooperative ventures and share-ownership of vessels rather than seeking commercial loans.⁴⁷ In the absence of sufficient domestic credit, Norwegian industry therefore required foreign capital investment. The flood of foreign capital following independence was to have a major impact upon Norwegian economic and political life. The state of Norway was becoming linked to the global economy by a dependence upon foreign capital. Yet contrary to models of state development that consider foreign investment restrictive upon the state, in Norway, foreign investment in industry led to state regulatory expansion and enhanced control. Even before WWI the Norwegian Government, using new institutions began to monitor and regulate foreign investment. This development was centred on the Concession Laws and the controversy of foreign ownership of rivers and waterfalls. The next chapter will examine in detail the way the new laws contributed to a state managed industrialization process. The following section analyzes the nature and extent of foreign investment and ownership in the new industrial economy of Norway

INVESTMENT IN METELS AND CHEMICALS

Aluminium production was started by a British concern: British Aluminium Company Limited. Production commenced in 1908 following the granting of concessionary access to a waterfall in 1906.⁴⁸ The appeal of Norway as a site for the electrometallurgical industry lay in the supply of cheap power. With no indigenous source of bauxite or alumina, ore was imported, mostly from France and Greece.⁴⁹ As world demand for aluminium grew, several joint venture companies were established in the following years, notably Det Norske Nitridaktieselskap and A/S Arendal Smelteverk, both of which were dependent upon French and German capital respectively.⁵⁰ Locating power intensive industries next to waterfalls and their power stations provided the added advantage of easy access to existing or easily constructed

⁴⁷ See With Anderson, 'Producing Producers: Shippers, Shipyards and the Cooperative Infrastructure of the Norwegian Maritime Complex since 1850'.

⁴⁸ Stonehill, *Foreign Ownership in Norwegian Enterprises*, pp.37-8.

⁴⁹ Olge Adamson, *Industries of Norway: Technical and Commercial Achievements*, Dreyer, Oslo, 1952. p.70.

⁵⁰ Stonehill, *Foreign Ownership in Norwegian Enterprises*, p.37.

port facilities, often negating the need for extensive transport infrastructure to be built. The emerging companies also began to adopt and in some cases develop their own new technologies.⁵¹ The Norwegian engineering and scientific community developed new manufacturing techniques that increased efficiency and were often later adopted elsewhere in the world.⁵² The result of these factors was a dynamic industrial sector that produced twelve per cent of the world's aluminium in 1920, remarkable for a small country with minimal to non-existent mineral deposits to exploit.⁵³ Aluminium in finished rolls and ingots was exported to France, for utensils and other domestic applications.⁵⁴

Table 1: Norwegian metal production (tons)

Year	1923	1925	1927	1929	1931
Ferro-alloys	22301	84495	104054	124536	105975
Aluminium	13319	21304	20847	29142	21420

Source: Statistik Sentralbyrå, *Oversikter*, 1948

Cheap electricity had wide applications in the production of other metals and chemicals and spurred rapid export led growth. Synthetic fertilizers formed the basis for an array of chemical products, all dependent upon an energy intensive manufacturing process. Chlorine manufacture supplied the bleaching product for the paper and pulp industry.⁵⁵ With coniferous forests suited for pulping, Norway became an exporter of pulp and associated products for which demand for chlorine and caustic soda were imperative. Pulp products were especially reliant upon exports, with a great dependence upon Great Britain's markets and thus exposure to changing prices and demand was always a potential risk. Pulp and its related products in finished paper, especially newsprint, became one of the key growth industries in Norway in the early twentieth century. Producing just five per cent of export earnings at the turn of the century, pulp production reached its height in 1925 where it was responsible for almost thirty per cent of Norway's export earnings.⁵⁶ As world demand declined due to the Great Depression pulp production's growth lessened, however it remained, right up until the outbreak of WWII, a major growth industry. With the development of a

⁵¹ Adamson, *Industries of Norway: Technical and Commercial Achievements*, p.54.

⁵² See Sejersted, 'Science and Industry: Modernisation Strategies in Norway 1900-1940', p.265.

⁵³ Adamson, *Industries of Norway: Technical and Commercial Achievements*, p.73.

⁵⁴ *Ibid.*, p.74.

⁵⁵ Lieberman. *The Industrialization of Norway, 1800-1920*, p.141.

⁵⁶ Statistik Sentralbyrå, *Oversikter*, pp.162,169.

paper and pulp industry, the Norwegian forestry sector was able to link into industrial production.⁵⁷ Timber was no longer only used for building and furniture, but became part of the industrial process, connecting the traditional economy with the new, and the rural areas with the developing economic centres. Table Two below demonstrates the rapid growth of Norwegian industry.

Table 2

Year	GDP (millions of Kroner fixed to 1910 constant)	Manufacturing as per cent of GDP (not incl. building, construction, shipping.	Value of exports (millions of Kroner)	Exports as per cent of GDP	Manufactured goods as per cent of exports
1900	1131	*	0.173	15.3	9.77
1905	1197	*	0.217	18.1	11.44
1910	1431	*	0.282	19.7	15.10
1915	1756	*	0.677	35.55	14.34
1920	1987	*	1.25	62.9	22.45
1925	*	*	1.05	*	42.55
1930	*	*	0.684	*	39.56
1935	3446	33.02	0.605	*	42.37

Source: Statistik Sentralbyrå, *Oversikter*, 1948, Lieberman. *The Industrialization of Norway, 1800-1920*, pp.132, 147.

THE IMPACT OF INDUSTRIALIZATION ON SOCIETY

Industrialization led to a flood of people from rural centres into cities. Considerable population increases had created a large labour force that enjoyed better working conditions and improved health. Previously isolated communities were now increasingly linked via transport and communications. State expenditure on public works grew enormously in the inter-war years, with new railways and the development of air transport making quickening the movement of goods and people.⁵⁸ For a landscape often so inaccessible, modern technologies had a massive impact on how Norwegians went about their lives. A noteworthy development was public radio,

⁵⁷ Hodne. *The Norwegian Economy, 1920-1980*, p.6.

⁵⁸ Public works expenditure grew ten-fold between 1910 and 1920. The length of railway lines grew from around 2000 km in 1901 to 3800 in 1930, most of which was public railway, Statistik Sentralbyrå, *Oversikter*, pp.279-83.

first heard in 1923. By the early 1930s, the state developed a monopoly, modelled on the British Broadcasting Corporation.⁵⁹ Radio and the ability for people to communicate so rapidly through telegraph and phone lines was a direct consequence of the industrial revolution in Norway. The changes wrought by the new economy were to have far reaching implications for how Norwegian society in the state arena was organized.

Table 3: Employment by sector 1890-1930

% of employment by sector	1890	1900	1910	1920	1930
Agriculture	30.1	24.9	25.3	21.4	19.5
Industry	14.0	17.1	16.0	17.5	15.5
Commerce	3.8	5.0	5.5	6.7	7.3
Transport/communications	4.5	4.8	4.9	5.2	5.4

Source: Statistik Sentralbyrå, *Oversikter*, 1948, passim.

Industrialization for Norway was a major break with the traditional economy. In the nineteenth century, the Norwegian economy was confined to agriculture and a handful of services in localised areas. The arrival of foreign investment and a rapidly growing chemical and metals sector created thousands of new jobs and led to an array of new services and other industries. The economy had transformed in a few decades. This chapter now turns to the impact of industrialization upon the Norwegian state arena and its organization. It takes us to the second dynamic of change this thesis is addressing: how social organizations were reshaped by industrialization. The new economy gave social organizations new power and new interests because of their influence over components of the industrial economy. Loose forms of social organization gave way to formalised groups that formed linkages with other organizations. The interests and purpose of many new organizations became defined in economic terms. Modern state development became shaped by this interactive process as social organizations increasingly sought interaction with state institutions.

The analytical model developed in Part One required that economic change in Norway be considered a consequence of domestic and international processes of investment. With the industrial transformation and the social impact in entailed addressed, it is

⁵⁹ Derry. *A History of Modern Norway 1814-1972*, p.332.

now possible to turn to the impact of this process on new and developing social organizations. The transformation of production from labour intensive to capital intensive economic activity does not occur in isolation from social and political forces. The significant social impact of industrialization in Norway lay in the development of organized labour, business organizations and new political parties. Such groups became economically powerful because of their roles in the new industrial economy. Business groups and organized labour organizations had great and growing influence over capital and labour, two key components of the industrial economy. They in turn sought to express this emerging power via political parties. As a result, they increasingly interacted with the institutions of the state over problems and conflicts arising from the industrialized economy.

ORGANIZED LABOUR

Non-existent in an agricultural economy, trade unions grew quickly as people began to work together in factories and workshops. The rapid development of trade unions as a direct consequence of industrialization and their key economic and political role will be the focus of the following section. It will demonstrate how labour organized in an industrial economy and became politically powerful as they influenced the labour supply.

Pre-industrial Norway had few organized labour groups beyond loose associations and cooperatives. Casual and part time employment was the norm for many people. Rural workers in particular were engaged in several jobs at different times of the year and were often self-employed. With such a fragmented agricultural economy there was little incentive for people to organize into modern unions. Landowners employing numerous labourers were exceptions in a rural system that tended toward small land holdings owned and operated by the peasantry. Thus, unlike the continental European feudal structure, Norway never experienced equivalent inequalities of land ownership. Therefore, there was not a critical mass of poor or landless workers in the mid nineteenth century to generate unions or collectivization in the same manner as experienced in continental Europe. Unionization in Norway

occurred belatedly, then rapidly and radically in the inter-war years.⁶⁰ Its rapid development mirrored the rapid development of the industrial economy.

The cities of Oslo and Bergen that grew in the late nineteenth century provided the settings for the development of organized labour.⁶¹ Yet the radicalism that emerged in the late nineteenth century did not only originate from urbanized workers. Both the opportunity for jobs and the surge of migration to the United States and Canada drew people from rural and outlying regions into the cities and towns.⁶² And it was from this transient rural population that the first significant radical political views emerged from.

A series of radical protests were led by Marcus Thrane in the mid nineteenth century.⁶³ Representing landless peasants, Thrane advocated major land reforms. His organization amassed a membership approaching 20,000 by 1851, demanding legislation aimed at protecting wages and labour standards, mostly for agricultural workers.⁶⁴ The Thranite movement, in understanding the development of Norwegian unions, is more symbolic than significant, yet it illustrates a distinction between modern and pre-industrial labour organization in Norway. The Thranites, whilst organized, were not structured in the same manner as the modern trade unions that

⁶⁰ This is a central argument of Edvard Bull and William Lafferty; that 'late' industrialization (in a European context) made for a more radical union movement. See Edvard Bull, *The Norwegian Trade Union Movement*, International Confederation of Free Trade Unions, Brussels, 1956, and William M Lafferty, *Industrialization, Community Structure and Socialism : An Ecological Analysis of Norway, 1875-1924*, Universitetsforlaget, Oslo, 1974.

⁶¹ The capital Oslo was, until 1924 known as Cristiania. For consistency, the capital will be referred to as Oslo regardless of the year in question.

⁶² For a discussion of the emigration of Norwegians to Canada and the United States see Derry. *A History of Modern Norway 1814-1972*, pp.206-16. See also Lieberman. *The Industrialization of Norway, 1800-1920*, pp.27-56. Lieberman's conclusions are criticized in a review by Thorvald Moe, 'The History of Economic Growth in Norway', *The Scandinavian Economic History Review* 1, 1966, 174-181, pp.175-6.

⁶³ Thrane's attempts to reform the conditions of many rural workers, have with the passage of time, created some almost mythical reputations. Thrane's imprisonment in one text is described as 'doubtless the most unjust sentence ever pronounced by a Norwegian tribunal'. See Wilhelm Keilhau, *Norway in World History*, Macdonald, London, 1944, p.183.

⁶⁴ For histories of the Thranite movement see Kåre Tønnesson, 'Popular Protest and Organization: The Thranite Movement in Pre-Industrial Norway, 1849-55', *Scandinavian Journal of History*, 13:1, 1988, 13-26. See also T. Pryser, 'The Thranite Movement in Norway 1849-1851' *Scandinavian Journal of History* 18:3, 1993, 347-58. See also Bull. *The Norwegian Trade Union Movement*, pp.26-30. There were at this time, few urban workers, explaining why the first impulses of radicalism began in the agricultural sector. But following several strikes and a handful of violent incidents Thrane and his key followers were arrested and imprisoned. The establishment was not ready in the mid nineteenth century to accept the reforms proposed. Thrane upon his release departed for the United States, never to return.

emerged in the late nineteenth century. For modern organized labour groups to develop, industrialization needs to impact society on a large scale.

THE MODERN LABOUR MOVEMENT EMERGES

The first modern organized labour group grew from the printing industry. The Oslo Typographical Union formed in the aftermath of the first major strike by urban workers in 1872. Significantly, this union included only workers in Oslo and surrounding districts, and highlights the problem that was to plague the embryonic labour movement for several more years. Oslo was also a transition point for many rural people, with a large percentage moving on to immigrate to the United States. Such a movement of people, often young and looking for work before departure, led to short term or casual employment and thus little incentive to join and support stable unions. By 1889, Walter Galenson points out that there existed only 3000 to 4000 workers affiliated with some form of labour organization, illustrating the urban localization of industrial economic activity at the time.⁶⁵ Industrialization, prior to the development of hydroelectric schemes, was yet to impact regions beyond Oslo.

Toward the end of the century more people became located full time in factories and linked to employers through a regular salary. As a consequence, union membership grew.⁶⁶ The need for greater cooperation between disparate labour groups now became apparent, particularly during strikes.⁶⁷ The National Federation of Labour (*Landsorganisasjonen* or LO) was formed in 1899, the umbrella body that sought to integrate the scattered Norwegian unions.⁶⁸ With a single organization uniting organized labour, it became possible to better leverage wage demands with employers through a formally organized leadership. This became even more important when interacting with the state, as the disputes and discussions with the state's Labour Court will demonstrate in the next chapter.

⁶⁵ Galenson, Walter. *Labor in Norway*. Harvard University Press, Cambridge, 1949, p.9.

⁶⁶ See Harriet Holter, 'Disputes and Tensions in Industry', in J. A. Lauwerys (ed.), *Scandinavian Democracy*, The Danish Institute, Copenhagen, 1958, pp.219-21.

⁶⁷ Bull. *The Norwegian Trade Union Movement*, p.39.

⁶⁸ *Ibid.*, p.35.

Developing a cohesive organizational structure faced hurdles in Norway. The many casual and part time workers were one problem. But so too was the divide between rural and urban workers. This was a problem that diminished as communication infrastructure improved in the early twentieth century, yet consolidation was not an overnight process with several major unions reluctant to come aboard. Negotiations within the organized labour movement continued until the outbreak of WWI, with problems over authority and guidelines debated heavily. The LO's major conference held every two to three years since 1899 became an important meeting for debate and decision making and contributed to the growth of the movement. Most importantly, once the LO had centralized leadership, it enabled it to act in a representative manner toward employer groups and the state. The Labourer's Union was one of the largest groups to join the LO in 1903, an organization of mostly young men in recently created jobs.⁶⁹ The growing membership led to greater centralization of management and administration. Yet the drift toward central organization was not without its problems, particularly as newer unions joined the national body.⁷⁰ It took several years for the LO to evolve from a representative organization of disparate unions, to a centrally organized committee overseeing more day to day activities and acting as an advocate for labour affairs toward the state.⁷¹

RADICAL UNIONISM

The new structure of trade unions reflected the changes in labour practices. The previous manufacturing base was located in small workshops and factories, typically with fewer than a dozen workers within a firm. Paper and aluminium production required larger factories and plants, with the correlating rise in cohesion amongst workers. With larger groups of people together in their place of work, the previously conservative tendencies of skilled workers declined. The growing union membership of unskilled workers, i.e. labourers as opposed to craftsmen and the like opened the door to greater radicalism. Such radicalism made the trade union movement in Norway prominent and also potentially dangerous to continued economic growth in the eyes of employers and government leaders.

⁶⁹ Galenson. *Labor in Norway*, p.15.

⁷⁰ Bull. *The Norwegian Trade Union Movement*, p.38.

⁷¹ Galenson. *Labor in Norway*, pp.14-15

Activist Martin Tranmæl led a group that broke away from the mainstream labour movement prior to WWI, espousing a revolutionary agenda.⁷² Tranmæl, along with supporters of various radical and anarcho-syndicalist groups advocated the use of mass strikes against employers, and therefore required cooperation with the other unions.⁷³ Yet his advocacy of sabotage of factories and the use of other direct, and in some instances violent methods against employers and scab labour led to a decline of the radical movement within Norwegian trade unionism.⁷⁴ The radicals required the mass support of the union movement to be effective, yet as centralization of unions continued, the trend was toward more conciliatory approaches with employers.⁷⁵ Tranmæl's approaches were also at odds with the many pacifists in the broader left and disagreements contributed to the major split between the Labour Party and its affiliates. Tranmæl's program continued to be influential into the 1920s, but his dream of radical social transformation was never realized.

UNION CONSOLIDATION AND LEGITIMACY DURING THE DEPRESSION

The growth of a moderate position by trade union leaders during the most dramatic period of industrial change requires an explanation that goes beyond a shift in the leadership's priorities. Galenson argues that the economic depression of the early 1920s contributed to a decline in both membership and employment and was the major factor in radicalism's decline.⁷⁶ With shrinking demand, the leverage that could be employed by striking workers diminished. Employers were better able to withstand strikes in times of a downturn, and so the union movement had greater interest in negotiation and the securing of more long term agreements than inciting strikes and unrest.⁷⁷ As the next chapter will demonstrate, unions became intimately involved in negotiations over wages and conditions with the state. Through negotiation, the union movement gained status as a legitimate political organization. This negotiation

⁷² Bull. *The Norwegian Trade Union Movement*, pp.62-5.

⁷³ Derry. *A History of Modern Norway 1814-1972*, p.204.

⁷⁴ Tranmæl famously announced at a Trondheim rally in 1912 'If there was some dynamite left in the boreholes, which the strikers only knew about, wouldn't the strike breakers think twice before they began to work?' Quoted in Bull. *The Norwegian Trade Union Movement*, p.65.

⁷⁵ Ibid., p.68.

⁷⁶ Galenson. *Labor in Norway*, p.26.

⁷⁷ Ibid., pp.26-7

process was instrumental in shaping institutions such as the Labour Court and legislative agreements between trade unions, business organizations and the state.

The union leadership involved themselves within a legitimate and established system of political contest to make changes in the interests of their membership; the impact of economic decline and defeat in several key strikes also contributed toward this trend. Radicalism's waning significance began a push by moderate union elements toward parliamentary politics through the Labour Party and state institutions.⁷⁸ The continuation of economic growth through cooperation became an interest of the union leadership, as well as pressing for improved wages and conditions.

Radicalism declined among trade unions in the 1920s and became almost insignificant as the decade wore on. As the LO became more centrally governed, their capacity to channel wage and condition demands into the political process of government became greater. Much of the strength of the organized labour movement was enhanced by its deepening relationship with the Labour Party. This capacity was reflected by the growing size of the Labour Party in the *Storting*.⁷⁹ In the 1920s, the Labour Party advanced from twenty-nine to forty-seven seats, and as it continued to grow in the 1930s, the power of the labour movement increased.⁸⁰ Industrialization, as an economic process led to the development of a powerful social organization that came to influence a key component of industry, namely labour. The growing power held (indirectly) by workers contributed to the raft of laws and changes to the industrial relations system in the inter-war years: organized labour became influential in political decision making. This is not to imply that industrial relations during this period were not troublesome. During times in the 1920s and into the 1930s they were often poisonous, as mass strikes took place and the Great Depression impacted heavily upon living standards. Yet during this period of strife the interaction with employer's groups and most significantly, with state institutions grew. The next chapter will show in detail how the great strikes of the 1920s and 1930s threatened the Norwegian

⁷⁸ Bull. *The Norwegian Trade Union Movement*, pp.71-2.

⁷⁹ The *Storting* is the name of the Norwegian Parliament. The name is derived from the Nordic word 'ting', the name given to village meetings in pre-modern times. See Royal Institute of International Affairs. *The Scandinavian States and Finland : A Political and Economic Survey*, pp.184-5. See also Hilmar Rommenvedt, 'The Norwegian Storting: Central Assembly of the Periphery', *Scandinavian Political Studies*, 15:2, 1992, 79-97.

⁸⁰ John Eric Nordskog, *Social Reform in Norway*, Greenwood Press, Westport, 1935, p.21.

economy. The state intervened between the warring parties to negotiate agreements through modern institutional arrangements such as the Labour Court and a general industrial accord. Before turning to these episodes, several other organizations in the industrialized state arena must be examined. In industrial relations business organizations, like labour unions came to have a major role in shaping the economy and modern state development.

BUSINESS GROUPS

Cooperation among employers began early in the Norwegian industrialization process.⁸¹ Yet the cooperative efforts that began in the late nineteenth century were not only aimed at resisting the efforts of organized labour to win wage increases. Employers had other motivations to cooperate with each other for mutual benefit. Insurance, an essential requirement in the shipping industry, was not sourced from large brokers in Norway for there were none available. Shipping was dominated by small owners, who drew on small scale capital to finance operations.⁸² In the nineteenth century, cooperatives evolved in shipping to provide affordable insurance. Norway's major business association, the *Norsk Arbeidsgiverforening* (NAF), was established in 1900 as a response to the consolidation of the union movement.⁸³ Initially smaller in size than the LO, the NAF came to function as a representative of firms in industrial negotiations. Employers paid an annual fee, and in doing so, deferred to the NAF their ability to negotiate with unions over conditions.⁸⁴ The strength of the NAF was the solidarity it built among employers. Rather than employers competing with each other, the NAF system fostered cooperation between them. This was assisted by the NAF's powerful central board that developed considerable decision making power on behalf of employers in negotiations with unions.

⁸¹ Holter, 'Disputes and Tensions in Industry', pp.226-25.

⁸² See With Anderson, 'Producing Producers: Shippers, Shipyards and the Cooperative Infrastructure of the Norwegian Maritime Complex since 1850'.

⁸³ See Herbert Dorfman, *Labor Relations in Norway*, The Norwegian Joint Committee on International Social Policy, Oslo, 1966. See chapter five in particular for a history of the NAF.

⁸⁴ Galenson. *Labor in Norway*, p.86.

The new industrial economy made for shared interests between employers, particularly in manufacturing where several sectors engaged in producing a final single product requiring coordination such as machinery. In the early twentieth century until WWII, the NAF formed the major business organization that negotiated with organized labour and the state. It came to be largely representative of business interests, but was not, as instrumental concepts of the state can imply, able to ever entirely 'capture' the state or have overwhelming power over Government policy. The next chapter will demonstrate how political interests, not just economic ones, shaped Government industrial relations policy and the way the state interacted with the NAF.

The relationship between the NAF and the state underwent strain during the inter-war years before it settled into a steady working relationship following the institutionalization of industrial relations negotiations in 1935. The NAF often opposed an interventionist state role in industrial relations.⁸⁵ This was notably expressed in the resistance to the establishment of the state Labour Court in 1915. The NAF saw its power potentially curtailed by such a state development and opposed efforts by the Government to institutionalize wage negotiations with unions. Over particular issues, the NAF sought negotiations with organized labour that bypassed the Labour Court.⁸⁶ Yet agreements without a third party were prone to breaking down, and the NAF increasingly sought out state intervention and participated in an institutionalized negotiation process just as the LO did. As industrial production expanded, the state intervention required to ensure agreement between business organizations and organized labour also deepened. How the state went about such an intervention and with what purpose will be considered in detail in the next chapter. It will analyze the way in which the state came to intervene between the opposing camps of labour and business when deadlocks were reached between the NAF and the LO. By doing so, the state entered into a management and regulatory role that shaped the continuing industrialization of the economy.

⁸⁵ Johan Castberg, 'Compulsory Arbitration in Norway' *International Labour Review* 11:1, 1925, 15-38, p.21.

⁸⁶ Paul Knutsen, 'Norsk Arbeidsgiverforening, Revolusjonsfrykten Og De Korporative Tendenser 1918-1920', *Historisk Tidsskrift* 64:4, 1985, 369-413. Knutsen holds the view that the NAF was often reluctant to pursue its interests via the state, just as labour often resisted state intervention via arbitration. This perspective is supported to a lesser degree in Svein Dahl, 'Norsk Arbeidsgiverforening 1927/28', *Historisk Tidsskrift* 60:1, 1981, 1-25.

The need to negotiate pay and conditions with the increasingly powerful LO helped develop the NAF into a well organized and cohesive business organization.⁸⁷ By the 1930s, as industry was becoming the dominant economic sector, the importance of the NAF as a major economic and thus political organization cannot be underestimated. The business people leading the rapidly growing industrial sector became organized into a body that influenced investments, employment and had an impact upon Government decision making. The NAF had a key role to play in the industrialization process by negotiating wage agreements with organized labour. Such interaction often led to greater cooperation and informal relationships between NAF and LO leadership developed. In the years immediately after WWI, the close and friendly relationship between the NAF leader Lars Rasmussen and the LO head Ole Lian improved relations and at times facilitated industrial agreements.⁸⁸ That the NAF was organized in a similar fashion to trade unions also gave them great power as they advocated on behalf of employers. A consequence of interaction around the industrialization process was the development of ties between business leaders and political parties. NAF members and businessmen often moved across to political parties, particularly the *Venstre* and *Høyre* parties that traditionally represented business and conservative interests respectively. The new industrial economy built connections between these groups, which became active participants in the political issues stemming from industrialization. The manner of the NAF's development into a body representing industry gave it great negotiating power over wages and production with organized labour and the state. The political parties that it and organized labour became connected to were also directly impacted by the new economic landscape. How they developed and why they are important in Norway's state development is addressed next.

POLITICAL PARTIES

In Norway, the organizations closest to the institutions of the state were the major political parties.⁸⁹ Because they play a role in government, political parties are central

⁸⁷ See Holter, 'Disputes and Tensions in Industry', p.226. The Shipping Association, representing one of Norway's most important economic sectors, did not join the NAF for a period. Ibid., p.225.

⁸⁸ Knutsen, 'Norsk Arbeidsgiverforening, Revolusjonsfrykten Og De Korporative Tendenser 1918-1920' pp.383-85.

⁸⁹ See Henry Valen and Daniel Katz, *Political Parties in Norway: A Community Study*, Universitetsforlaget, Oslo, 1964, Chapter 2 for a useful overview of the Norwegian political party structure.

in the modern state development process. More than any other social organization, they represent the area of interaction between the state and society this thesis is analysing. From the late nineteenth century, the key Norwegian political parties underwent major changes, primarily as a result of economic change. The changes in representation, ideology and level of voter support were directly influenced by the new economic landscape. The inter-war years were a period of instability with small parties emerging and disappearing and government changing hands between party groups several times. By the mid 1930s the Norwegian political scene stabilised around several major parties that represented the constituent groups of the industrial economy.

PRE-INDUSTRIAL POLITICAL PARTIES

The two parties that represented the major economic class interests in nineteenth century Norway dominated the *Storting* from 1884 till 1918. The Conservative Party (*Høyre*) membership consisted mostly of the civil servant community in and around Oslo that had controlled Norwegian political life under the crown for almost a century.⁹⁰ With such entrenched interests, it adopted a conservative legislative position. As Norwegian society underwent demographic and economic changes in the late nineteenth century with the emergence of the industrial economy, the growing urban middle class became an important political force. This development contributed to the growth of the Liberal Party (*Venstre*), officially founded in 1884.⁹¹ Yet bourgeois interests at this stage were not sufficient alone to mount a challenge to the vested conservative interests in the *Storting*. A collection of farming groups made up the other half of the *Venstre* alliance. Both groups opposed the *Høyre* party; farmers wished to keep taxes and state expenditure to a minimum and the urban middle classes, as their economic significance grew, demanded greater political representation in parliament.⁹²

⁹⁰ Rommenvedt, 'The Norwegian Storting: Central Assembly of the Periphery', p.81.

⁹¹ The names of the Liberal and Conservative Parties being *Venstre* and *Høyre* mean 'left' and 'right' respectively.

⁹² Valen and Katz, *Political Parties in Norway: A Community Study*, p.22.

In the years each side of 1900 one political issue dominated above all others: the continuing union with Sweden and the possibility of full independence.⁹³ The unresolved problem became greater as Norwegian trade and industry grew and full diplomatic representation overseas became desirable by many business leaders and politicians.⁹⁴ The key agitators for independence lay within the ranks of the *Venstre*: it was the issue that held an otherwise diverse group of people together over the period. But despite this show of unity on the key issue of the period, the *Venstre* found it difficult to maintain themselves as a cohesive entity in the years around the turn of the century.⁹⁵ The economic changes of the period pulled the *Venstre* in different directions. A splinter group named the Moderates, who drew support from Lutheran Christians and more social conservative voters, broke away in 1888. Yet this group, in the face of an overwhelming two party system only survived twelve years of independence before joining the *Høyre*. The remaining *Venstre* was by this time known as the 'Pure' wing, and attempted to maintain its support base in the face of rapidly changing economic and social patterns. Whilst agricultural interests remained important, the middle classes, typically located in the towns and cities and working in newer areas of manufacturing and trades, were growing in strength. Thus, the *Venstre* found itself increasingly torn between divergent rural and urban interests. As industrialization continued, the divisions grew between conservative interests and urban business groups within the party.

THE EMERGENCE OF THE LABOUR PARTY

What the *Venstre* and *Høyre* parties needed to maintain their cohesion was a common political 'enemy'. And because of industrialization's impact they received it. Founded in 1887, the Labour Party was the newest political party both in its support base and its policies. With the support of the just emerging urban working class, the Labour Party adopted its most radical standpoint early in its history, drawing upon ideas from other

⁹³ Raymond E. Lindgren, *Norway-Sweden: Union, Disunion and Scandinavian Integration*, Princeton University Press, Princeton, 1959. See especially chapter five.

⁹⁴ The process by which Norway gained full independence from Sweden and established a constitutional monarchy will be dealt with in more depth in the next chapter. For a fine overview of this period see: Ibid.

⁹⁵ Stein Rokkan and Henry Valen, 'Regional Contrasts in Norwegian Politics' in E. Allardt and S. Rokkan (eds.), *Mass Politics: Studies in Political Sociology*, The Free Press, New York, 1970, p. 193.

European socialist movements and parties.⁹⁶ Radicalism in Norway was not limited to the emerging working class in the new industrial centres: it had previously been most concentrated in rural areas, as demonstrated by the peasant movement led by Marcus Thrane in the mid nineteenth century.⁹⁷ Rural radicals came to support the Labour Party in its early decades, uniting poor farmers with often equally poor urban workers. Industrialization supported this process, as many poor rural workers moved to the towns and cities. Their jobs changed but they remained supportive of the same political party. The Labor Party was that most directly shaped and transformed by industrialization. As the party representing the workers in factories and workshops its role as the major political voice of employees and growing power makes it central in Norwegian state development. From its humble beginnings at the turn of the century, it was transformed in size and power, till it won Government in 1935.

The Labour Party first developed as a radical-socialist organization committed to major social and political change. But the Norwegian example of a left wing movement followed a different same path to other European cases.⁹⁸ The Norwegian Labour Party, whilst it maintained socialist views, also adopted an array of social policies that did not always fit with such ideals. Among these included a powerful temperance movement that had diverse regional support, contributing to the national referendum on prohibition in 1919.⁹⁹ The combination of Marxist ideas originating from larger western European countries and the more local ideas and norms created a unique, if at times unlikely, mix of policies.¹⁰⁰ The Labour leadership was perhaps the most influenced by doctrinal ideas of revolution and sought to instil in the working class a

⁹⁶ Bull. *The Norwegian Trade Union Movement*, pp.62, 67.

⁹⁷ See Hodne. *An Economic History of Norway 1815-1970*, pp.364-5; Roy Melvin Tollefson, *Political Thought inside the Norwegian Labor Party, 1917-1928*. Chicago, University of Chicago, 1957, pp.19-20.

⁹⁸ Bull. *The Norwegian Trade Union Movement*, pp.66-7.

⁹⁹ Prohibition was a defining social issues of the inter-war years and is worthy of mention. Industrialization did have an influence upon the increased consumption of drink in urban areas through increased salaries. A plebiscite in 1918, followed by the 1919 referendum, resulted in a blanket ban on alcohol, mostly supported by Lutherans and rural groups. Politically, the extreme left were the biggest supporters of the ban, with Martin Tranmæl one of the most notable enemies of 'the demon drink'. The Prohibition era lasted until 1927, when it was apparent that a ban, as opposed to regulation was impossible to enforce. Much of the pressure came from abroad. The French, Spanish and Portuguese Governments, mindful of their large wine exports, requested the Norwegian government permit wine sales, and by 1921 the system was modified, permitting sales through state owned outlets. With smuggling and the black market rampant, the ban was repealed in favor of a heavily controlled and regulated system of sales and distribution. For the view within the Labour Party on alcohol the best discussion is found in Tollefson *Political Thought inside the Norwegian Labor Party, 1917-1928*, pp.31-40. See also Derry, *A History of Modern Norway 1814-1972*, pp.300-4.

¹⁰⁰ Tollefson *Political Thought inside the Norwegian Labor Party, 1917-1928*. pp.16-19.

greater level of class consciousness. Yet holding to the orthodoxies of classical Marxist and revolutionary ideas espoused by the Third International was difficult. Chief among the problems was maintaining hostility to religion, a view that was rarely accepted within the strongly Lutheran rural population and urban working class who were otherwise quite radical in social and economic views.¹⁰¹ Nevertheless, growth of the industrial economy in the early twentieth century increased the Labour Party's support from urban workers and diminished the need to maintain support from the rural poor. An important development of the inter-war period was the growing enmeshment of the Labour Party and the trade unions.¹⁰² Union officials filled the ranks of the Labour Party leadership. This network also grew into the Norwegian civil service with union members according to one perspective 'colonizing' the bureaucracy.¹⁰³ The policies of the Labour Party thus became directly shaped and influenced by the problems and issues of the new industrial economy as expressed by organized labour, primarily the leadership of the LO.¹⁰⁴

THE LABOUR PARTY DIVIDED

In the period until the Great Depression, the size and strength of the Labour Party increased in accordance with the growth of the industrial economy. It gained its first seats in the *Storting* in 1903 and won more with each subsequent election. The increasing popularity of the Labour Party was the result of growing ranks of urban workers and the wish for greater political representation of the working class. The Labour Party's policies that developed in this period were not however revolutionary. Whilst the influence of the Russian Revolution was significant, the Norwegian Labour Party, much like the union movement, shifted away from radicalism, leading to friction and splits. The most important of the radical groups within the Labour Party broke away and formed the Union Opposition in 1912.¹⁰⁵ This party for a period proved

¹⁰¹ Ibid., pp.41-48.

¹⁰² See Egil Fivelsdal and John Higley, 'The Labor Union Elite in Norway', *Scandinavian Political Studies* 5, 1970, 165-207, pp.194-98.

¹⁰³ Ibid., p.189.

¹⁰⁴ Bull, *The Norwegian Trade Union Movement*, pp.73-4.

¹⁰⁵ See Tollefson *Political Thought inside the Norwegian Labor Party, 1917-1928*, pp.49-132 for a history of the breakaway. See also Sten Sparre Nilson, 'Factional Strife in the Norwegian Labour Party 1918-1924' *Journal of Contemporary History*, 16, 1981, 691-704. For a background into the reasons for this instability within the party related to the economic changes brought about by industrialization see, Sten Sparre Nilson, 'Labor Insurgency in Norway', *Social Science History*, 5:4, 1981, 393-416.

controversial, mostly for the reputation and activities of their firebrand leader Martin Tranmæl. As a political force, the Union Opposition was significant only for a brief period. The rapid growth of employment in factories and workshops led to a body of workers agitating for changes to poor pay and conditions. The Union Opposition proved a popular choice, but as its leadership were increasingly under pressure from moderate politicians and the government, they failed to gain any strength in the form of *Storting* seats. Tranmæl was never able to build the Union Opposition into a self-sustaining party. His personal leadership was always central, and as his popularity waned, so too did the appeal of his party. Not enough industrial workers supported such a radical agenda, preferring to support the more centrist Labour Party that offered greater support in times of strikes as well as greater legitimacy as a political party.¹⁰⁶ As the Labour Party offered a platform of access to the state, revolutionary and reactionary groups gradually lost support in the 1920s. Many of the problems experienced by members of trade unions such as low wages and poor work place safety were best addressed via the Labour Party that could advocate on their behalf to the NAF and the government.

The most serious split in the political left occurred after WWI. Within the Labour Party, a strong communist group developed, and after 1917 the divisions became more obvious. The influence of the Russian Revolution contributed to a disorganized decade in Norwegian leftist politics. Moderate leaders were ousted in 1919 and the new leadership joined the Third International whereby the more centrist elements departed to form the Social Democratic Party in 1921.¹⁰⁷ What remained of the Labour Party was beset by internal divisions, with the more radical elements advocating a restructure along syndicalist lines.¹⁰⁸ The powerful nationalist feeling amongst many and the desire to maintain independence allowed the Labour Party to resist this push, and the Communists established their own, albeit small party in 1923. The Communist Party became a revolutionary force for only a short time, with their main constituency being

¹⁰⁶ The reasons for workers to support the Communist Party and the Union Opposition were often due to a variety of factors, not always directly linked to industrialization. Popularity of particular leaders in local areas was a notable factor as were specific localised issues. See Lafferty, *Industrialization, Community Structure and Socialism : An Ecological Analysis of Norway, 1875-1924*, pp.322-25.

¹⁰⁷ Valen and Katz, *Political Parties in Norway: A Community Study*, p.27.

¹⁰⁸ *Ibid.*, p.27.

urban factory workers, many of whom laboured in poor conditions for low pay.¹⁰⁹ In contrast, the Labour Party leadership was mid decade recognising the need to maintain a moderate political position: it was the only way to build a platform to challenge the other major parties and implement change. This view was also held by some in the Union Opposition and the Syndicalist Party; despite their advocacy of direct action against the industrial economy rather than engagement with the institutions of the state.¹¹⁰

THE CONSOLIDATION OF THE MAJOR POLITICAL PARTIES

The various groups within the Labour Party collectively won almost a third of the vote in the 1915 general elections. Yet leftist groups were excluded from representation until the adoption of a proportional system in 1920.¹¹¹ Following its introduction the new proportional system produced a blossoming of political groups and parties.¹¹² A party structure was not a constitutional requirement to stand for election, but in Norway such a system evolved. The proportional system resulted in the new industrial economic interests being fiercely advocated via the political parties, a key feature of a modern political party system. Each party began to draw upon key economic interest groups, mobilising support and channelling demands toward government. Conflict and disagreement over economic issues became the nature of political party interaction.¹¹³ As parties increasingly represented groups defined by economic interests, the problems and issues of the new industrial economy became played out within parties.¹¹⁴

The Norwegian party political system underwent major changes as a consequence of industrialization. At the time of the dissolution of the Swedish Union only two major parties were participants in the *Storting*. The period until the mid 1930s was one in which several major political groupings formed, and others became marginal or

¹⁰⁹ For a history of the Norwegian Communist Party before WWII see Jahn Otto Johansen, 'Norway' in W. E. Griffith (ed.), *Communism in Europe: Continuity, Change and the Sino-Soviet Dispute*, Pergamon Press Oxford, 1967, pp.321-26.

¹¹⁰ Tollefson, *Political Thought inside the Norwegian Labor Party, 1917-1928*, p.82.

¹¹¹ See Valen and Katz, *Political Parties in Norway: A Community Study*, pp.23-5.

¹¹² *Ibid.*, p.27.

¹¹³ Frank H. Aarebot, 'Norway: Centre and Periphery in a Peripheral State' in S. Rokkan and D. Urwin (eds.), *The Politics of Territorial Identity: Studies in European Regionalism*, Sage, London, 1982, p.90.

¹¹⁴ Valen and Katz, *Political Parties in Norway: A Community Study*, p.28.

disappeared. The impact of industrialization was that the major parties became defined by the economic interests of their constituency. Old economic interests, embedded in nineteenth century society declined, to be replaced by interests defined by economic status in the industrial economy. The working classes flocked to the Labour Party, whilst the middle classes came to support the *Venstre*. The *Høyre*, as their constituency declined or deserted to other parties, maintained a support base of property owners and businessmen. Success at elections in the industrial age was dictated by each party's ability to best represent their constituent's economic interests.¹¹⁵

As the previous discussion showed, organized labour and business groups emerged as powerful social organizations in Norway. The political parties that stabilized by the middle of the 1930s became closely connected to these social organizations. The modern political party system became the conduit for the major social organizations of industrial Norway to channel their views toward the institutions of the state. The Labour Party, *Venstre* and *Høyre* all reflected social interests that were shaped by the industrial economy. This is the most significant party development of the inter-war period. The early twentieth century saw an array of parties emerge, from communist and communist leaning groups on the left, to religiously motivated parties on the right of the spectrum.¹¹⁶ Parties on the far left tended to remain small. Their significance has perhaps been a little overemphasised by the many studies conducted from various Marxist perspectives.¹¹⁷ A more accurate way to depict the many leftist groups is to see them as a cluster of parties and interests with the Labour Party at the centre. When Labour was rejoined by the Social Democratic Party in 1927, the coalition stuck, and as Frank Aarebot states, their period of division ended and they became the central

¹¹⁵ Ibid.,

¹¹⁶ The most notorious of right wing groups were the National Socialists. In the mid 1930s they, along with other small groups, became influenced by ideas originating from Continental Europe. Led by Vidkun Quisling, the National Socialists took power on the back of the Nazi invasion in 1940. Quisling was executed in 1945 along with several other collaborators. The death penalty, whilst abolished previously, was reinstated temporarily for the trial of Nazi collaborators. Quisling's collaboration with the German occupation led to his name becoming synonymous with treachery: the term *quisling* became adopted in English as well as Norwegian to describe a traitor.

¹¹⁷ The perspectives of Edvard Bull, Walter Galenson and William Lafferty have been particularly influential in this regard. See Galenson. *Labor in Norway*, Lafferty. *Industrialization, Community Structure and Socialism : An Ecological Analysis of Norway, 1875-1924*. Bull's work was mostly in Norwegian, however as the leading (Marxist) historian of Norway for many years, his ideas were of major influence. He was the leading communist intellectual of the period in Norway and was also a major figure in the political left wing. As a member of the *Storting* in the 1920s, he became foreign minister in the short lived Labour led government of 1928.

political party in Norway, and have remained so to this day.¹¹⁸ The political parties of the left, all a result of the industrialization process, eventually united in order to gain power via electoral victory. Industrialization led to party interests consolidating around the economic interests of their constituency. The economic interest groups that emerged in the period began to demand and receive, to varying degrees, some sort of representation toward government by the leadership of political parties. This channelling of interests, and the development of the conduits for which economic interests could be expressed was a major consequence of industrialization and was to have major implications for modern state development.

INDUSTRIALIZATION AND THE TRANSFORMATION OF THE NORWEGIAN STATE ARENA

This chapter has examined how industrialization shaped and impacted the development of key social organizations within the state arena of Norway. The period from independence until 1935 saw several significant interrelated developments in both economy and society. The changes constituted a major break with the past and were central in shaping modern state development. The first significant feature of Norwegian industrialization was its dependence upon outside investment. Norway, a small country with little surplus capital, required finance from overseas to get industry moving in a substantial scale. Major industrial projects of the early twentieth century all received large injections of foreign capital that only began to decline in the 1920s as domestic investment increased on the back of accumulated capital. The new sectors resulted in greater employment in factories and workshops, and the increasing organization of business groups and capital. Industrialization transformed the economy by linking different sectors with manufacturing. It led to the emergence of services in insurance and banking which developed through continuing investment in chemical and metal manufacturing. These linkages led to greatly increased cooperation and organization between employers. It is this degree of organization, and the decreasing isolation of particular economic activities, that transformed the Norwegian economy.

¹¹⁸ Aarebot, 'Norway: Centre and Periphery in a Peripheral State', p.83.

THE SOCIAL IMPACT

Industrialization had far-reaching impact on society. The state arena was reshaped by the growth of trade unions, the expanding organization of business groups and the formation, growth and decline of major political parties. These organizations became important political actors because of their central role in the new industrial economy. Business groups, led by the NAF held great sway over Government policy and industrial relations. Organized labour, as represented by the LO had a key role in influencing the labour supply to industry. Both institutions became formally organized with paid memberships and were constituted as bodies with a specific set of activities directly related to the industrial economy. The LO, by offering protection to workers, gained support and through collective bargaining and wage negotiations central to the management of the labour supply to industry. Industrial production, due to its need for labour on a large and coordinated scale created the LO and thus industrial employers, coordinated by the NAF, had to interact with the LO to supply workers at a negotiated price. The next chapter will examine this interaction in detail and how the relationship led to institutional development of modern state.

Political parties became significant in the inter-war years as representative of the economic groups that emerged. To become effective in the new economy, political parties modernized, becoming centrally organized parties with mass support, unlike the nineteenth century form of political organization. As the industrial economy grew, modern political parties became connected to key social organizations and channeled their interests toward government. The political impact of industrialization resulted in growing relationships between social organizations and political parties that influenced their policies.

The development of linkages between economic actors created the basis for political interaction that would build the modern state. By analysing three events in the inter-war period the next chapter will demonstrate the way the institutions of the Norwegian state interacted with the key components and social organizations of the industrialization process. These interactions, the political conflicts that occurred, and their outcomes shaped the modern institutions of the Norwegian state. The entry point for this analysis is the final years of the nineteenth century. 1895 to 1905 became the

period in which Norwegian nationalism was realized in the modern political form of a nation state. Upon independence, the state became further exposed to the inflow of capital investment and the shock of rapid economic growth and change. This harkened a rise in economic nationalism among political leaders who believed the Norwegian state was ill-prepared to manage a new industrial economy. Such nationalism was politically expressed through the Concession Laws that attempted to regulate and manage the rapid influx of foreign investment into industry. The second period of state - society interaction under consideration is the banking crisis of the 1920s. The economic problems experienced after WWI led to major financial problems for industry and consequently changes in the role and functions of the Norges Bank. The collapse of many private banks led to a state response in the form of greater administration and control of the financial sector to support industry demand for credit. During the banking crisis, the Norges Bank expanded its role dramatically, becoming a modern central bank charged with managing the industrial economy. Continued growth of the Norwegian economy was threatened by the labour unrest of the 1920s and 1930s, the final period of state - society interactive analysis. As the Great Depression worsened, labour unions, business groups and the state came into conflict. The state attempted on several occasions to arbitrate between unions and business groups, finally imposing in 1935 an agreed framework for all labour negotiations. These three periods all witnessed a significant growth of state regulation and management over the key components of the industrial economy which became institutionalized.

By the mid 1930s, Norway was able to recover quicker than other European states from the Great Depression through a Keynesian influenced set of demand led reforms. The ability for the Norwegian state to manage and regulate the industrial economy to recovery demonstrates the significance of the developments that took place in the preceding decades.

CHAPTER FOUR

The Development of the Modern Norwegian State

INTRODUCTION

The period from independence up until the outbreak of WWII saw rapid economic change. The process of industrialization was shaped by foreign investment and the formation of new social organizations. New and altered organizations emerged, changed by the economic process. The preceding chapter analyzed the modern Norwegian state as an arena populated by social organizations. This chapter will examine how institutions of the Norwegian state interacted with social organizations and with the industrialization process more generally. The analysis will centre upon the Concession Laws, the banking crisis following WWI, and the industrial unrest of the 1920s and 1930s. All three episodes posed a major challenge to continued industrial development in that key sectors of the economy were affected or even threatened. During each episode the state enhanced its capacity to intervene in the industrialization process through formalized regulation and management. State institutions were developed to manage industrialization and negotiate issues with the key organizations identified in Chapter Three. The development of state institutions was also driven by the desire on the part of political and bureaucratic leaders to manage and shape the new economic landscape through intervention. As a consequence of this dynamic, the industrialization process was shaped by the actions of state institutions. The chapter will conclude with an analysis of the changes wrought by industrialization upon the state of Norway. To provide a context for this chapter, the process by which Norway gained independence will be first discussed to understand the pre-industrial state at the end of the nineteenth century.

INDEPENDENCE AND THE CONCESSION LAWS

At the end of the nineteenth century Norwegian state institutions were small in size and limited in their capacity to influence society and the economy. A parliament, along with a central bank, judicial and policing system and small statistical collection agencies existed.¹ Importantly, Norway had enjoyed great political stability provided by its Constitution of 1814, a document modelled upon the US and French equivalents.² Parliamentaryism was established in 1884, substantially reducing the power of the entrenched conservative bureaucracy and handing greater political power to elected politicians. Norway began in this period to develop a genuine national culture, a set of values that were typically constructed and artificial, yet became also, the topic of fierce national debate.³ The debates over these expressions of nationalism were played out over language and the issue of how the Norwegian language was to be taught in schools.⁴ Yet in such nationalism being reflected politically, Norway had a problem. Despite being mostly self-governed, it was still - as it had been since 1814 - under the official rule of the king of Sweden. Denmark, the previous colonial power, relinquished Norway in the aftermath of the Napoleonic wars and Norway was Sweden's prize in return for support of Great Britain and Russia.⁵ The period of Swedish control could hardly be described as colonialist in the conventional sense of economic exploitation and control. At its end, the union was marked by indifference

¹ A useful description of the Norwegian system is found in Royal Institute of International Affairs. *The Scandinavian States and Finland : A Political and Economic Survey*, pp.180-88.

² See Kåre Tonnesson, 'The Norwegian Constitution of 17 May 1814- International Influences and Models', *Parliaments, Estates & Representation*, 21, 2001, 175-186.

³ Anne-Lise Seip, 'Nation-Building within the Union: Politics, Class and Culture in the Norwegian Nation-State in the Nineteenth Century', *Scandinavian Journal of History*, 20, 1994. 35-50.

⁴ The language issue and other aspects of cultural identity were partisan issues in the late nineteenth century and increasingly this debate occurred in the public realm of parliament. Under the period of Danish rule until 1814, the Norwegian bureaucratic elite, having mostly been educated in Denmark, spoke a version of Norwegian closely associated with their colonial masters (*bokmal*). Much of the peasant population spoke the more colloquial folk language known as old norsk. See Royal Institute of International Affairs, *The Scandinavian States and Finland : A Political and Economic Survey*, pp.178-80. Indigenous literature also gained in popularity a great deal in this pre-independence period. See Oscar Julius Falnes, *National Romanticism in Norway*, AMS Press, New York, 1968; Kjell Haugland, 'An Outline of Norwegian Cultural Nationalism in the Second Half of the Nineteenth Century', in R. Mitchison (ed.), *The Roots of Nationalism: Studies in Northern Europe*, John Donald Publishers, Edinburgh, 1980. For studies that examine changes in Norwegian society associated with the national revival see Sivert Langholm, 'The New Nationalism and the New Universities-the Case of Norway in the Early Nineteenth Century', *Scandinavian Journal of History* 20:1, 1995, 35-50; Alf Kaartvedt, 'The Economic Basis of Norwegian Nationalism in the Nineteenth Century' in R. Mitchison, *The Roots of Nationalism: Studies in Northern Europe*.

⁵ For a history of the role of Great Britain in the union see Colin Lucas, 'Great Britain and the Union of Norway and Sweden' *Scandinavian Journal of History*, 15:4, 1990, 269-278.

because of the lack of genuine economic and political ties rather than any great hostility or antagonism.

THE LEAD UP TO INDEPENDENCE

Despite the emergence of a national identity, Norway lacked sovereign independence to complement it.⁶ Murmurings emerged in the 1880s in support of the step toward Norwegian emancipation. The relationship had little to maintain it beyond Norway providing a useful security bulwark for Sweden's western border. As Sweden industrialized, the mostly agricultural Norwegian economy did not follow suit, weakening the already tenuous economic ties.⁷ As Norway already had many of the features of an independent state, the union was also not overly binding. Agitation against the union began to publicly emerge in Norwegian political circles in the 1880s.⁸ Norwegian political and educated elites in the civil service remained more aligned with Danish ways than Swedish, reflecting the language similarities and the influence of the previous colonial power. If enough Norwegians, particularly those in government and the bureaucracy objected to remaining under the Swedish crown, there was little the Swedes could do to prevent a breakaway.

Finding the leverage for independence had to be carefully sought. As Norway had been mostly self-ruled since parliamentarianism was established there were few explicit signs to remind Norwegians of Swedish rule. Yet many political leaders felt independence to be worth pursuing, even when conflict between the two nations was a possibility. The charismatic Johan Sverdrup, the first Prime Minister appointed after 1884, pushed for a peaceful breakaway and was supported by his *Venstre* Party where support for independence was support. The Prime Ministers of the next decade from both the Liberal and Conservative parties all pursued a delicate path between seeking independence and placating Sweden. A step forward took place in 1884 when the

⁶ See Iver B. Neumann, 'State and Nation in the Nineteenth Century: Recent Research on the Norwegian Case' *Scandinavian Journal of History*, 25:3, 2000, 239-260, pp.254-5.

⁷ Hodne. *An Economic History of Norway 1815-1970*, pp.254-5. The lack of integration also led to the view that Norway had a dualist economy, with a services sector (shipping) well integrated into the European economy whilst other economic sectors remained isolated from trade. See Hodne. "Growth in a Dual Economy- the Norwegian Experience 1814-1914." See also Suzanne Berger and Michael J. Piore, *Dualism and Discontinuity in Industrial Societies*, Cambridge University Press, Cambridge, 1980.

⁸ See Derry. *A History of Modern Norway 1814-1972*, chapter five for the most thorough English language discussion of the independence process.

Swedish king was no longer able to appoint the Norwegian cabinet; his role shifted to rubber stamping *Storting* decisions. To press for independence, the *Venstre* members of the *Storting* began to call for full Norwegian consular representation overseas to support the shipping industry. This had practical implications as well as symbolic, for the Norwegian merchant marine would enjoy its own representatives when trading in Europe.⁹ Adding to the pressure was the desire to allow Norwegian vessels to sail under their own flag, as well as an equal role with Sweden in the making of foreign policy. The issue became prominent as two leading members of the *Venstre* party, in Christian Michelson and Gunnar Knudsen, as major shipowners, had considerable personal interests in any such decision.¹⁰ These emerging industrial interests were most concentrated among the *Venstre* party; on the issue of independence, their economic power was beginning to shape the political agenda.

As T.K. Derry argues, independence offered economic disadvantages.¹¹ Sweden was industrializing and the benefits for Norway in maintaining the Union were great, particularly the considerable savings on defence as well as economic opportunities in trade. But a popular desire for Norwegian national independence overcame these disadvantages. Negotiations between Sweden and Norway over the status of consular officials commenced and continued for months in 1903-4. Offers were exchanged, and in 1904 the matter reached a head when the Swedish Prime Minister E.G. Boström made a modified proposal to maintain the union that the coalition Norwegian Government refused to accept. With an impasse reached, the *Storting* dissolved itself in protest.

Public opinion was vocal in its support of a breakaway, supported by newspapers carrying letters and editorials expressing support. Committees of politicians and people from the growing middle classes of Oslo made frequent declarations in favour of independence.¹² With the wind in their sails, the Norwegian Government reformed and led by new Prime Minister Christian Michelson, several opportunistic political

⁹ Ibid., p.148.

¹⁰ Lindgren. *Norway-Sweden: Union, Disunion and Scandinavian Integration*, p.74.

¹¹ Derry. *A History of Modern Norway 1814-1972*, p.136.

¹² See Lindgren. *Norway-Sweden: Union, Disunion and Scandinavian Integration*, pp.80-9

leaders took a more belligerent stance with Sweden.¹³ A plebiscite in August 1905 returned almost 100 per cent support for independence; only 182 votes nation wide favoured maintaining the Union.¹⁴ Despite the victory, the Norwegian Government was not well placed in the restarted negotiations with Sweden. But upon agreement to dismantle the few military emplacements remaining on the border, Sweden accepted and the dissolution was negotiated in a peaceful fashion.¹⁵

THE PRE-INDUSTRIAL NORWEGIAN STATE

Norway, after a process lasting a decade, was finally an independent state. Key state institutions of rule were already established and the country was now free of external control. But the state's capacity to manage and regulate economic resources was very limited. In pre-industrial Norway, the size of the civil service and the strength of state institutions over society were considerably less than prior to the outbreak of WWII. Most importantly, the Norwegian state lacked the ability to manage capital and labour; key components of a modern economy. To provide the basis for analysing the development of the inter-war period this section considers the Norwegian state at independence.

The Norwegian state at independence had enjoyed stability since 1814 under the one constitution. A liberal economic system had been maintained through the nineteenth century that kept the state at a distance from the economy.¹⁶ A feature of this system was the lack of banking regulation. The Norges Bank issued currency but was not able to support or regulate the private banking sector. The state had no institutions to monitor or control capital flows, either within Norway or from foreign sources.

¹³ The lack of support by the major powers of Europe proved to be little barrier to the Norwegians. To support the cause the Arctic explorer and national hero Fridtjof Nansen published a book in Great Britain advocating separation and acted as an informal ambassador for the cause of independence. See Fridtjof Nansen, *Norway and the Union with Sweden*, Macmillan, London, 1905.

¹⁴ Lindgren. *Norway-Sweden: Union, Disunion and Scandinavian Integration*, p.179.

¹⁵ The sole remaining issue was to be sorted also by a popular vote; the decision to become a republic or adopt a monarchy. With a monarchy regarded as the preferred choice by the public if not the *Storting*, a Danish crown prince with apparent lineage to pre-modern Norwegian monarchs accepted the offer and arrived in Oslo to much fanfare in November 1905, taking the name Haakon VII. Haakon VII was previously known as Prince Carl, the second son of Frederick VIII of Denmark.

¹⁶ See Derry. *A History of Modern Norway 1814-1972*, Chapter four. See also Iver B. Neumann, 'State and Nation in the Nineteenth Century: Recent Research on the Norwegian Case'.

Industrial relations were not regulated by the state; with wages and conditions a matter for employers to negotiate with their staff individually. As discussed, the emergence of industry led to a major increase in foreign and domestic investment and borrowing and a subsequent increase in wage negotiations between employers and organized labour. Economic growth expanded the cash economy and the movement of money. These changes had a profound impact on social organization; particularly political parties that were influenced by the new groups emerging. These were the major developments of the industrializing economy, yet in 1905 the Norwegian state had no institutions or mechanisms to regulate, manage or oversee these activities.

State receipts from income taxes increased over thirty-fold from 1905 to 1935 - by far the largest increase of state revenue.¹⁷ Total state spending in 1904-05 totalled 97 million kroner; doubling the pre-independence spending of 1890. By 1920-21, spending increased to some Kr745 million.¹⁸ This may be contrasted with the increase in receipts in customs, excises and duties that while also growing over the period in question, did so only around seven-fold.¹⁹ The growth demonstrates the limited ability for the state in 1905 to collect income tax. Agriculture and small scale trades did not create the cash exchange economy that could permit the state to generate income. Yet what the also exemplified the Norwegian state at the time of independence was a very limited ability to manage and regulate economic activity in ways other than just claiming taxation revenue.

Karen Larsen argues that independence led to the Norwegian state orientating toward particular political goals.²⁰ By obtaining independence, the Norwegian Government was able to respond to the major issues and problems of the period, namely the dramatic influx of foreign capital and its role in the growth of the industrial economy. The Concession Laws that followed independence were the first instance of the Norwegian state intervening in the economy in a major way by attempting to control and regulate the influx of foreign capital investment. This development marked the

¹⁷ Statistik Sentralbyrå, *Øversikter*. p.415.

¹⁸ Ibid. p.414. Do note that the figures of state spending over the period in question are slightly problematic. From 1914, the Central Bureau of Statistics included all spending and receipts whether they were formally included on the government's budget or not.

¹⁹ Ibid. p.415

²⁰ Karen Larsen, *A History of Norway*, Princeton University Press for the American-Scandinavian Foundation, Princeton, 1948, p.496.

end of the liberal state tradition in Norway. The following section will analyze how foreign investment - a key component of an industrial economy in a small state - shaped the development of modern state institutions, particularly the *Storting* as an institution of decision making over foreign investment flows and later, dedicated parts of the bureaucracy.

THE STATE RESPONSE TO FOREIGN INVESTMENT: THE CONCESSION LAWS

The introduction of hydro-electric power to remote regions opened up the countryside and brought communications and transport to outlying areas.²¹ The hydroelectric schemes which introduced affordable electricity generated an exciting atmosphere of change. Towns in the far north became lit by electric lighting during winter. In the first years of independence, the defining political issue came to be between foreign capital investment and the emerging set of national interests that now had a sovereign state to express them. Political conflict directly led to the first major development of Norwegian state institutions post-independence and a new regulatory relationship between the state and a component of the industrialization process.

In 1905 Norway lacked a modern commercial banking system, and in the early years of independence, had yet to build up capital reserves that could be invested in large-scale industrial projects. Norsk Hydro's founder Sam Eyde first sought capital from banks in France, Germany and Sweden. After securing a loan from German lenders in 1906, Eyde approached contacts in the Norwegian Government and offered to accept the existing concessions and the future sale of his power plant to the state in exchange for permission to construct a railway and powerlines from the Rjukan and Vamma waterfalls. Negotiations over the unusual offer proved fruitful and the Government accepted the deal, even though Eyde was bankrolled by mostly French and German capital.²² This sudden influx of investment was not the first intrusion of foreign interests into Norway. British concerns had previous involvement in the forestry sector, and the few commercial mining projects in Norway were usually foreign financed; capital shortages in Norway prevented the purchase of expensive equipment

²¹ See Hodne, *An Economic History of Norway 1815-1970*, pp.208-222. for a good discussion of the public and private railway construction of the late nineteenth century.

²² Lieberman. *The Industrialization of Norway, 1800-1920*, pp.136-7.

in the costly start up process. Norway had maintained a weak regime of foreign ownership controls in the nineteenth century under the liberal system: it was however rarely enforced, usually because it was of minor concern and thus not much of a public issue. But Norsk Hydro's investment, and effective control of Norway's biggest and most famous river - the Glomma - granted the affair national prominence.

The presence of continental European financial interests raised concerns locally.²³ Independence had just been achieved, yet it seemed that foreign control was again growing, even after a foreign king had departed the scene.²⁴ Many Norwegian waterfalls and their surrounds were purchased, either for immediate development or for a later date when exploitation became feasible. Industrialization introduced a large influx of foreign capital leading to concerns that many valuable natural assets were slipping out of public control. The left-wing politician Johan Castburg blew the whistle on the deal made between Eyde's Norsk Hydro and the Government, then led by Michelsen. Castburg demanded in the *Storting*: 'what does the Government intend to do to prevent more of the waterpower of our country from falling into the hands of foreigners?'²⁵ With Castburg and the left gaining support from conservative nationalist politicians, an emergency provision law was passed in April 1906 that required government permission for the purchase of waterfalls by foreign interests.²⁶ Later that year, the law was extended to forests and mines.²⁷ Beginning a three year period of debate in the *Storting*, the laws were finalised and passed in late 1909. In doing so, the capacity of Parliament, to make day to day decisions on regulating foreign investment was greatly expanded.

The restrictions the Concession Laws placed upon foreign capital were severe. The Norwegian state reserved the right to confiscate title to waterfalls, forests and mines and any installed equipment without compensation after a period of sixty to eighty years.²⁸ The laws, motivated by a fear of foreign dominance over waterfalls, were

²³ Even Lange, 'The Concession Laws of 1906-09 and Norwegian Industrial Development', *Scandinavian Journal of History* 2, 1977, pp.311-330, p.312.

²⁴ Hodne, *An Economic History of Norway 1815-1970*, p.312.

²⁵ Larsen, *A History of Norway*, p.501.

²⁶ Lieberman, *The Industrialization of Norway, 1800-1920*, p.137

²⁷ Lange, 'The Concession Laws of 1906-09 and Norwegian Industrial Development', p.312.

²⁸ *Ibid.*, p.312.

opposed by local business interests as well as foreign companies seeking to invest.²⁹ There was recognition at the time that Norway's industrial growth was dependent upon foreign capital; to scare it away would only retard growth. The Concession Laws, it was argued, by barring foreign investment set back industrial growth in Norway considerably. Wilhelm Keilhau, a leading Norwegian economist and historian of the inter-war period was a fierce critic of the legislation for hindering investment and extending control of the state. Keilhau remarked '...the fear of domination by foreign capital led the radical parties to pursue an industrial policy that was inimical to economic progress'.³⁰ Keilhau was unable to amass much evidence in support for his claim, whilst the Government, now controlled by the left leaning *Venstre* Party, were motivated by socialist ideas of state control over the economy as well as attempting to manage the industrialization process.³¹ The Concession Laws marked the end of the liberal economic tradition in Norwegian politics, heralding a new era of state intervention in the economy.³² This development was critical in shaping the modern state. Control over foreign investment was now embedded in the *Storting* and subject to the control of the Government of the day.

THE CONCESSION LAWS: HOW THE STATE BEGAN TO REGULATE FOREIGN INVESTMENT

The Concession Laws were disruptive to businesses that previously had enjoyed relatively stable or non-existent regulation, as the institutions of the state were mostly concerned with the gaining and securing of independence. But after 1905, attention became directed toward the growing industrial economy, and Parliament came to act. Leading the charge was Prime Minister Michelson of the *Venstre* party, who despite his previous career as a shipping magnate, was vocal in his support for the new laws and had a leading role in their construction.³³ With Norwegian national interests seemingly at stake, public support was widespread for such legislation.³⁴ This support was led by parliamentary members of the *Venstre* Party, and its support base of urban dwellers in

²⁹ Lange has a fine discussion of the opposition to the laws. See *Ibid.*, pp.312-15.

³⁰ Quoted in *Ibid.*, p.313. Keilau's views were given considerable hearing at the time, given his frequent columns in the prominent Oslo daily newspaper *Aftenposten*.

³¹ Hodne, *An Economic History of Norway 1815-1970*, p.313.

³² *Ibid.*, pp.315-17

³³ Larsen, *A History of Norway*, pp.501-2.

³⁴ *Ibid.*, p.502.

and around Oslo. It was these groups that had begun to gain the ascendancy in Norwegian politics and the socialist ideas of state control over the economy began to influence Government policy. The Norwegian state, faced with rapid industrialization and the controversies it created, responded by attempting to manage and control investment in ways that often defied entrenched economic interests.

Pushing for state intervention the most was Castburg, the radical member of the *Venstre* Party. Castburg, whilst not a card carrying socialist, had clear ideas of how the new industrial economy was to be managed and considerable state control was to be a major part of it. His popularity had grown after he had called the government to account on its deal with Sam Eyde. After writing the Concession Laws with Prime Minister Gunnar Knudsen in 1909, Castburg wrote:

The state is the strong arm of society that can be made to do justice, to protect the weak, to create equal terms as far as possible for the strong and the weak in their efforts to improve their standing. It is this arm that should be made to modify the cruel law of nature by which the strong rules over the weak, the strong tramples over the weak and the strong does not suffer the weak to exist. It is precisely the state...that can prevent this principle from being made the rule in our society.³⁵

Castburg's motivations were clear: the Concession Laws were to be a part of a new state framework of regulations and control intended to ensure Norway remained egalitarian in practice as well as spirit. Industrialization and its impact had to be managed by the state. Prime Minister Michelson in 1906 did not share the same vision; his emergency laws were also designed to maintain public support amid a political climate of national protectionism.³⁶ Michelsen also recognised that his support was waning after several years of popularity as the statesman who had led the independence process.³⁷ But both Michelsen and Castburg, and the subsequent Prime Ministers that continued the process, also shared similar aims in implementing the Concession Laws. Managing ownership of Norway's greatest assets was key to

³⁵ Johan Castburg, 1909, quoted in Hodne. *An Economic History of Norway 1815-1970*, p.315.

³⁶ Lange, 'The Concession Laws of 1906-09 and Norwegian Industrial Development', p.315-16.

³⁷ Michelsen lost the position of Prime Minister in 1907, and the coalition he had maintained over the independence period began to break down. The *Venstre* leader Gunnar Knudsen took power in 1908.

ensuring the new industrial economy served public interests and not just generate profits for a few, especially foreign interests.³⁸ Bringing control of investment to the *Storting* also reflected the democratic ideals of the period; that industrialization's impact had to be regulated by an elected body. These views were most strongly held by members of the *Venstre* Party, the party that had gained the most support in the first years of industrialization from middle class business interests.

Controlling the sale of waterfalls and other resources was an attempt to regulate rather than directly control industrialization.³⁹ At a glance, the Concession Laws seem an orthodox response by a developing country to expand the state by intervening in its most profitable economic sectors. The implementation of the Concession Laws is important; whilst interventionist, they did not discourage investment, but brought foreign and domestic capital under state surveillance and regulation. The laws were to ensure the political aims of the Government in preventing a foreign company from dominating the industrial economy. The purchase of waterfalls tended to be mostly straightforward for local companies, and this process was not usually hindered either if foreign capital was paying a majority of the bills.⁴⁰

Whilst the Concession Laws may, in instances, have scared off some foreign capital, there is little evidence to prove this as a general trend.⁴¹ Historians of the period have come to argue that charging concessions to industry did not slow down investment, either foreign or domestic in the lead up to WWI.⁴² The period from 1906 until the outbreak of WWI witnessed the greatest inflow of foreign investment, particularly in the sectors that fell under the shadow of the new laws. National statistics demonstrate that foreign investment, as a percentage of total capital stock in Norway, reached a height of 38.8 per cent in 1909, when the Concession Laws were formalised.⁴³ State regulation did not, contrary to classical economic theory and Keilhau's misgivings, hinder foreign investment.

³⁸ Larsen, *A History of Norway*, p.501.

³⁹ Lange, 'The Concession Laws of 1906-09 and Norwegian Industrial Development', p.315.

⁴⁰ *Ibid.*, p.326.

⁴¹ This is the general conclusion of Lange in *Ibid.*, p.328.

⁴² Stonehill, *Foreign Ownership in Norwegian Enterprises*, pp.43-44. Hodne also shares this view, see Hodne, *An Economic History of Norway 1815-1970*, pp.313-17.

⁴³ Stonehill, *Foreign Ownership in Norwegian Enterprises*, p.44.

Thus, the nascent Norwegian state extended its arm considerably into the growing industrial economy; mostly however it was in benign fashion, permitting flexibility in controlling foreign capital to continue to encourage growth.⁴⁴ The result of the capital influx was the development of a modern state negotiating mechanism over foreign capital located in the *Storting*. Loopholes and ways of avoiding state interference also abounded and were often exploited by local companies when inviting foreign capital in.⁴⁵

In December 1917, the first official and formalised Concession Act was passed in the *Storting*, later amended in 1924.⁴⁶ In a process of institutional development that shifted regulatory power from the *Storting* to the bureaucracy, the Ministry of Industry became responsible for enforcing the laws. The law controlled foreign and Norwegian companies with greater than twenty per cent foreign capital stock.⁴⁷ Companies that sought to own property such as waterfalls and mines were required to follow guidelines that Norwegian management, labour and resources were given preference, as well as requiring fees be paid to the state. In 1921, the Government established a new institution, the Norwegian River and Electricity Board (NVE), tasked to formally manage the new hydroelectric sector. Its responsibilities included planning and surveying, as well as developing national hydroelectric infrastructure that came to be an entirely state controlled sector from the 1920s onward.⁴⁸ The Ministry of Commerce also began to regulate the activities of foreign companies, especially those involved in trade, requiring that newly established branch offices had majority Norwegian control.⁴⁹ These developments were led by the Norwegian Government (of both the *Venstre* and *Høyre* Parties) and bureaucratic leaders that sought to manage and regulate industrialization. Ensuring Norwegian control was maintained by establishing a

⁴⁴ Lange, 'The Concession Laws of 1906-09 and Norwegian Industrial Development', p.326.

⁴⁵ Rolf Harald Stensland, 'Erverv Og Konsesjon', *Historisk Tidsskrift*, 76:1, 1997, 50-56, discusses how one such mining company, A/S Bjørkaasen Gruber transferred ownership to Swedish financiers in to avoid penalties under the Concession Act of 1917 of share sales to overseas interests.

⁴⁶ The Concession Laws became the centrepiece of the Norwegian state's new regulations in the early years of independence. Around the Concession Laws a regulatory regime developed as a response to the problems and issues created by industrialization. In the years following independence, the Norwegian Government set up a regulatory framework which was among the most ambitious and detailed in the world at the time. The expansion of laws and controls occurred in parallel with industrialization, not as a follow up or a belated response to the worst social excesses of mechanized production.

⁴⁷ Stonehill, *Foreign Ownership in Norwegian Enterprises*, pp.28-9.

⁴⁸ Hodne, *An Economic History of Norway 1815-1970*, pp.314-15.

⁴⁹ Stonehill, *Foreign Ownership in Norwegian Enterprises*, p.30.

formalised bureaucratic regulatory regime that monitored investment activity in Norway.

Industrialization and the controversy over foreign investment created the circumstances for the state to expand regulation over the economy through the Concession Laws. Such development generated a social response, reflected in the desire by the social organizations discussed in the previous chapter to negotiate with the state as Norsk Hydro's follow-up discussions over development of industrial infrastructure demonstrates.⁵⁰ Foreign investment was flowing into Norway, and a political structure was emerging that sought to promote the interests of business and investment and the welfare of the citizenry and nationalistic sentiment together.⁵¹

Foreign investment in world systems accounts of the state is assumed to constrain or dominate government policy making. Yet the Norwegian experience of foreign capital investment in the industrial sector in the early twentieth century requires a modified assessment. The Concession Laws and the refinements they underwent were an attempt by the Norwegian state to manage the process of foreign ownership and investment leading to the construction of a new bureaucratic state institution, the NVE and changes to the Ministries of Industry and Commerce. Regulatory power, first vested in the *Storting*, became the province of specialised institutions. The Concession Laws required that the civil service control business activity in accordance with the new regime. Independence generated a wave of national pride, and this momentum had continued to be expressed by the development of regulatory capacity by the state over ownership of key industrial assets. Foreign investment was permitted and even encouraged, but it had to be controlled: independence politically could not be sustained if economic independence was jeopardized. Norwegian industrialization required foreign investment in its formative years. Yet by investing, capital flows directly contributed to a process of modern state institutional development that regulated investment. By the early 1920s, the state was developing the means to manage foreign capital. The next step in its modern development was the regulation and management of the domestic financial sector.

⁵⁰ Businessmen were, following the Concession Laws, forced by law to purchase concessions. Forestry and mining interests, as well as hydroelectric companies were required to purchase and therefore negotiate licences.

⁵¹ Hodne, *The Norwegian Economy, 1920-1980*, p.8.

THE ECONOMIC AFTERMATH OF WWI AND THE BANKING CRISIS

The finance and banking sector is a critical component of an industrial economy providing investment for labour, resources and equipment.⁵² The banking crisis that struck Norway in the 1920s became a serious threat to Norway's new industrial economy. The following section will analyze the banking crisis of the 1920s; its origins, impact, and the state regulatory response that led to a state organized and managed banking system.

The Great War of 1914-18 contributed to a series of economic problems that caused the collapse of the banking sector in the 1920s.⁵³ The crisis was a result of several factors that exposed the Norwegian economy to global economic problems. First, Norway remained dependent upon trade for many of the basics of modern living and trade was threatened by the war. With no indigenous source of coal and a need to import grain, stockpiling of food and fuel was essential, and a state ban on the export of foodstuffs began in 1914.⁵⁴ Second was the legal status and position of the Norwegian merchant fleet. Even as a neutral country, the conduct of merchant shipping became difficult, and by 1917 proved extremely dangerous when the German Navy began to attack Norwegian shipping.⁵⁵ In the new context of modern naval warfare, Norway could not stay isolated, and her proximity to the naval theatre made her a participant in the conflict, whether desired or not.⁵⁶ The need to implement a regime of rationing led to

⁵² See for example the essays in Rondo E. Cameron, Olga Crisp, Hugh T. Patrick and Richard Tilly, *Banking in the Early Stages of Industrialization : A Study in Comparative Economic History*, Oxford University Press, New York, 1967; Rondo E. Cameron (ed.), *Banking and Economic Development : Some Lessons of History*, Oxford University Press, New York, 1972.

⁵³ Sverre Knutsen, 'From Expansion to Panic and Crash: The Norwegian Banking System and Its Customers 1913-1924', *The Scandinavian Economic History Review*, 39:3, 1991, 20-40, p.34.

⁵⁴ Olav Riste, *The Neutral Ally*, Universitetsforlaget, Oslo, 1965, p.41.

⁵⁵ WWI threw much of the European shipping industry into jeopardy. After several very profitable years, the merchant fleet in Norway, and those of other seafaring nations, were unsure of their position in the context of a major European conflict. Whilst the Norwegian government adopted a neutral stance, how this would affect trade was unclear. There were few international laws established to govern such matters, as few international conflicts until now had presented a genuine threat to merchant sailing. However with the two major protagonists vying to control the passage of the seas, neutrality would not necessarily offer sanctity from harm. Essentially, Norway as a minor player was not in a position to make any rules. Prior to the outbreak of conflict there were guidelines as to what cargo was regarded as contraband, establishing whether a merchant ship was a legitimate target. But definitions of contraband changed so frequently that it was rarely certain as to the legality of a particular cargo. In the concluding stages of the war, Great Britain considered almost all cargo destined for Germany, including food and clothing, as contraband and therefore subject to boarding and confiscation.

⁵⁶ Throughout the four years of the Great War, Norwegian neutrality had to be constantly negotiated. Agreements with one of the major powers were torn up if the other side responded with a counter offer or with force. It has to be stressed that Norway, despite having a large and key maritime sector, was a bit

some novel policies. Restaurants were prohibited from serving more than three courses for a fixed menu and later, meat could not be served for two days of the week.⁵⁷

The state bureaucracy grew in 1917-18, as the need to increasingly regulate and negotiate with business groups became a central state function. The state's budget allocation to industry, commerce and shipping management increased ten fold between 1913 and 1920.⁵⁸ But as Keilhau points out, Norway, by implementing controls was not motivated by militarism or the fear of military threats.⁵⁹ As a neutral state, Norway's state expansion process was directed at supporting the key aspects of the Norwegian economy, both domestic and the maritime sector.⁶⁰ Thomas Wyller argues that the new roles taken on by the state were motivated not by the security requirements of the war, but for economic reasons that predated the war.⁶¹ There is continuity with pre-1914 state expansion; WWI was rather a backdrop that provided some opportunities to justify many of the new state roles in economic intervention such as price controls.⁶²

Except for the major ship losses, Norway was physically untouched by the Great War and its major economic sectors emerged undisrupted. Further, the expansion of state agencies in the period contributed to an enlarged public infrastructure sector. The exploitation of Norwegian resources had previously been held back by poor infrastructure: only by the late nineteenth and early twentieth centuries did railways and roads began to penetrate the Norwegian hinterland. Private companies took on a share of construction; the opening of mines and the new electricity dependent industries, often remotely located, necessitated transport and energy infrastructure, often paid for with foreign investment.⁶³ The foreign income earned by the shipping

player in the conflict and was rarely able to negotiate trade deals on purely its own terms. Yet the necessity of constant negotiation to maintain trade routes was instrumental in developing the capacity to deal with the outside world. Previous to the War, foreign policy had mostly concerned Scandinavian countries, particularly Sweden.

⁵⁷ Keilhau, *Norway in World History*, p.379.

⁵⁸ Statistik Sentralbyrå, *Oversikter*, p.410.

⁵⁹ Keilhau, *Norway in World History*, p.384.

⁶⁰ Hodne, *The Norwegian Economy, 1920-1980*, p.14.

⁶¹ Thomas Chr. Wyller, 'Utvidelsen Av Statens Myndighetsområde I Norge under Første Verdenskrig' *Historisk Tidsskrift*, 39:4, 1959, 321-337.

⁶² *Ibid.*, pp.332-37.

⁶³ For a discussion of the growth of railways and infrastructure see Hodne, *An Economic History of Norway 1815-1970*, pp.208-28.

sector and formative industries transformed Norway's pre-war public debt into a considerable surplus by 1918. But government policy and management of the new economy was yet to adjust to the new economic landscape and the rapid growth was short-lived. Many of the government war controls such as price controls and import duties were mishandled, improperly maintained and in 1918, hastily abolished. As a result, imports soon overtook export earnings, sending the national ledger back into debt, rapidly draining Norway of its foreign currency reserves and leading to the banking crisis of the 1920s.⁶⁴ The banking system, due to the crisis, became a new place of interaction between the regulatory role of the state and components of industrial development.

THE BANKING CRISIS

Norway's banking system had some unique features that set it apart from other European states of the period. By 1918 many small commercial banks were tied to their local economies. But there were virtually no branch banks and the many small savings banks were the main domestic lenders to business.⁶⁵ The first commercial banks began to only slowly grow in the 1850s, but such institutions remained small well into the twentieth century.⁶⁶ As discussed, heavy foreign investment in industry and mining made up for the shortage of local capital. But by the early 1920s, local capital was beginning to accumulate, lessening the necessity of foreign investment capital.⁶⁷ Yet as demand for local capital grew prior to WWI and banks expanded to provide credit there was almost no state regulation of banks and the financial sector more generally. Except for the Savings Bank Act of 1887, there were no laws, regulations or state authorities supervising or even monitoring banking activities.⁶⁸ Norway had a central bank (Norges Bank), but its functions were limited by its small

⁶⁴ Hodne, *The Norwegian Economy, 1920-1980*, pp. 13-14.

⁶⁵ Nordvik, 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective', pp.434-48.

⁶⁶ Egge, 'Transformation of Bank Structures in the Industrial Period: The Case of Norway 1830-1914', p.276.

⁶⁷ Where academic disputes arise is whether the lack of a commercial banking sector acted as a break on industrialization in Norway. Åsmund Egge argues that the Norwegian banking sector was backward in size and structure compared to the other Scandinavian states. This view is disputed however by the work of Helg Nordvik who claims that the slow development of commercial banking was rather a reflection of low demand. See Nordvik, 'The Banking System, Industrialization and Economic Growth in Norway 1850-1914' See also With Anderson, 'Producing Producers: Shippers, Shipyards and the Cooperative Infrastructure of the Norwegian Maritime Complex since 1850'.

⁶⁸ Nordvik, 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective', p.437.

size and the lack of professionalism of its directors and staff. A Norges Bank board member is alleged to have remarked in 1835 that he might as well be the emperor of Morocco for all he knew about being a central bank director.⁶⁹ The Norges Bank had even, up until 1897, been based in Trondheim and not the capital Oslo.⁷⁰ The justification for this location was to prevent Government tampering with the money supply.⁷¹ The Norwegian financial sector, until the banking crisis of the 1920s, lacked modern organization and regulation and was poorly equipped to provide reliable credit to growing industries.

The rapid inflation of the post war period contributed to high bank debts. The WWI boom flooded Norwegian banks with capital, which then made often unsecured loans. For industrialization to continue, secure lines of credit to business are essential. As the Norwegian banking system was fragmented and localised, it was not well positioned to support industrial development; foreign investment had filled the gap in the early years of the century. But by the 1920s, a crisis in the banking sector threatened the continuation of secure lines of credit to Norway's young industries in hydro-electricity, aluminium, chemicals and paper and pulp production. Such a threat to the industrial economy was both an economic and a political issue for business groups and unions. Thus, the linkages between banks, investment capital and these organizations became a concern of the Norwegian state as problems could jeopardise continued growth.

Some 129 banks were bankrupted during the period, many subsequently falling under public administration. A massive surge in imports - a 121 per cent rise in 1919 alone - put enormous pressure on the currency, particularly as it had not returned to the gold standard that was lifted in 1914.⁷² 1921 brought a surge in unemployment, several bank collapses and growing levels of private debt. At the same time, wages increased significantly.⁷³ The response to these compounding economic problems was a series of drastic actions by the Norges Bank. Led by its new governor Nicolai Rygg, who held the position from 1920 till 1947, the Norges Bank raised interest rates dramatically and

⁶⁹ Hodne, *An Economic History of Norway 1815-1970*, p.320.

⁷⁰ Ibid., p.321.

⁷¹ Ibid., p.321.

⁷² Karsten Gerdrup, *Three Episodes of Financial Fragility in Norway since the 1890s*, BIS Working Paper no. 142, Bank of International Settlements, 2003, p.18.

⁷³ Between 1915 and 1920, the annual average wage for men in rural areas rose from Kr.374 to Kr1233. Urban wages were higher, but the increase from Kr525 to Kr1482 was a similar percentage increase. Statistik Sentralbyrå, *Oversikter*, p.366.

withdrew circulating currency, all in an effort to deflate the krone. The measures were largely successful; the krone was restored to its former value, particularly as exports picked up again. Rygg was criticised at the time and even blamed for many of the banking woes.⁷⁴ But his perseverance in stabilizing the Norwegian economy eventually paid off and he gained increasing support of *Storting* members who recognised the need to increase state regulation of the financial sector, but lacked the expertise to do so themselves. As bank collapses began in the early 1920s the Bank Administration Act was initially passed only as a temporary measure. This Act was proposed by the Norges Bank itself and not the Government, permitting private banks in trouble to be taken under guarantee of the state. The wresting of regulatory control of the financial system by the Norges Bank from the *Storting* was a process beset with uncertainties, but marks a significant shift in the relationship between the Government and the bureaucracy. Rygg expressed concerns about bailing out poorly managed banks whilst successful banks saw capital depart to state protected banks for enhanced security.⁷⁵ Under the Bank Administration Act of 1923, the state took on a role as guarantor, allowing private banks under serious financial pressure to obtain state support by placing their deposits under public administration. The Administration Act was made permanent in 1925, lasting until 1928 when it was agreed that no more banks would be afforded state protection. The banking crisis was contributing to a key development of the modern state; that of a regulated and centrally managed financial system. Most significantly for the development of a modern state, the efforts of Rygg and the Norges Bank saw regulatory power pass from the *Storting*, to the bureaucracy which was deemed to have the expertise to manage such a complex system.

INTERVENTION BY THE NORGES BANK

The decisions made by the Norges Bank and its governor in the 1920s have been heavily debated in Norwegian literature; the dominant argument is that the deflation and depression of the early 1920s was an unfortunate necessity.⁷⁶ Rygg's long tenure and stubborn personality allowed him to make unpopular decisions throughout the

⁷⁴ Hodne, *The Norwegian Economy, 1920-1980*, p.35.

⁷⁵ Knutsen, 'From Expansion to Panic and Crash: The Norwegian Banking System and Its Customers 1913-1924', p.37.

⁷⁶ Nordvik is a proponent of this view. See Nordvik, 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective'.

decade: the decision to maintain a floating currency until the krone was pegged to the British pound in 1931 was debated considerably in the *Storting* and in the public realm.⁷⁷ Industrialization had changed the nature of the Norwegian economy, connecting industries with banks and lenders, requiring cooperation and the maintenance of linkages within industry. Central banking therefore required the maintenance of national financial stability, not only currency distribution and basic inflationary controls.⁷⁸ The Norges Bank now became an institution interested in currency stability to support the growing Norwegian economy.⁷⁹ This key area of modern state development was a consequence of the problems of the industrial economy, banking and its impact upon society.

The long period of Rygg's leadership contrasts with frequent changes of government throughout the 1920s. The short term and unstable governments of the 1920s led to conflict between the executive branch of the Norwegian state and the growing power of the banking bureaucracy. The eighteen day rule of the first Labour party controlled Government in 1928 ended when Rygg, in an effort to gain the support of politicians to bail out several major collapsing banks, approached the opposition leader Johan Mowinckel (*Venstre*) who subsequently massed enough votes in the *Storting* to overthrow the young Labour Government.⁸⁰ Rygg as head of the Norges Bank was a central figure, who, despite heavy criticism, was considered an authority and had great influence over Governments of the inter-war years: indeed as the Mowinckel overthrow demonstrated, he had the ability to influence a change of government.

The close management of banking became a day-to-day requirement in the industrialized economy, necessitating a state regulatory role. Industrialization had made the local banking sector fundamental to growth and the risk of future banking collapses to this were too great to be ignored by the state. By regulating and monitoring the commercial banking sector, the Norwegian state built the institutions to

⁷⁷ The Norwegian economist Wilhelm Keilhau, perhaps one of the foremost commentators of the period was a critic of Rygg, voicing his opinions as a newspaper columnist. See also Erlend Bjørtvedt and Christian Venneslan, 'The Gold Standard, Trade and Recovery in the 1930s: The Norwegian Case', *Scandinavian Economic History Review*, 47:2, 1999, 23-44, for a discussion of banking policies and the impact upon the recovery of the 1930s.

⁷⁸ Knutsen, 'From Expansion to Panic and Crash: The Norwegian Banking System and Its Customers 1913-1924', pp.57-8.

⁷⁹ Ibid., p.61.

⁸⁰ Derry, *A History of Modern Norway 1814-1972*, p.318.

prevent such crises from occurring in the future. The Government, following advice from the Norges Bank, established a new institution in August 1924 to monitor private banks. The Banking Inspectorate became tasked with supervising commercial and savings banking activity.⁸¹ Hundreds of bank inspections and audits followed in the late 1920s, with the Inspectorate developing cooperative relationships with commercial banks, the Norges Bank and Government. In addition, Nordvik argues that the state refinancing process enhanced the linkages between banks and industry as cooperation better served their respective interests.⁸² With a standardised set of financial data from the Banking Inspectorate, it became easier for the Norwegian bureaucracy to see what private banks were up to.⁸³ The new regulatory powers granted to the Norges Bank and its administrative arms by the Government demonstrate an important advance by the state into a previously private area of society. It also represents a shift from *Storting* and government power to a growth in administrative and regulatory power of the bureaucracy, an important development of the modern state.

The state regulation is an important development: when the private sector was unable to withstand financial pressures emanating from overseas, the state, via the Norges Bank, intervened and retained in a regulatory role after the crisis. Banks became limited in their exposure and a state controlled fund was established to finance bail-outs.⁸⁴ The intervention into the financial and banking sector is a key feature of the modern state. It is even more significant in the context of the limited role of the Norwegian state in banking prior to the crisis. Commercial banking was totally unregulated until 1918, and there were no general laws pertaining to the sector until 1924.⁸⁵

MODERN STATE DEVELOPMENT: THE OUTCOME OF THE BANKING CRISIS

The banking crisis resulted in two major political responses by the state. First, the problems resulted in a shake up of the overall banking sector. Norwegian commercial

⁸¹ Sverre Knutsen, *Financial Fragility or Informational Asymmetry? -the Inter-War Banking Crisis in Norway*, Working Paper Series, Norwegian School of Management, 2001, p.13.

⁸² Nordvik, 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective', p.450.

⁸³ Knutsen 'Financial Fragility or Informational Asymmetry? -the Inter-War Banking Crisis in Norway', pp. 19-21. From 1925 onwards, the Banking Inspectorate published monthly statistical reports on private Norwegian banks. Statistik Sentralbyrå, *Oversikter*, p.291.

⁸⁴ Gerdrup, 'Three Episodes of Financial Fragility in Norway since the 1890s', p.21.

⁸⁵ Nordvik. 'Norwegian Banking in the Inter-War Period: A Scandinavian Perspective', p.437.

banking in its formative years was dominated by small, localised operations susceptible to a few loans going sour. The many failed operations resulted in changes pushed by the bail-outs; surviving banks consolidated through mergers to distribute their risk. Second, and most significant for modern state development, the state came to play a permanent regulatory role in the private banking sector. The Norges Bank, led by its governor and supporters within the *Storting* and bureaucracy transformed its pre-industrialization role of an issuer of currency and sometime lender of last resort to an effective national banking administrator. The banking crisis, brought about by external and domestic economic factors stemming from industrialization, precipitated a major development of a key administrative arm of the state. The maintenance of economic stability and continued industrial growth, more difficult in the growing, exposed and diversified industrial economy, required the expansion of the state as a regulator of the credit supply.

The controversies over the decisions made by Rygg indicate how modern banking regulation independent of Government was new political territory in Norway.⁸⁶ The new Norges Bank roles were not without hiccups, for interventionist central banking and regulation was a learning process for the Norwegian Government and bureaucracy. At times the new state role in the banking sector was poorly managed. The Conservative led government of Prime Minister Abraham Berg was scandalized in 1922 when it was publicly revealed that Berg had permitted unauthorized state loans be made to a struggling Oslo bank with political connections to the *Høyre* Party, bypassing the authority of the Norges Bank.⁸⁷ Whilst the conservatives had shown a willingness to protect their constituent's interests and bypass the bureaucracy, *Venstre* and the left parties were scathing in their subsequent investigations.⁸⁸ This consequently gave greater authority to the Norge Bank, taking financial regulation out of the hands of politicians in the *Storting* and onto the bureaucracy. This process continued the formal institutionalization of management of the financial sector. Regulatory and managerial state power was claimed by the bureaucracy, and therefore less liable to be used by politicians in a partisan fashion. The modern Norwegian state,

⁸⁶ For a first hand account see Nicolai Rygg, *Norges Bank I Mellomkrigstiden*, Gylendal Norsk Forlag, Oslo, 1950.

⁸⁷ Thorvald Gran, *The State in the Modernization Process : The Case of Norway, 1850-1970*, ad Notam Gyldendal, Oslo, 1994, pp.219-37. Berg, along with several other ministers was later acquitted of any wrong doing. He remains to this day the only Norwegian Prime Minister to be impeached.

⁸⁸ *Ibid.*, p.231.

in dramatic contrast to its pre-industrial version, was developing a set of regulatory institutions, staffed by professional bureaucrats who grew in independence from government.

The interventionist actions of the Norges Bank following the banking crisis had dealt with the financial problems that had emerged with industrial production and the post-war boom and slump cycle. The state had extended its reach during the war into price controls and had begun in the 1920s to formally regulate the banking and financial sector. This shift enjoyed support not only from the Labour and *Venstre* Parties. The *Høyre* party on occasions also took a lead in intervention and regulation of economic activity.⁸⁹ By the late 1920s there was a growing awareness among political parties that the problems generated by industrialization needed to be addressed through an expansion of a modern bureaucratic state. This process did not follow a consistent pattern with the degree of intervention being heavily debated within Government, the bureaucracy and in public. But by the end of the 1920s the Norwegian state was well entrenched in the management and control of foreign capital, local credit and the banking sector. The next step in the development of the modern Norwegian state arose from the need to keep key group relations settled in the context of great economic change. The problems that would come to shape Norwegian inter-war political history were centred upon industrial relations and the changing roles of organized labour, business groups and the state.

STRIKES AND DEPRESSION IN THE INTER-WAR YEARS: THE MODERN REGULATORY STATE EMERGES

After the banking crisis a new problem emerged, with disruption spreading in the key area of industrial relations. By the mid 1920s major divisions had developed between employers and the ever growing union movement. Declining economic growth in Norway (and across Europe) set the scene for a series of major strikes that would threaten continued industrial development. The period witnessed growing disputes between labour unions, the NAF and the Norwegian Government. This section will examine the mass strikes and industrial disputes of the period and the response by the

⁸⁹ See Svein Dahl, 'The Attitude of the Norwegian Conservative Party Towards State Intervention in Economic Life During the Interwar Period', *Scandinavian Journal of History*, 12:4, 1987, 297-305.

state. From tentative levels of management, the state established a permanent Labour Court and an arbitration system to manage the labour supply and relations with employers. By the mid 1930s, the state was permanently engaged in the management of relations, terms and conditions between industrial employers and employees.

THE STRIKES OF THE 1920s

The first major industrial strike, that by railway workers in 1920, was followed a year later by the first nation wide strike of the decade. Initiated by the LO, more than 150,000 industrial workers joined, demanding improvements to working conditions and wages. The NAF exacerbated the situation by organizing lock-outs which increased the unrest. During the May 1921 strike, the Government sought to organize emergency labour and requisitioned ships and other transport in order to keep the essential infrastructure of the country operating.⁹⁰ The state however was a bystander in the dispute itself. Whilst the Government took action to stymie the effects of the strike, it could do nothing to resolve the dispute as it had no permanent or institutionalised arbitration arrangements. There were no formal institutions or legal mechanisms to bring parties together to negotiate industrial conditions and pay, as the state had maintained a non-interventionist stance since independence. Only during severe disagreements did the state seek to arbitrate between parties in an informal way. Through short term Arbitration Acts that were passed and renewed upon expiry in the early twentieth century, a temporary negotiating process was implemented. Yet these agreements were dependent upon the major protagonists agreeing to negotiate. Compulsory arbitration of disputes had a minor pre-war history in Norway, from the first *Storting* bill of 1902 that forbade employers from pressuring employees how to vote during elections.⁹¹ The bill also permitted workers to form unions and protected these organizations from attacks and blackmail. In the following years, governments, when led by the *Venstre* party, initiated legislation aimed at the development of a compulsory arbitration system.⁹² A Royal Commission of 1908 led to attempts to

⁹⁰ Galenson, *Labor in Norway*, p.162.

⁹¹ Castberg, 'Compulsory Arbitration in Norway' p.17.

⁹² *Ibid.*, p.19.

establish a Labour Court to resolve industrial disputes, an initiative opposed by both labour union representatives and employers.⁹³

TENTATIVE STEPS: THE EARLY YEARS OF THE LABOUR COURT

For the next few years, a piecemeal approach by the state continued, with protagonist groups staunchly resisting efforts to negotiate via the state. Neither trade unions nor business groups sought the state's assistance when negotiating with each other. During periods of economic growth, unions did not want to be restrained by a compulsory negotiating process, potentially restricting the possibility for larger wage claims. The LO wished to ensure that strikes remained a tool to extract better conditions from employers. The LO were also disconnected from government, having no Labour Party representatives in the *Storting* until 1920. Employer groups, led by the NAF, maintained their traditional stance against state interference in industrial relations. Indeed the only issue that united the NAF and the LO was their staunch resistance to compulsory arbitration and by 1913, the various Government bills on offer had been postponed or abandoned.⁹⁴ Yet despite the opposition from the major protagonists, the Government persisted, and a new proposal was passed as an Act in 1915, establishing a permanent Labour Court and a conciliation process that required industrial disputes be reported to the new authority.⁹⁵ Pushed by leading members of the *Venstre*, notably Johan Castburg, this institution broke new ground for the Norwegian state.⁹⁶ It was now encroaching quite deliberately into a previously uncharted area of social interaction. Previously the state had attempted to solve disputes as they arose, through *ad-hoc* negotiations. With the establishment of the Labour Court, the state was now attempting to play a permanent and entrenched role in industrial relations with the aim of resolving disputes quickly and before they spread. Staffed by former judges and lawyers appointed by the Government, the Court was designed to remain an impartial institution, free of influence from the *Storting*, business groups and unions.⁹⁷

⁹³ Ibid., p.12.

⁹⁴ Ibid., p.20.

⁹⁵ Galenson, *Labor in Norway*, p.99.

⁹⁶ Castberg, 'Compulsory Arbitration in Norway', p.21.

⁹⁷ Galenson, *Labor in Norway*, p.101.

Among Norwegian policy makers, preventing disruptive strikes became a priority and a compulsory arbitration system offered a solution.⁹⁸ The initial attempts during the war years were moderately successful, with trade unions and the NAF coming to the negotiating table on occasions; the emergency conditions created by WWI permitted the state to intervene in economic affairs to a greater degree than before. Yet during the post-war economic decline, the effectiveness of the state's power to negotiate industrial activity again waned. The worsening international economic climate gave greater strength to employers, whilst for trade unions the effectiveness of strikes lessened as the demand for labour declined. As a result the still fragile arbitration system began to order lower wages and reject the claims made by the LO. This is an important development; the state was now managing the process of wage negotiation in particular industries in great contrast to the pre-industrial era. By 1923, as inflation increased and the banking sector struggled, industrial relations in Norway worsened. The current awards arrangement expired in the spring, and as many employers began to attempt to reduce wages, the Government, then *Venstre* led, attempted to extend the old agreements.⁹⁹ But the old agreements it was feared would create an imbalance, for employers wished to further lower wages, whilst knowing that industrial strife would result. The attempt by *Venstre* parliamentarians failed, as the governing coalition partners in the Labour and Communist parties, realising the plight faced by their working class constituency, began to oppose compulsory arbitration.¹⁰⁰ The *Høyre* maintained their opposition to state intervention in wage negotiations and the result was a withdrawal of state managed negotiations and growing industrial unrest into the mid 1920s, with thousands of man hours lost. As the previous chapter demonstrated, the major political parties were, by mid decade, beginning to reflect in their policies the economic views of their constituencies; as the trade union movement supported the Labour Party, business groups supported the *Høyre* and the *Venstre* attracted those in between. State power in industrial relations in the early 1920s was constrained by all major political parties that preferred to let the NAF and the LO fight their own battles.

⁹⁸ Castberg, 'Compulsory Arbitration in Norway', *passim*

⁹⁹ *Ibid.*, p.33.

¹⁰⁰ The Labour and Communist Parties now had a major presence in the Storting. The elections of 1921 had returned twenty-nine Labour Party candidates, whilst the 1924 elections saw the Communist Party at their height with six members elected. With the Labour Party's twenty-four members they formed a coalition with the *Venstre* to oppose the *Høyre* Party, which was beginning to decline in popularity. Nordskog, *Social Reform in Norway*, p.21.

The encroachment of state institutions into industrial relations was thus held back by Government and resistance by the NAF and LO.

Metal workers, transport and harbour workers and paper mill employees all took strike action in the middle of the 1920s. Employers became unwilling to accept wage and condition demands as the post war business cycle reached its lowest ebb and the continuing currency problems made exports difficult to sell. As the compulsory arbitration process had ended, the state appointed Mediator was unsuccessful in bringing parties together in 1926.¹⁰¹ This failure and the continuing strikes in 1927 led to the collapse of the weakened arbitration system as the Labour Court and previous industrial agreements were ignored by the LO and the NAF who were both able to resist Government pressure to agree upon terms. Public pressure was now building for the Government to again intervene in disputes that threatened the growth of the Norwegian industrial economy.¹⁰² The Conservative led government of Prime Minister Ivar Lykke advocated a compulsory arbitration agreement that would force trade unions and employers groups into a state managed negotiation process.¹⁰³ In the development of the Norwegian state, the economic growth generated by industrialization became a central area of interest for all political parties. The *Høyre*, formerly opponents of arbitration, now believed that state intervention in industrial relations was necessary.¹⁰⁴ The state by the 1920s had also become wedded to the income generated by taxes and other sources of income generated by the industrial economy.¹⁰⁵ Industrial disputes, of the scale experienced to this point, placed continuing growth and therefore the income of the state, at risk. In addition, the NAF and the LO were beginning to waver in their commitment to confrontation in the 1920s. Cooperation, or at least a willingness to negotiate industrial bargaining was becoming more acceptable to the NAF and LO leadership. Such a development made increased state management of industrial relations possible.

¹⁰¹ Galenson, *Labor in Norway*, pp.166-7.

¹⁰² Ibid., p.168.

¹⁰³ Dahl, 'The Attitude of the Norwegian Conservative Party Towards State Intervention in Economic Life During the Interwar Period', p.304.

¹⁰⁴ See Svein Dahl, 'Høyres Finans- Og Budsjettpolitikk I Mellomkrigstiden' *Historisk Tidsskrift*, 57:3, 1978, 347-381, for a discussion of *Høyre* and their changing perspective on the role of the state during the inter-war period.

¹⁰⁵ State revenue from taxes and excises was Kr89 million in FY 1913/14. This figure rose to a height of Kr543 million in FY 1919/20, before declining a little and remaining stable until the mid 1930s when it began to rise again. Statistisk Sentralbyrå, *Oversikter*, p.414.

1927 saw the passing of yet another Arbitration Act, this time approving a major wage reduction that had been mooted by mediators the previous year.¹⁰⁶ The following year, employers saw an opportunity to further reduce wages, which again inspired the union movement to begin a series of running strikes, with many sympathetic non-union workers joining. Under the new Act, strikes by building workers were deemed illegal and the Government sought to hold the LO leadership responsible for the actions of its members. Representatives of business and organized labour organizations were now potentially liable for the actions of their members and were exposed to the possibility of fines and even jail terms.¹⁰⁷ Both organizations had grown greatly in size and power through industrialization. Both organizations were also being held to greater levels of responsibility and potentially, legal liability for their actions. The new Act also protected non-striking workers from retribution.¹⁰⁸ The legislative pressure from the state influenced the union leadership, as well as cautioning employer groups who sought to aggressively pursue wage reductions and force lock-outs. This was an important development from the 1915 Act. The state was gaining in reach and the resistance to arbitration by political parties was declining. The new laws were supported by all political parties, though not always in the best interests of their constituency. A set of state regulations and laws was forming around industrial relations, granting the state, as a set of institutions, increased managerial power and control and reducing that of the LO and the NAF. This process was matched by these key organizations which increasingly used negotiations as an option. As Galenson concludes, industrial unrest was also precipitated by the international economic fortunes and their impact upon the Norwegian economy.¹⁰⁹ Maintaining industrial growth in this context required greater cooperation on terms initiated by government.

¹⁰⁶ Galenson. *Labor in Norway*, p.168.

¹⁰⁷ The legislation was also known as the 'prison act', see Dahl, 'The Attitude of the Norwegian Conservative Party Towards State Intervention in Economic Life During the Interwar Period', p.304.

¹⁰⁸ Paal Berg, 'Legislation on Labour Disputes in Norway', *International Labour Review*, 28:6, 1933, 774-795, p.779

¹⁰⁹ See Galenson. *Labor in Norway*, pp.179-182. William Lafferty argues that late industrialization in Norway contributed to a radical labour movement, whereas other European states that industrialized earlier experienced fewer radical impulses. See Lafferty. *Industrialization, Community Structure and Socialism : An Ecological Analysis of Norway, 1875-1924*.

By the late 1920s, arbitration was becoming practice, even if the government sometimes gave up on managing a formal institutionalized process. The LO leadership, having undergone the turmoil of the past decade's left wing party splits, began also to moderate their approach, seeking compromise with the Labour Court and the state.¹¹⁰ For the union leadership, better outcomes could be sought through negotiation; a process increasingly managed via the state through the Labour Court. The development of this institution was therefore a gradual but steady process of institutional formation as the LO and the NAF accepted its role.

Drastic state intervention still remained an option reserved for severe crises, when both sides of industry were unable to break a deadlock. The state was also establishing in this period an array of economic regulations and controls, influencing the direction of Norwegian industry. In accordance with global protectionist trends, the state began to place tariffs and import bans upon building materials and foodstuffs, mostly with an eye to protecting local manufacturers. This expansion of regulatory power even included the compulsory labelling of many products with their country of origin.¹¹¹ Increased controls and monitoring power over industrial production exemplified this trend of modern state development.

Despite the losses incurred by industrial unrest, and the problems of the currency crisis, the Norwegian economy grew substantially through the inter-war years. The state, with its expanding revenue base, was beginning to take the modern institutional and administrative form that it would be associated with in the post WWII period. Yet the fragile arbitration agreements and Labour Court were still not strong enough to prevent national strikes and resolve major disputes. These institutions were yet to fully engage with the most powerful industrial groups and integrate them into the state managed negotiating process. The formal and permanent establishment of state mechanisms to manage industrial relations required a crisis to instigate and 1931 witnessed the biggest general strike experienced yet.¹¹²

¹¹⁰ Galenson. *Labor in Norway*, p.169.

¹¹¹ Jan Tore Klovland, 'The Silver Age of Manufacturing in Norway: New Estimates of the Growth of Industrial Production, 1927-1948', *Scandinavian Economic History Review*, 1:1997, 3-29, pp. 26-8.

¹¹² See Tore Hanisch, 'The Economic Crisis in Norway in the 1930s: A Tentative Analysis of Its Causes', *Scandinavian Economic History Review*, 2:1978, 145-155 for a discussion of the various economic problems of the period.

THE 1931 GENERAL STRIKE AND ITS OUTCOME

Initiated by the Great Depression, the 1931 strike lasted five months and ended with the breaking of the consolidated union movement and the formalising of state intervention in all areas of Norwegian industrial relations. In 1931 the NAF offered a fifteen per cent wage reduction when negotiations began for new agreements which the LO rejected and much of its constituency opposed. Mediation between the two parties failed, and after four months of strike, the LO requested individual unions seek settlements with their employers, signalling a moderation in position by the union hierarchy and an unwillingness to continue mass strikes as a negotiation tool. The policy shift within the LO leadership is a significant development. It was primarily due to the growing success of the Labour Party in national elections. Rank and file workers were however not willing to concede and the strike continued, only being sustainable for such a long period with financial aid from Swedish and Danish trade unions.¹¹³

The 1931 strike left both the LO and the NAF weakened. Union coffers were drained and employers had suffered due to lost man hours. Meanwhile, the Labour Party, in the national elections of 1930, 1933 and 1935 increased its vote from thirty-one per cent to forty-three per cent.¹¹⁴ Bull, the foremost Norwegian historian of the period, argues that the shift in priorities of the LO, from opposing capital to negotiating continued industrialization was a key milestone in Norwegian political development.¹¹⁵ Further evidence of the significance of the shift was the decline in support for the still revolutionary Communist Party, reduced to only two percent of the vote in 1933. Through the Labour Party's increasing power, the LO enjoyed greater influence in the *Storting*. Their interests could now be channelled towards the government through the Labour Party.¹¹⁶ Consequently, unions were increasingly bound to the formal negotiating processes managed by the state such as the Labour Court. Negotiating the industrialization process with the NAF, became a priority of the LO and the Labour

¹¹³ Galenson, *Labor in Norway*, pp.172-3.

¹¹⁴ Bull, *The Norwegian Trade Union Movement*, p.94.

¹¹⁵ Ibid., pp.96-7. Edvard Bull was also Foreign Minister and the primary policy maker of the short lived Labour government of 1928 led by Prime Minister Christopher Hornsrud. See also Dahl, 'The Attitude of the Norwegian Conservative Party Towards State Intervention in Economic Life During the Interwar Period', p.305.

¹¹⁶ Rune Slagstad, 'Shifting Knowledge Regimes: The Metamorphoses of Norwegian Reformism', *Thesis Eleven*, 77:2004, 65-84, p.72.

Party leadership. Institutions of the state were at the centre of this process and were thus responsible for managing negotiations, further supporting their development and acceptance by previously antagonistic organizations.

The aftermath of the 1931 strike contributed to a new cooperative approach between the LO, NAF and the state. Norway, as it had been throughout its short history of independence, was heavily dependent upon trade and exposed to the fluctuations of the global economy. The need to compete with overseas producers to recover from the Great Depression became recognised by the leadership of the NAF and the LO. An example of this shift was the increased levels of cooperation over industrial production. As the state introduced protective measures such as tariffs, unions began to take part in campaigns to support local industry; an about turn from their stance of the 1920s. This included lobbying to produce large industrial items such as turbines and railway locomotives in Norway rather than purchasing from overseas.¹¹⁷ The interests of the LO, NAF, political leaders and state institutions, in the context of industrial relations, were converging, making for greater agreement between the parties.¹¹⁸

THE BASIC AGREEMENT: PERMANENT STATE REGULATION OF INDUSTRIAL RELATIONS

The increase in unemployment caused by the Great Depression weakened the revolutionary elements of the Communist Party and trade unions to insignificance.¹¹⁹ Bringing the once resistant groups under LO and state control and management was completed in 1935 with the signing by LO and NAF representatives of the industrial

¹¹⁷ Bull. *The Norwegian Trade Union Movement*, p.96.

¹¹⁸ John R. Bowman, 'Employers and the Persistence of Centralized Wage Setting', *Comparative Political Studies*, 35:9, 2002, 995-1026, p.1001.

¹¹⁹ Unemployment in the 1920s veered between three per cent and twenty-nine per cent. In late 1932, the rate hit over forty-two per cent, however was probably far lower due to the problematic nature of statistical collection at the time. Unemployment statistics at the time were provided by unions, who whilst accurate in their counting, may often have excluded non-union workers of which many did exist. See Ola H. Grytten, 'Arbeidsledighetens Omfang I Mellomkrigstiden', *Historisk Tidsskrift* 71:3, 1992, 249-277. Grytten argues that unemployment in Norway during the inter-war years never exceeded ten per cent of the total workforce. He may well be correct, as unemployment figures collected by unions tended to be sourced from mostly industry (the sector that declined most as opposed to primary production). Further, these figures were often sourced from localised areas, and did not depict an overall picture of Norwegian employment levels. Grytten also points out, that in the inter-war years, Norway experienced significant growth in production and employment overall, a fact that does not square well with the high unemployment figures typically quoted.

accord known as the 'Basic Agreement'; a landmark institutional development. A short document with less than a dozen points, the agreement became a legal requirement to be inserted into all collective bargaining arrangements. It marked the formalization of industrial bargaining in which parties became part of an organized negotiating process with the state at the centre. The agreement laid out the rights and obligations of negotiating parties and became the standard template of all future agreements and the basis for all industrial negotiations. The state, through the Labour Court and the Basic Agreement was now positioned permanently in the arena of industrial relations. Wage negotiations were judged on the basis of considerations such as a living wage, the financial needs of workers and employer affordability. Industrialization had given rise to powerful unions and employers groups with interests that, as the industrial economy grew, were increasingly convergent. Toward the end of the 1931 strike, the NAF director stated 'we have no interest in revolutionizing our opponents...if the LO leaders are destroyed or weakened...it will be a very dark day for us.'¹²⁰ Following the Basic Agreement, the state was now the only channel by which trade unions and employers in the industrial economy could negotiate wages and conditions. All negotiating parties had obligations and rights set out in law, enabling them to function within a state mandated set of rules. The state had now built a framework by which capital and organized labour was forced to interact within. This framework included a detailed outline of the expectations of parties, and the conditions by which they interacted. These state functions were an enormous development from pre-industrial Norway when such matters were of little concern of the state. The analysis has demonstrated how the key groups in the inter-war years, that of the LO and the NAF also sought to manage their negotiations through the state sanctioned mechanisms. Interaction between these organizations contributed to the development of powerful state institutions to manage industrial relations. State development therefore occurred as a result of pressure from two directions; from powerful social organizations that emerged with the industrialization process and, pressure from the state to manage and regulate their interaction through institutional development.

¹²⁰Quoted in Bowman, 'Employers and the Persistence of Centralized Wage Setting', p.1004.

THE NORWEGIAN STATE IN 1935

The elections of 1935 saw a Labour controlled government assume office. It symbolized the end of a long road for the labour movement, which had begun at the barricades, and concluded with the claiming of government. Under the leadership of Johan Nygaardsvold, Labour won sixty-nine *Storting* seats and negotiated a coalition with the then strong Agrarian Party (*Bondepartiet*).¹²¹ Both Labour and the Agrarian Party recognized the opportunity by working together, the result being the 'crisis accord' that led to Labour taking government in 1935. Two parties, once quite different in ideological disposition and constituency, were now in coalition.¹²²

Industrialization, the Great Depression and the subsequent high unemployment in industry led to a transformation of the Labour Party and trade unions in their size, power and approach to politics.¹²³ It was only in 1933 that the Labour Party announced that it sought to gain parliamentary power and form government, a distinct shift from the revolutionary rhetoric of its past.¹²⁴ The Labour Party, from its minority government position, went on to hold power as a majority, and following the period of exile during World War Two, returned in 1945 to lead Norway into a period of

¹²¹ The Agrarian Party or *Bondepartiet* was renamed the Centre Party in 1959. Founded in 1920, it represented rural and more traditional interests, typically being in favour of protectionist agricultural policies. Yet, it has historically been willing to compromise and has often sought negotiations with one or more of the major political parties. By 1935, the Great Depression had made a severe impact, and the deflationary policies of the Norge Bank had hurt farmers and urban workers, even though it enhanced the competitiveness of Norwegian products abroad. The agricultural sector in particular was suffering a debt crisis, and the *Bondepartiet* sought to see many of the debts cancelled or reduced, preferably by the state, as Norges Bank policies had played a hand in increasing the burden. See Øistein Hveding, 'Gjeldsførlighet Mellom Bondepartiet Og Arbeidpartiet I 1934' *Historisk Tidsskrift* 58:3, 1979, 326-357. Agrarian interests through the Agrarian Party were now appealing to the state to aid them in their financial difficulties. This approach to the state represents a major change by the rural sector, which previously resisted efforts by the state to manage and interfere.

¹²² Dahl, 'The Attitude of the Norwegian Conservative Party Towards State Intervention in Economic Life During the Interwar Period', p.299.

¹²³ The Labour party in 1934 put forward a radical economic plan to parliament, which, heavily influenced by the thinking of J.M. Keynes, advocated a deficit financed program of job creation. The plans were the brainchild of two influential thinkers, Ole Colbjørnsen and Ragnar Frisch. Colbjørnsen, the economic commentator for the *Arbeiderbladet*, the Labour Party newspaper, was influential in shaping the new economic policies. His first public release was a Soviet inspired pamphlet *A Norwegian Three-Year Plan*. Financing such a program in a liberal democratic state was problematic; following the Soviet model was not an altogether desirable path. Frisch, who taught economics at the University of Oslo, provided solutions to financing the program through expansionary monetary policies, drawing upon Keynesian ideas. Through the efforts of these two figures, the Labour Party came to formulate their crisis plan: an interventionist approach to the unemployment problem. See Helge Nordvik, 'Krisepolitikken Og Den Teoretiske Nyorientering Av Den Økonomiske Politikken I Norge I 1930-Årene', *Historisk Tidsskrift*, 56:3, 1977, 289-317.

¹²⁴ Valen and Katz, *Political Parties in Norway: A Community Study*, p.29.

prolonged post-war economic prosperity.¹²⁵ Far from opposing industrial development, by 1935, the LO was as committed to continued economic growth as the NAF. The distinguishing characteristics of these key social organizations in 1935 were starkly different from what they had been in 1905. The most powerful and important political organizations of 1935 were hardly in existence in the late nineteenth century and their emergence greatly reshaped the state arena. This chapter has described how these organizations interacted and how key institutions of the modern state developed and evolved as a consequence of social interaction. Gradually, cooperation became the guiding principle of the major social organizations of industrial Norway. This trend was encouraged through the development of state institutions that managed and regulated components of the economy. By 1935, a consensus between the major political organizations and parties of Norway had formed that was to continue in the post World War II era. Consensus became institutionalized in the form of the Labour Court, the Basic Agreement, Norge Bank and specialized bureaucratic bodies.

The Basic Agreement and the Labour Court were the state institutional developments that managed the industrial relations consensus: a negotiated approach to economic activity became the norm in Norway. And negotiation entailed regulatory expansion by the state, the process shaped by the changing requirements of industrial production. The key social organizations that emerged became orientated toward the modern institutions of the state that developed. The LO and the NAF changed approach and became supportive of a state managed process of regulation. Banks and credit agencies underwent a merger process and accepted the intrusion of the state into its activities. Banks were forced to operate in a new regulatory system with new rules that limited their autonomy. In return banks recognized that they could receive support from the state in times of great difficulty. Foreign capital investment also continued to flow into Norway, balanced by the state enforcing stiff controls on ownership and resource management. The new industrial economy had created the necessity for new working relationships between producers, investors and organized labour. Consequently, friction and conflict occurred between these groups, leading to the need for regulatory mechanisms to achieve resolution. The management of these interactions become the responsibility of the state, and the modern Norges Bank, the Banking Inspectorate and

¹²⁵ For an ideological history of the Norwegian Labour Party in the post WWII period see Trond Bergh 'Pragmatic and Democratic Socialism', *Scandinavian Journal of History* 16:3, 1991, 205-213.

the Labour Court exemplified the modern institutions of control. These three institutional examples demonstrated how social interaction between groups and pressure from government and the bureaucracy led to organizational change within the state.

Modern state institutions were, by the mid 1930s, engaged in the formal management and regulation of the industrialization process. Norwegian banks became the subject of close monitoring by the state. Armed with legislation and new rules of financial conduct, the Norge Bank and the Banking Inspectorate subjected the financial sector to scrutiny to manage the credit supply and prevent banks from collapsing. In the key area of industrial relations, the Labour Court managed negotiations between employers and employees. Wages and conditions became the subject of state decision making as the industrial strife of the preceding two decades was no longer deemed acceptable to the leadership of all concerned parties as well as that of Government. The once reactionary Concession Laws, by 1935 had developed into an array of regulations over foreign investment managed by several Government ministries. The key components of the industrial economy, in capital, labour and resources, were now regulated and managed by the Norwegian state in a formal way. For the institutions of the state, industrialization led to a significant shift in power toward the bureaucracy, moving control away from the executive branch of government. The continued management of the industrial economy became priority of government and the major organizations involved in the industrialization process. Consensus and a willingness to overcome conflict through managed cooperation now shaped interaction between the state and the major social actors of Norway.

The analytical framework developed in Part One identified how the modern Norwegian state, considered as both an arena and a set of institutions was shaped by the industrialization process. Conceptually separating the state from society - as many previous approaches have - would not have revealed the significance of interaction between society and the state in shaping modern state development. How these findings contribute to a modified conceptual understanding of modern state development in the twentieth century will be addressed in Part Three. To examine a similar process in a second case study, at the other end of the twentieth century this

thesis leaps several decades and several thousand miles to Malaysia; a state that like Norway, followed up its independence with an industrial transformation.

CHAPTER 5

The Industrialization of Malaysia 1969-1999

INTRODUCTION

Unlike ethnically homogeneous Norway, modern Malaysian politics has been dominated by the divisions between three major ethnic groups, each of different background, culture and religion. Since independence, the key political question has concerned the difficulty of uniting a society beset by these ethnic cleavages. The inter-ethnic riots of May 1969 are considered a low point of Malaysia's post-independence history and are the departure point for this analysis of the development of the industrial economy and its relationship with the modern Malaysian state. Whilst Malaysia differs from Norway in many respects, similar patterns of social organization and state institutional development can be discerned. Like Norway, state institutions developed around the need to regulate and manage economic activity.

The conceptual framework developed in Part One permitted an analysis of the state as an arena of political action and contestation as well as a set of institutions, to identify how industrialization impacted upon and changed social organization. Important social organizations, as we shall see, became key actors in the process of Malaysian state development because the industrialization of the economy made them politically influential. This chapter will first examine the industrialization of Malaysia as an economic process, highlighting the role of foreign investment in manufacturing. The chapter will then analyze how key organizations in Malaysian society developed in response to industrialization. The analysis will focus upon business organizations and political parties that became politically influential in the new economy. The section will in particular scrutinize the unique role of the dominant United Malays National Organization (UMNO). Industrialization had a profound impact upon these groups, reshaping their activities and increasing their interaction with state institutions. They also became more formally organized and developed linkages with each other in ways shaped by the industrial economy. Such organizations became important because of



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their growing ability to influence or control capital flows and investment, the labour supply and government policy. Because of such influence they came to have political power and increased their interaction with the institutions of the state through modern political parties.

Chapter Six will then identify how institutions in the modern Malaysian state interacted with these social organizations in three historical episodes between 1969 and 1999. Each episode resulted in a significant development of the modern Malaysian state. The key question to be addressed in this chapter is: how did industrialization shape and impact upon the development of key social organizations within the state arena. To provide the necessary contextual background, the granting of independence from Great Britain is discussed first.

INDEPENDENCE

Malaysia became independent in 1957. Whilst it was a more stable transition than that of many new African states, the years either side of independence were made difficult by the conflict known as the 'Emergency' instigated by anti-colonial groups.¹ Much of the actual fighting was conducted by British soldiers and other Commonwealth country troops, while the Malaysian Government, established as the British departed was only just developing the means to manage its civil affairs.² The conflict's impact galvanised the federal system of Malaysia and provided impetus to the development of a centralized government.³ As a result of federal consolidation there also took place an expansion of the civil service and its functions. War continued to have an impact upon the shape of the Malaysian state in the early 1960s. In a four year conflict over the status of Borneo, Malaysia, again supported by Commonwealth forces, fought a war

¹ See Richard Stubbs, *Hearts and Minds in Guerrilla Warfare: The Malayan Emergency, 1948-1960*. Oxford University Press, Singapore, 1989.

² An account of the Emergency that links the conflict to the Malaysian state building process is Richard Stubbs, 'The Malayan Emergency and the Development of the Malaysian State' in P. B. Rich and R. Stubbs (eds.), *The Counter-Insurgent State: Guerrilla Warfare and State Building in the Twentieth Century*, Macmillan Press, Houndsmills, 1997. But Stubbs' description of Malaysian state building is primarily concerned with the shift from a federal system to a stronger central government. This process is identified as an expansion of the civil service in numbers as well as a more robust tax system that collected more revenue.

³ Ibid., see also Stubbs. *Hearts and Minds in Guerrilla Warfare: The Malayan Emergency, 1948-1960*.

against Indonesian proxy forces.⁴ Insurgents moved into southern Malaysia, fighting a guerrilla conflict with the nascent Malaysian state. Known as the 'Confrontation' the war ended with the rise to power of General Suharto in Indonesia. In Malaysia the institutions concerned with national security were bolstered by resources and through the Internal Security Act that dramatically increased state power. Greater centralisation of power took place, with local councils now selected by state governments rather than elections. Yet, the development of modern state institutions directly tasked with economic management and regulation did not follow a similar path of expansion. For example, the pre-independence Rural Industrial Development Authority, intended to promote rural development, functioned mostly as a fund to employ transient agricultural workers rather than plan and manage a cash crop economy.⁵ The institutions of the pre-industrial Malaysian state, though they expanded in reach and strength through federalism, continued to operate largely within pre-independence structures and roles.

THE PRE-INDUSTRIAL MALAYSIAN STATE AT INDEPENDENCE

The Malaysian state's political system was inherited from the British, who established a Westminster system of government after World War II.⁶ With pressure from the British, the divided states of Malaya became a Union, with all ethnic groups granted formal equality.⁷ A parliamentary based executive government with an independent judiciary was enshrined in the constitution. The states of Malaysia retained considerable authority for services and administration with the Federal government retaining power over foreign policy, law making and policing. The structure that emerged in the 1950s saw three groups of ethnic political leaders take over control of

⁴ See J. A. C. Mackie, *Konfrontasi: The Indonesia-Malaysia Dispute, 1963-1966*. Oxford University Press, Kuala Lumpur, 1974. For an international perspective and the role played by the major powers see Matthew Jones, *Conflict and confrontation in South East Asia, 1961-1965 : Britain, the United States and the creation of Malaysia*, Cambridge University Press, Cambridge, 2002.

⁵ Rajah Rasiah, *Foreign Capital and Industrialization in Malaysia*, St. Martin's Press, New York, 1995, p.63.

⁶ For good general histories of this period see Barbara Watson Andaya and Leonard Y. Andaya, *A History of Malaysia*, University of Hawai'i Press, Honolulu, 2001; R. S. Milne and Diane K. Mauzy, *Politics and Government in Malaysia*, Times Book International, Singapore, 1980.

⁷ Eugene K. B. Tan, 'From Sojourners to Citizens: Managing the Ethnic Chinese in Indonesia and Malaysia', *Ethnic and Racial Studies*, 24:6, 2001, 949-978, p.957.

the Federal government in an alliance coalition.⁸ The 'Alliance', combined UMNO, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC). Decision making became enshrined within the Alliance's National Executive Committee which, in sharing membership of Cabinet, resulted in the development of informal ties between government and party members; relationships which, as we shall see, grew steadily stronger.⁹ The primary role of the state in this early period was the maintenance of territorial security and internal stability: the Confrontation period contributed to change in these characteristics as the war-making thesis discussed in Part One suggests.¹⁰ Nevertheless, the *modern* state may be characterized as more than just a way of organizing territory and people for security. The important advances of modern state development were yet to unfold, as industry had not gained a foothold and the state lacked the means to regulate and manage the key components of the economy. Ethnic groups were divided politically through the major parties that reflected the divisions of economic life. Urban Malays dominated the civil service, military, police and judiciary whilst the majority of the Malay population were rural poor and worked in subsistence agriculture. Contrastingly, the ethnic Chinese controlled the most productive areas of the economy in banking, trade and small scale manufacturing in urban areas. Indian Malaysians, imported by the British as labourers in the colonial era, typically worked on rubber plantations and in mines.

Ethnic tensions as a result of economic division and poverty increased in the 1960s, sometimes turning into violent protests and unrest. These tensions were a continuation of those that had emerged following WWII and independence.¹¹ Institutions such as the police and justice system served to maintain social stability but were unable to implement any societal or economic reform to address the economic inequalities. It was only with a coalition agreement that government could function.¹² The state, controlled by the Malay majority, conceded control of the most productive

⁸ For a class based analysis of Malaysian society moving into independence see Yin Hua Wu, *Class and Communalism in Malaysia : Politics in a Dependent Capitalist State*, Zed Books, London, 1983. Wu's analysis is based upon a world system theory perspective of the Malaysian state, portraying Malaysian political arrangements as a system maintaining structure inherited from the colonial period.

⁹ Milne and Mauzy, *Politics and Government in Malaysia*, p.130.

¹⁰ For an outline of the changing concept of national security in Malaysia see Hari Singh, 'Malaysia's National Security: Rhetoric and Substance' in *Contemporary Southeast Asia*, 26:1, 2004, 1-25.

¹¹ Tan, 'From Sojourners to Citizens: Managing the Ethnic Chinese in Indonesia and Malaysia', p.956.

¹² William Case, *Elites and Regimes in Malaysia*, Monash Asia Institute, Melbourne, 1996, see Chapter Two. See Arend Lijphart, *Democracy in Plural Societies: A Comparative Exploration*, Yale University Press, New Haven, 1977, for a discussion of consociational societies: pp. 150-2 consider Malaysia.

sectors of the economy to the Chinese population in return for political dominance. Known as a 'consociational' arrangement, it required a considerable degree of compromise and power sharing.¹³ As the evidence will show, such a system could not be indefinitely maintained in the face of industrial development and the resulting social impact. Economic change led to a breakdown of the post independence political arrangements by impacting upon the makeup of the political parties, in particular that of the UMNO party.

THE PRE-INDUSTRIAL ECONOMY

This section examines the pre-industrial economic sectors and how they became connected to light manufacturing in partnership with foreign investment. Agricultural employment gradually declined in the 1970s, leading to urbanization and the emergence of new economic activities. The industrial economy, first emerging from the agricultural and primary sectors led to major economic growth as foreign investment and exports grew.

THE PRE-INDUSTRIAL ECONOMY: AGRICULTURE AND PRIMARY PRODUCTION

Agriculture accounted for the bulk of employment and over a quarter of GDP in post-independence Malaysia.¹⁴ Rubber plantations developed during the colonial era by the British provided a major cash crop. Indian workers were imported to provide labour and an industry of major importance to world supplies grew along the west coast of Peninsular Malaysia.¹⁵ By 1970, some forty per cent of the world's rubber was produced in Malaysia.¹⁶ Yet the natural rubber industry would face severe challenges after independence. First was the competition brought about by the development of synthetic rubbers derived from crude oil, and second, the world price of rubber often

¹³ Ibid., pp.83-5.

¹⁴ World Bank, *Malaysia: Matching Risks and Rewards in a Mixed Economy Program*, World Bank, Washington DC, 1989, p.141.

¹⁵ There exists a considerable literature on the world rubber industry and the rubber industry in Malaysia. The British created a cash-crop industry on the Malay Peninsula, importing rubber trees from Brazil, and in the early twentieth century it became very successful. See Thomas R. McHale, *Rubber and the Malaysian Economy*, M.P.H. Publications, Singapore, 1967; Colin Barlow, *The Natural Rubber Industry: Its Development, Technology, and Economy in Malaysia*, Oxford University Press, Kuala Lumpur, 1978; John H. Drabble, *Rubber in Malaya 1876-1922: The Genesis of the Industry*, Oxford University Press, Kuala Lumpur, 1973. For a global perspective see Colin Barlow, S. K. W. Jayasuriya and C. Cuan Tan, *The World Rubber Industry*, Routledge, London, 1994.

¹⁶ Barlow, Jayasuriya, et al., *The World Rubber Industry*, pp.31-2.

fluctuated, affecting incomes and profits. But the emergence of manufacturing led to a resurgence. Malaysian rubber producers, independently and in cooperation with Japanese companies, proved apt at the manufacture of products such as gloves, condoms and tyres.¹⁷ The oil shocks of the 1970s also boosted the value of natural rubber as synthetic rubber became costlier to produce. Many rubber products could be manufactured in small factories, with lower skill levels and capital investment compared for example with mining. The ability to link primary products to light manufacturing with small start up costs is an important factor in industrial development. While the rubber sector declined in the 1980s, it provided the light manufacturing sector with a primary product to transform into readily exportable goods.

Harvesting the abundant timber resources of Borneo became an important industry in the late 1960s. Sabah and Sarawak - the most economically backward of the Malaysian states - had fewer rubber plantations than the Peninsula and relied heavily upon forestry for income. Both regions, in the period of industrialization, relied upon forestry for between forty and fifty per cent of their regional GDP with much of it exported.¹⁸ Forestry contributed little to new manufacturing industries in Malaysia compared to rubber, except for some furniture and chipboard production. Most timber was directly exported to Japan, with the cleared land turned over to cash-crop agriculture and the profits from timber processing remaining largely overseas. Foreign investment and control of Malaysia's forests contributed to the economic links with the East Asia region that developed in the 1970s. Japanese financed logging did little however to assist Malaysian industrial development with most timber directly exported as raw logs. As a British colony, Malaysia had functioned as a source of raw

¹⁷ Ibid., p.169. Some US companies were also involved in manufacturing, notably Goodyear (tyres).

¹⁸ For a history of the Sarawak economy see R. A. Cramb and R. H. W. Reece (eds.), *Development in Sarawak: Historical and Contemporary Perspectives*, Centre of Southeast Asian Studies, Clayton, 1988. See the chapter by Hamid Bugo 'Economic Development Since Independence: Performance and Prospects' in particular. See also Amarjit Kaur, *Economic Change in East Malaysia: Sabah and Sarawak since 1850*, St. Martin's Press, New York, 1998; R. S. Milne and Ratnam, K. J., *Malaysia - New States in a New Nation: Political Development of Sarawak and Sabah in Malaysia*, Frank Cass, London, 1974, pp.386-7; K. S. Jomo, Y.T. Chang and K.J. Khoo, *Deforesting Malaysia: The Political Economy and Social Ecology of Agricultural Expansion and Commercial Logging*, Zed, London, 2004, p.20. For a history of the timber export trade see Peter Dauvergne, *Shadows in the Forest: Japan and the Politics of Timber in Southeast Asia*, MIT Press, Cambridge, 1997. See also Harold Brookfield, 'The End of the 'Resource Frontier'', in H. C. Brookfield, Loene Doube and Barbara Banks (eds.), *Transformation with Industrialization in Peninsular Malaysia*, South-East Asian Social Science Monographs, Oxford University Press, Kuala Lumpur, 1994.

materials and the Japanese presence maintained this tradition. Wresting control from foreign influence and developing domestic investment was a major challenge for the Malaysian state in the 1980s and 1990s. To this end it proved necessary to begin regulation of the timber sector to prevent the siphoning of profits offshore. Yet foreign investment was required initially before the Malaysian state could develop a locally financed industry orientated toward exports.

PRIMARY PRODUCTION AND THE SHORTAGE OF DOMESTIC CAPITAL

The primary sectors outlined above cannot be regarded as the engines of industrial development.¹⁹ While agricultural production and mining enjoyed growth from 1969 onwards, the ability of these sectors, on their own, to contribute to an industrial transformation was limited. Growth required that raw materials such as timber and rubber be turned into manufactured products for export markets. In Malaysia, the shift to manufacturing required major capital investment. But domestic capital for local manufacturing expansion was lacking in the 1960s.²⁰ Not surprisingly, the impact of this decade's economic developments upon Malaysian state building was small, resulting in little institutional innovation. Foreign investment in the primary sector developed economic activity that was disconnected with manufacturing, creating, as development economics of the period argued, a 'dualist economy'.²¹ On the other hand, foreign investment in manufacturing, the core of the industrial economy that began to develop in the 1970s, was to have a major impact upon the Malaysian state as it began to disrupt pre-industrial social and political roles and relationships.

¹⁹ With major tin reserves the Malay Peninsula also supplied in the 1960s and 1970s much of the world's tin, most of it destined for European markets. British companies, who relied on imported labour, controlled most of the tin mining operations. For histories of the industry see Lin Ken Wong, *The Malayan Tin Industry to 1914, with Special Reference to the States of Perak, Selangor, Negri Sembilan, and Pahang*, Association for Asian Studies by the University of Arizona Press, Tucson, 1965; Yat Hoong Yip, *The Development of the Tin Mining Industry of Malaya*. University of Malaya Press, Kuala Lumpur, 1969.

²⁰ Rasiah, *Foreign Capital and Industrialization in Malaysia*, p.198.

²¹ See for example Hans Singer, 'Dualism Revisited: A New Approach to the Problems of the Dual Society in Developing Countries', and Singer, *The Strategy of International Development : Essays in the Economics of Backwardness*.

FOREIGN INVESTMENT AND INDUSTRIALIZATION

The East Asian regional economic context was an important factor in Malaysian industrialization. For the Malaysian economy to industrialize, a major injection of capital was needed to finance equipment and infrastructure. Japan's economic growth after WWII, followed by Korea and Taiwan, led to a rapidly expanding regional economy. Such growth resulted in increased capital seeking investment in the region. Capital investment in the first decade of Malaysian industrialization came almost entirely from Japan. Foreign direct investment was to impact upon the state and shape policy directions of the Malaysian Government. Just as the Norwegian Government responded to the foreign purchase of waterfalls through the Concession Laws, the Malaysian state reacted in a similar fashion to the foreign dominated oil and gas industry.

OIL AND GAS

Small quantities of oil had been extracted around Sarawak as early as the 1920s. The industry took off when substantial oil and gas reserves were discovered in the South China Sea in the late 1960s and large deposits of natural gas were further discovered off Sabah in 1970, leading to a rush of foreign investment. A combined venture between the UK-Dutch Shell Oil Company and the Japanese Mitsubishi Corporation in 1971 built a gas plant in Sarawak.²² The oil and natural gas industry rapidly became a major export earner. Sarawak extracted some 200,000 tonnes of oil in 1968, expanding production to over four million tonnes in 1973.²³ The flood of investment into the region also contributed to spending on infrastructure by private companies, in a region that had not developed at the same pace as the Peninsula. The influx of foreign capital into the oil sector prompted the Malaysian Government to establish in 1974 a state owned company to develop shared operations with foreign companies. The National Petroleum Development Corporation, known as Petronas, became the instrument by

²² John H. Drabble, *An Economic History of Malaysia, C. 1800-1990 : The Transition to Modern Economic Growth*, St. Martin's Press, New York, 2000, p.232.

²³ Ibid., p.231-32. Sarawak derived over half its export earnings from petroleum and natural gas by 1997. Michael Leigh, 'The New Realities for Sarawak' in C. Barlow (ed.), *Modern Malaysia in the Global Economy*, Edward Elgar, Cheltenham, 2001, p.120.

which the state extended its control into the oil and gas sector.²⁴ The Malaysian state engaged in negotiations with foreign oil companies and developed the means to manage the oil sector and gradually exclude foreign companies.²⁵ When large oil and gas reserves were discovered off the east coast of the Peninsula in the 1980s, Petronas was well established to exploit them without a reliance upon foreign capital and equipment.

Petronas, which was established by the state as a counter to foreign control, could link up its production with foreign companies and develop the skills of local staff.²⁶ The capital to establish industry initially came from overseas; Japanese and European firms provided equipment and expertise in the 1970s. Only afterwards could Malaysian partnerships with foreign interests be established or outright state control be exercised. Petronas became the vehicle by which this was achieved, extracting skills and knowledge from European and US companies and gradually building up domestic capacity. For the state, gaining the technical expertise to manage and regulate foreign investment through Petronas was vital to expanding its management role.²⁷ Asserting similar leverage in the emerging manufacturing sector would become a government priority in the 1980s and beyond.

MANUFACTURING AND FOREIGN INVESTMENT

Export orientated industry emerged in light manufacturing, textiles and food production.²⁸ In 1969, manufacturing, defined in the broadest of terms, comprised only thirteen per cent of GDP. It would grow at an average annual rate of between five and 13.5 per cent until 1989, becoming the heart of the economic transformation.²⁹ After

²⁴ See Bruce Gale, 'Petronas: Malaysia's National Oil Corporation', *Asian Survey*, 21:11, 1981, for a history of the establishment of Petronas.

²⁵ Ibid., pp.1134-7.

²⁶ Ibid., pp.1141-2.

²⁷ Rasiah. *Foreign Capital and Industrialization in Malaysia*, is perhaps the most complete book on the role of foreign investment in the growth of the Malaysian industrial economy. For perspectives on the role of Japanese investment see K. S. Jomo (ed.), *Japan and Malaysian Development : In the Shadow of the Rising Sun*, Routledge, London, 1994 & Friedmann Bartu, *The Ugly Japanese: Nippon's Economic Empire in Asia*, Longman, Singapore, 1992.

²⁸ Michael Taylor & Marion Ward, 'Industrial Transformation since 1970: The Context and the Means' in Brookfield, Doube, and Banks (eds.), *Transformation with Industrialization in Peninsular Malaysia*, p.109.

²⁹ Drabble, *An Economic History of Malaysia, C. 1800-1990 : The Transition to Modern Economic Growth*, p.237.

1970 the number of people employed in manufacturing more than doubled within ten years. Manufacturing made up eleven per cent of Malaysia's total export values in 1970. By the mid 1990s, the proportion had risen to over eighty per cent.³⁰ In thirty years, an economy based on agriculture and a few other primary commodities had expanded dramatically into manufacturing and services. With an existing supply of raw materials, Malaysia required capital expenditure for machinery and the skilled labour to operate it. Labour for factories and workshops was plentiful, whilst capital, at least in the early 1970s, was required from overseas, only later provided by the state and domestic private sources.

The largest share of foreign investment in Malaysia throughout the 1970s was Japanese. Significant capital investment, as well as machinery and transport equipment, resulted in Malaysia experiencing a trade deficit with Japan in the twenty year period from 1971; the only country with which it did not enjoy a trade surplus.³¹ Japan's demand for timber, rubber, oil and gas was amply served by Malaysia. In the early 1970s many Japanese industries relocated to other countries of East Asia, with Malaysia attracting many light manufacturing firms. Low labour costs and a concerted push by the Malaysian Government to attract investment saw the growth of factories producing consumer electrical and electronic goods for export. The manufacture of small, easily assembled goods has historically given way to the development of heavier and more technologically products. In Malaysia's case, the shift to heavy industry did not occur without state intervention. The challenge for the state in the late 1970s was to build domestic heavy industry on the back of Japanese investment and then squeeze out the foreign involvement. This was a strategy the Malaysian Government would use to great effect.

FOREIGN CAPITAL DEPENDENCE

Dependence upon foreign companies for the initial Malaysian manufacturing boom gave rise to a number of critiques. Kunio Yoshihara, taking up a world systems perspective, has argued that Malaysia experienced the growth of an 'ersatz capitalism'

³⁰ World Bank, 'Malaysia at a Glance', http://devdata.worldbank.org/AAG/mys_aag.pdf (accessed 4 May 2006).

³¹ Mohamed Aslam & Mohd Haflah Piei, 'Malaysia-Japan: Unequal Trade Partners' in K.S. Jomo (ed.), *Japan and Malaysian Development : In the Shadow of the Rising Sun*, p.23.

built upon borrowed and imported capital.³² Dependent upon foreign investment there was little domestic accumulation, leading to the risk that capital could depart in an economic slowdown. A not unrelated perspective located Malaysia in a regional context, describing its growth within the 'flying geese' pattern of industrial development.³³ Malaysia, according to these arguments, did not experience 'real' industrialization, but provided simply a cheap labour source for Japanese corporations.³⁴ These arguments reflect a view that small, peripheral states are reliant upon foreign capital and as a consequence struggle to accumulate domestic investment.³⁵ Yet whilst exogenous factors had a great impact as the preceding section has shown, the Malaysian economy and state building were not entirely shaped by foreign investment. As the Petronas case exemplified, foreign investment acted as a promoter and stimulant of domestic investment and considerable state intervention. The modern Malaysian state was shaped - as the next chapter will explain in detail - by internal as much as by external influences.

Table 4: Foreign Direct Investment

Year/s	1970-74	1975-79	1980	1982	1984	1986
FDI (equiv. IMF Special Drawing Rights)	184	362	718	1266	778	452

Source: World Bank, *Matching Risks and Rewards in a Mixed Economy*, World Bank, Washington, 1989, p.198.

MANUFACTURING GROWTH AND DIVERSIFICATION

Industrial development led to new sources of foreign investment. Japanese capital declined from around thirty per cent of all investment in the mid 1970s to some twenty

³² Yoshihara. *The Rise of Ersatz Capitalism in South-East Asia*, Kanishka Jayasuriya argues that Malaysian and South East Asian economic growth was built upon an 'embedded mercantilism' that proved fragile in the wake of the economic crisis of 1997. See Kanishka Jayasuriya, 'Southeast Asia's Embedded Mercantilism in Crisis: International Strategies and Domestic Coalitions', *SEARC Working Paper Series*, 3, April 2001.

³³ For a critique of this view see Martin Hart-Ladsburg and Paul Burkett, 'Contradictions of Capitalist Industrialization in East Asia: A Critique of 'Flying Geese' Theories of Development', *Economic Geography*, 74:2, 87-111, 1998.

³⁴ See James Clad, *Behind the Myth : Business, Money and Power in Southeast Asia*, Unwin Hyman, London, 1989.

³⁵ A generalist critique of Malaysian development is found in Keith Suter, 'Malaysia: Dash for Economic Growth', *Contemporary Review*, 262:1529, 1993, 302-306.

per cent a decade later. The other major sources of investment were the United Kingdom, the United States, Singapore and Hong Kong. Further diversification occurred in the 1980s as companies from Australia and Association of South East Asian Nations (ASEAN) states increased their investments.³⁶ Industries with large scale spending in equipment and labour training received the greatest foreign input. Food, tobacco production and electronics would remain under foreign control well into the 1980s.³⁷ Reclaiming local control began to occur over the decade when the state began to heavily invest in selected industries in a similar manner to Korea and Taiwan's industry policies of the 1970s. The regulatory mechanisms developed by the Malaysian state to exclude foreign capital and the resulting shift in control of the manufacturing sector were central to modern state development and will be scrutinized in the next chapter.

In 1989 the manufacturing sector surpassed agriculture in size and then proceeded to grow at an average rate of seventeen per cent of GDP per year until 1997.³⁸ Unemployment by the 1990s became almost negligible, especially in the higher growth areas of the Peninsula. Manufacturing had further contributed to the growth of services, in particular transport, insurance, banking and communications. By 1997, after an almost thirty year period of uninterrupted growth, Malaysia was placed in the top tier of middle-income countries.³⁹ The resulting societal impact of this transformation would reshape the state.

Table 5: Manufacturing Production Growth (Index) 1993 = 100

Year	1982	1985	1987	1990	1993	1996	1999
	32.8	36.6	45.2	70.4	100	147.3	167.5

Source: ADB Key Country Indicators Malaysia 2006.

³⁶ Taylor & Ward, 'Industrial Transformation since 1970: The Context and the Means.' in Brookfield, Doube and Banks (eds.), *Transformation with Industrialization in Peninsular Malaysia*, p.110.

³⁷ *ibid.*, p.109.

³⁸ Prema-chandra Athukorala, 'The Macroeconomy up to 1997' in Colin Barlow, (ed.) *Modern Malaysia in the Global Economy*, p.14.

³⁹ See United Nations Development Program, *Human Development Report: Human Development to Eradicate Poverty*, UNDP, New York, 1997; World Bank, *World Development Report: The State in a Changing World*, World Bank/Oxford University Press, New York, 1997.

THE SOCIAL IMPACT OF INDUSTRIALIZATION

As discussed in Part One, industrialization exercised a major transformative influence over society and is therefore central to our understanding of the process of modern state development. This section will outline the impact industrialization had upon Malaysian society and state, especially when the latter is conceptualized as an arena. This approach will enable us to explain the development of key social organizations and their interaction with state institutions. Like the Norwegian case study, Malaysian industrialization contributed to social changes that had far-reaching institutional implications. Social organizations, because of their role in the new industrial economy, became politically influential and increasingly interacted with political parties and government over a range of issues associated with industrialization. The remainder of this chapter addresses the key social organizations that emerged or changed as a consequence of industrialization.

Table 6: Per Capita GDP Growth

Year	1983	1986	1989	1992	1995	1998
Per capita GDP	4731	4444	6065	7914	10753	12826

Source: ADB Key Country Indicators Malaysia (figures in Malaysian Ringgit fixed to 2006 prices).

In 1997, Malaysia's twenty-two million inhabitants enjoyed greatly improved living standards compared to those of the preceding generation. Across numerous economic and social indicators Malaysia had become, after Singapore, the most economically developed state in South East Asia. The population between 1969 and 1997 doubled, as high birth rates combined with plummeting levels of mortality.⁴⁰ As the population grew, life expectancy also increased from sixty-four years to over seventy by 1997.⁴¹ As manufacturing expanded, people shifted from rural areas into growing towns and cities. Internal migration was to have the biggest impact upon ethnic Malays. The Chinese population tended to live in towns and cities post-independence, whilst the smaller ethnic Indian group were less transient and dispersed around plantation areas

⁴⁰ Kamarrudin Sharif, 'The Demographic Situation' in E.K. Fisk and H. Osman-Rani (eds.), *The Political Economy of Malaysia*, Oxford University Press, Kuala Lumpur, 1982, p.67.

⁴¹ Government of Malaysia, 'Malaysia: 30 Years of Poverty Reduction, Growth and Racial Harmony', World Bank/Economic Planning Unit, Washington DC, p.46.

and towns. As the industrial economy grew, the regions that experienced the most economic development drew in more rural people seeking employment.

Table 7

Year	GDP*	Manufacturing as per cent of GDP	Exports as per cent of GDP	manufactured goods as a percentage of exports
1965	7019	#	47.6	12.2
1970	12308	13.4	50.9	11.9
1975	17365	17.0	53.8	21.4
1980	27885	20.0	54.4	21.6
1985	37019	18.8	60.2	32.1
1990	105977	26.8	85.4	53.9
1995	222473	26.3	94.1	82.3

*fixed at 1970 price in million ringgit # figure not available

Sources: K. S. Jomo, *Growth and Structural Change in the Malaysian Economy*, Macmillan, Basingstoke, 1990; Drabble. *An Economic History of Malaysia, C. 1800-1990 : The Transition to Modern Economic Growth*, p.59; Asian Development Bank, *Key Indicators Malaysia*, ADB, Manila, 2006; World Bank, *Malaysia: Matching Risks and Rewards in a Mixed Economy Program*, p.141.

The demand for labour, most notably in building and construction, attracted immigrant workers from Indonesia and the Philippines. This new sub-sector of the workforce, often immigrating illegally, settled in cities. Women too were employed as workers, particularly in the textile industry, and later, as the sector developed, in the assembly and manufacture of electronic components and products.⁴² The rising importance of women in the workplace was accompanied by the growth of the student population, especially following government efforts to increase the numbers of ethnic Malays pursuing tertiary study in the newly developing universities in the 1970s.⁴³

⁴² See Virginia H. Dancz, *Women and Party Politics in Peninsular Malaysia*, Oxford University Press, Singapore, 1987; Ariffin Jamilah, *Women & Development in Malaysia*, Pelanduk, Petaling Jaya, 1992; Cecilia Ng, *Positioning Women in Malaysia: Class and Gender in an Industrializing State*, Macmillan, Basingstoke, 1999.

⁴³ Participation in education continued to grow throughout the period of industrialization. See Government of Malaysia 'Malaysia: 30 Years of Poverty Reduction, Growth and Racial Harmony', p.47. On education see for example Francis Hoy Kee Wong (ed.), *Readings in Malaysian Education*, Penerbit Universiti Malaya, Kuala Lumpur, 1977. On the issues surrounding ethnic quotas in Malaysian higher

Industrialization changed the way people worked and interacted with each other. It created the economic and social conditions that connected and organized people in new ways. People who had previously toiled in rural areas growing crops now laboured in workshops and factories and earned a wage. The cash economy grew and industrialization required more specialized skills and infrastructure services to support manufacturing. The need to coordinate resources and the other components of industrial production led to greater organization between suppliers and employers. Economic interaction between people around the new economy reshaped the state arena. The consequence of these pressures was that social and economic organizations, especially businesses, increasingly interacted with the emerging modern state via political parties rather than opposing or ignoring it as before.

ORGANIZATIONAL CHANGE AND DEVELOPMENT IN MALAYSIA

The key social organizations to be analyzed in this section are business groups and corporations, organized labour and political parties and political leaders. These actors had an influential role in the new industrial economy and became politically influential. Attention will also be directed to the Malaysian bureaucracy which was tasked with implementing the broad prescriptions of government. Bureaucratic institutions, as discussed in Part One, are a key area of interaction between the organizations in the state arena and state institutions. The question asked in the following section is: how did industrialization shape and impact the development of key social organizations within the state arena?

BUSINESS ORGANIZATIONS

Prior to 1970 the most productive sectors of the Malaysian economy were controlled by Chinese Malaysians.⁴⁴ Chinese groups had traditionally organized along familial lines

education see Linda J. Reid, *The Politics of Education in Malaysia*, University of Tasmania, Hobart, 1988.

⁴⁴ See Edmund Terence Gomez, Loh Wei Leng and Lee Kam Hing, 'Malaysia' in E. T. Gomez and H.-H. M. Hsiao (eds.), *Chinese Business in Southeast Asia: Contesting Cultural Explanations, Researching Entrepreneurship*, Curzon Press London, 2001. See especially pp.64-7 for a discussion of pre 1970 Chinese business in Malaysia.

and developed relationships with the MCA leading to linkages between business people and MCA politicians.⁴⁵ But the changing economy impacted upon business, particularly the dominant Chinese controlled banks such as United Malayan Banking Corporation and Public Bank. As the New Economic Policy (NEP) took effect, a new generation of Malay business leaders, many with connections to UMNO emerged in the 1970s. The UMNO dominated government was instrumental in establishing public corporations that encouraged Malay participation in the industrial economy.⁴⁶ In turn, Malay businesses developed ties with the bureaucracy and government, often jockeying for contracts in state construction projects. By the 1990s, banking, financial services and construction were no longer the exclusive preserve of Chinese Malaysians and Malay entrepreneurs were beginning to move away from dependence upon state subsidies.⁴⁷ This was a result of both government policy and the nature of the rapidly expanding Malaysian economy, where investors and business people sought new sources of income, from public floats and banks, domestically and from overseas.⁴⁸ The shift in ownership in the banking sector, from Chinese Malaysian to state and Malay control is significant. Searle points out that by 1990, only one of Malaysia's ten biggest banks remained in Chinese Malaysian hands.⁴⁹ Yet the changes in ownership did not lead to the disappearance of Chinese enterprise. Industrialization contributed to the development of a Malay business class, but it also created new Chinese Malaysian business organizations and new ways of operating. Chinese firms had in the past interacted with the state via the MCA. Industrialization gave rise to many new Chinese businesses in trade and manufacturing bypassing the MCA and interacting directly with Malay dominated state institutions, lessening the ethnic exclusivity that had previously shaped the economic landscape.

⁴⁵ Ibid., p.68.

⁴⁶ Edmund Terence Gomez and K. S. Jomo, *Malaysia's Political Economy : Politics, Patronage, and Profits*, Cambridge University Press, Cambridge, 1999, p.30.

⁴⁷ Peter W. Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, Allen & Unwin, St Leonards, 1998, p.174.

⁴⁸ See Ibid., for the most thorough discussion of the various changes in Malaysian business circles. Searle is particularly critical of simplistic notions that the Malay business class was 'artificially created' or that the Chinese were excluded from the UMNO-business relationship.

⁴⁹ Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, p.75.

BUSINESS ORGANIZATIONS AND THE RELATIONSHIP WITH UMNO

Ethnicity as a basis of division declined in business organizations as a direct consequence of industrial growth. Whilst affirmative action policies by the state did much to generate Malay wealth, the opportunities provided by the industrialization process created momentum for greater capital accumulation and development. Chinese dominated businesses, initially frozen out of government contracts, came to interact more with Malay owned businesses.⁵⁰ In the newer service sectors of the economy a range of multi-ethnic businesses developed, building on the linkages between government, investment capital groups and individuals within UMNO. With a network developing between business and the state, and government policies encouraging economic growth, there was little antagonism between government and business groups. The Malaysian Business Council enjoyed close ties with UMNO and the government leadership and established relationships with senior civil servants.⁵¹ A feature of this emerging bloc was the group of Malay tycoons that emerged from the state - business relationship. This small elite group came to own large chunks of the Malaysian corporate sector, often due to favourable treatment by government.⁵² This process was given considerable impetus as the government began to privatise state assets in the 1980s: sales were often directed by senior politicians towards favoured companies and individuals.⁵³ Such prominent UMNO politicians as Ghafar Baba and Datuk Syed Kechik turned to business and became powerful corporate leaders, drawing upon their connections in government for favours.⁵⁴ Industrialization during the 1980s generated much wealth, but it also led to greater concentration of ownership, further strengthening connections between businesses, the bureaucracy and the state.⁵⁵ Businesses well placed in the new industrial economy exerted significant influence over Malaysian politics through personal ties. These connections were greatly

⁵⁰ Gomez, Leng and Hing, 'Malaysia', p.69.

⁵¹ Natasha Hamilton-Hart, *Asian States, Asian Bankers*, Cornell University Press, Ithaca, 2000, p.113.

⁵² See Yik Koon Teh, 'Money Politics in Malaysia', *Journal of Contemporary Asia* 32:3, 2002, 338-46.

⁵³ K. S. Jomo (ed.), *Privatizing Malaysia: Rents, Rhetoric and Realities*, Westview Press, Boulder, 1995, pp.144-51.

⁵⁴ Searle, *The Riddle of Malaysian Capitalism*, pp. 128-33.

⁵⁵ Ibid., p.176. See also Helen B. Nankini, 'Lessons of Privatization in Developing Countries', *Finance and Development* 27:1, 1990, 43-45; Laurens Bawe, 'Private Profit at Public Expense', *The Ecologist* 26: 5, 1996, 229-233.

facilitated by industrialization in that business, UMNO and government became reliant upon one another for finance and organization of resources to continue industrial development. The Malaysian experience suggests that particular economic groups in the industrial era were able to use the state as an instrument to maintain and support their own interests. Malaysian business groups in manufacturing, trade and finance certainly became powerful, but the relationship with the state requires deeper analysis than that offered by an instrumentalist reading of the state. As the Malaysian economy grew, state behaviour could not always be understood as directly aligning with the interests of powerful business organizations. This was certainly the case following the Asian economic crisis of 1997 where the state oversaw the merger of banks that had previously been unregulated and had provided cheap credit to risky ventures. The consequences of unrestrained industrialization and the need for the state to maintain financial stability led to increased regulation and control by the state that sometimes overrode the interests of business.

The UMNO organization was built around relationships between the state and business. Public asset sales were directed by senior government figures all the way up to the Prime Minister toward individuals within the party. Favouritism often influenced share sales, a notorious example being the decision to award in 1987 a public tender to build the major North-South Highway to United Engineers, a company that had no experience in road construction and were at the time suspended from share trading. Yet United Engineers were controlled by a holding company led by several senior government officials.⁵⁶ Such instances were not isolated and the success of Malaysia's privatization process remains mixed among critics. Government officials and the World Bank gave the process mostly full marks, arguing that privatization reduced debt and did much to encourage efficiency within previously poorly performing state sectors.⁵⁷ Critics less enamoured of the process have pointed to widespread price increases for basic services, at times outrageous favouritism, and corrupted tendering processes.⁵⁸ Issues of transparency aside, the privatization process paved the way for closer ties between business organizations and government via

⁵⁶ Winnie Goh and Jomo Sundram, 'Privatisation in Malaysia: A Social and Economic Paradox' in M. Hossain and J. Malbon (eds.), *Who Benefits from Privatisation?*, Routledge, London, 1998, p.188.

⁵⁷ See G Naidu and Cassey Lee, 'The Transition to Privatization: Malaysia' in A. Mody (ed.), *Infrastructure Strategies in East Asia*, World Bank, Washington D.C., 1997.

⁵⁸ For a broad and thorough examination and critique of many aspects of the privatization process see Jomo, (ed.) *Privatizing Malaysia: Rents, Rhetoric and Realities*.

political parties, notably UMNO. Business organizations needed to interact with UMNO if they were to gain access to licences, permits and state financial assistance.

The most important social organizations during Malaysia's industrialization process were the major political parties. Impacted greatly by the economic change of the 1970s and 1980s, political parties became the major social organizations mediating the state and society. As in Norway, political parties were the key political organizations that represented and channelled social and economic interests vis-a-vis government. The following section will focus upon the three major political parties, with a particular emphasis on UMNO and its evolution.

THE UNITED MALAYS NATIONAL ORGANIZATION

Since independence, Malaysian political parties have taken centre stage as the primary actors in the modern state arena. By virtue of their proximity to government, political parties are organizations that can straddle the divide between society and the institutions of the state. They function as the major channels of political influence on the state. The major Malaysian political parties in 1969 represented their respective ethnic constituencies. Industrialization would impact significantly upon Malaysian political parties, with considerable ramifications for the ethnic divide. In modern Malaysian politics, it is difficult to separate the state from UMNO because of multiple ties and connections. An analytical focus upon interaction between society and the state developed in Part One will highlight UMNO's central role in the story of Malaysian state development.

UNITED MALAYS NATIONAL ORGANIZATION: THE CENTRE OF MALAYSIAN POLITICAL LIFE

UMNO has been the largest component of the ruling coalition since independence and provided all of Malaysia's Prime Ministers. Founded in 1946 on a platform of opposition to British rule, UMNO has occupied the centre of Malay political life, representing the indigenous Malays (*bumiputra* or 'sons of the soil'), who made up most of the rural workers and urban poor. While dominated and controlled by the

urban Malay elite, the major UMNO electoral base has remained the rural poor.⁵⁹ Espousing a mild ethnic nationalism, the leadership attempted to balance a variety of Malay interests, a process requiring at times considerable negotiating skill.⁶⁰ Industrialization profoundly impacted upon and changed UMNO. The following section demonstrates how, as a consequence of industrialization, a political party transformed itself into a vast network of political sub-groups, business interests and holding companies. The importance of UMNO as the core of interaction around industrialization therefore makes it central to modern state development.

UMNO AND INDUSTRIALIZATION

Post-independence, UMNO maintained itself as the dominant party in the ruling 'Grand Alliance' which included the MCA and the MIC. Known colloquially as 'the bargain', Malay dominance in government, police, judiciary and bureaucracy was nominally countered by Chinese control of the most productive sectors of the economy. As the election of 1969 demonstrated, such a political order was susceptible to outbidding by rival factions. By the early 1970s and the implementation of the NEP, UMNO had to seek new ways to cement its power and maintain ethnic harmony. The aftermath of 1969 was marked by conflict between the UMNO leadership and extremist youth elements over the party's direction.⁶¹ As UMNO also controlled the government, the communal bargain that had previously sustained Malaysian politics required renegotiation. The traditional ruling elements of UMNO were becoming subject to pressure from a new generation of leaders. This younger group had fewer traditional family based political ties, drawing upon their increasing economic power as members of the emerging professional middle class. The existing political structures were under pressure from the changing economic landscape.

UMNO leaders attempted to maintain unity in this changing environment. As an ethnically defined party that had assumed the responsibility of government, the UMNO leadership recognised the importance of preventing fractures. Coordinating factions, from within UMNO and other coalition parties was a primary role of

⁵⁹ Harold A. Crouch, *Government and Society in Malaysia*, Allen & Unwin, St. Leonards, 1996. p.37.

⁶⁰ Milne and Mauzy. *Politics and Government in Malaysia*, pp.123-4.

⁶¹ The future Prime Minister Mahatir bin Mohamad was expelled from UMNO in 1969. He was viewed as a destabilising element, particularly after he published *The Malay Dilemma* which was subsequently banned in Malaysia.

Malaysia's Prime Ministers. Tun Abdul Razak, the president of UMNO and Prime Minister of Malaysia from 1970 until 1976, was instrumental in uniting the party. The social and economic changes generated by industrialization required a carefully calibrated political response for the maintenance of stability and continuing growth.

Under Razak, the UMNO leadership sought to enlarge the ruling coalition but retain the one umbrella. Thus, the Alliance made a transition to the Barisan Nasional (BN), established by mid 1974.⁶² As Harold Crouch argues, the formation of the BN performed a dual role.⁶³ Expanding the coalition gave more parties a seat at the table. The hope of Razak was that by incorporating more groups, the problems stemming from economic change could be resolved 'in house' thereby lessening the incentive for groups to act outside the system and destabilize the coalition. The result was that factions were able to interact with the state from within the ruling BN. In immediate political terms, UMNO further extended its dominance, ensuring its continued central role in government.⁶⁴

THE GROWTH OF THE UMNO NETWORK

The UMNO led state apparatus controlled the complex set of relationships with business that some have described as a vast network of patronage.⁶⁵ State elections became hotly contested and were often subject to corrupting influences of excessive electoral spending by wealthy candidates.⁶⁶ Patronage and personal relationships were more effective means of building support than formal and legal processes.⁶⁷ Industrial development generated pools of capital under the control of UMNO through holding companies and trust funds established after the NEP. UMNO acquired immense political and economic power by drawing business leaders and organizations into its network. For manufacturing, construction and trade companies to succeed, close ties and preferably membership of UMNO became virtually compulsory. As a

⁶² For a good discussion of the process of transition to the BN see Gordon Paul Means, *Malaysian Politics: The Second Generation*, Hodder and Stoughton, London, 1976, pp.30-2.

⁶³ Crouch, *Government and Society in Malaysia*, p.33.

⁶⁴ Ibid., p.33.

⁶⁵ Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, chapter 5. See also Koon The, 'Money Politics in Malaysia'.

⁶⁶ Koon The, 'Money Politics in Malaysia', p.341.

⁶⁷ Ibid., p.340.

consequence, political and economic interests converged around the party and became closely entwined.

Though UMNO was beset by factionalism through the 1970s, Razak's considerable political skills allowed him to maintain and cement the national unity approach of his predecessor. Coalition building around UMNO drew in otherwise resistant factions; the UMNO leadership's ability to distribute financial largesse generated by industrial development was instrumental in this process.⁶⁸ Indirectly, the Malaysian Government was able to use the state share of the growing industrial economy as an instrument for coalition building; to ensure financial success business groups had to remain supportive of government policy. In-won Hwang describes this period as a shift from the 'consociational bargain' of the post-independence era to a period of increasing UMNO dominance.⁶⁹ During the 1970s UMNO expanded its economic activities by establishing holding companies and funds directed to the advancement of Malays in business. The process resulted in greater centralization of control within the party, with UMNO closely tied to the state and a burgeoning civil service. As the state gained greater control of the industrial economy via the handing out of financial incentives and the establishment of state owned companies, UMNO's ability to co-opt disparate splinter groups through its own financial incentives increased. Industrialization transformed UMNO from an ethnically defined political party, into a business friendly party with intimate links to Malaysian state institutions.

THE MODERN UMNO EMERGES

In the mid 1970s as Malaysia industrialized, the UMNO support base changed. No longer reliant upon just rural voters, a new urban middle class of Malays from the burgeoning bureaucracy, judiciary, military and developing private business began to be drawn into the UMNO network. Patronage brought about the growth of this new support base. Whether through favouritism or outright cronyism, UMNO, in line with the NEP, facilitated the development of a property-owning Malay middle class.⁷⁰

⁶⁸ Ibid., pp.339-40.

⁶⁹ In-Won Hwang, *Personalized Politics : The Malaysian State under Mahathir*, Institute of Southeast Asian Studies, Singapore, 2003, see chapters three and four.

⁷⁰ Crouch. *Government and Society in Malaysia*, p.42. See also World Bank, *Malaysia: Matching Risks and Rewards in a Mixed Economy Program*, World Bank. Washington D.C., 1989.

Through the many personal connections, much of the new industrial capital established by the state through holding companies and loans was channelled through UMNO.

The death of Razak in 1976 signified the end of the first generation of UMNO leadership, and permitted the entry and consolidation of younger politicians less influenced by the colonial era. For the five years until 1981, UMNO and the Malaysian Government were led by Tun Hussein Onn, the brother-in-law of Razak. Appointed deputy in 1973 Hussein lacked the time at the post to build a wide support base. His time as leader was notable for its inactivity; cautious decision making quite often appeared as ineffectiveness and indecisiveness.⁷¹ The late 1970s witnessed increasing party strife, with the legacy of the Razak era providing the main source of stability.⁷² To counter internal party manoeuvring, Onn appointed as Deputy Prime Minister Mahathir Mohamad in 1976, a move greeted with surprise as more experienced candidates were overlooked.⁷³ Mahathir became Prime Minister in 1981 when Onn stepped down due to illness.

Under Mahathir's leadership the 1980s brought a growing liberalization of the economy and increased centralization of UMNO. The leadership was secure, and UMNO was assured of clear majorities in state as well as federal elections.⁷⁴ The rapidly transforming economy dramatically changed UMNO and its mode of operation. No longer just the party of the Malays, UMNO became enmeshed with business, yet maintained responsibility for accommodating Chinese and Indian interests while continued to placate nationalist Malay groups. UMNO thus became the single most important institution of political contest in Malaysia. As the state offered economic opportunities in the form of contracts and sales of public assets to the private sector, interaction between UMNO, government and state institutions increased. Privatization, which began in earnest in the 1980s, involved selling public companies involved in such key sectors as communications (Syarikat Telekom Malaysia), and

⁷¹ Samad Paridah Abd, *Tun Abdul Razak, a Phenomenon in Malaysian Politics: A Political Biography*, Affluent Master Sdn. Bhd., Kuala Lumpur, 1998, pp.155-7.

⁷² Ibid., pp.158-64.

⁷³ Means, *Malaysian Politics: The Second Generation*, p.55.

⁷⁴ The exceptions to UMNO dominance were in Sabah and Sarawak. Smaller parties proved popular that did not always align with Peninsula and UMNO interests. See Crouch, *Government and Society in Malaysia*, pp.50-4.

transport (Malaysian Airlines, Malaysian International Shipping Corporation). Yet these and many other companies remained under the control of UMNO controlled funds and firms and thus retained their ties to the state. Industrialization created great wealth but with UMNO occupying the centre of the industrial transformation it inevitably became the site of political contestation. Consummate leadership would be needed to hold the party together and maintain the pace of Malaysian industrialization.

MAHATHIR

Mohamad Mahathir was representative of the emerging Malay business professional. Trained as a medical doctor, he did not share the aristocratic background of Prime Ministers Abdul Raman and Razak and had fewer obligations to maintain the traditions of consultation and deference in government.⁷⁵ The role of Prime Minister under Mahathir changed from a negotiator between ethnic parties to that of a policy maker and leader; indeed a heavy handed one. The considerable resources of the state were now at Mahathir's disposal and his new brand of assertive leadership. This section will analyze Mahathir's time as leader, and how the success of his authoritarian style was dependent upon maintaining rapid growth to encourage investment and further economic expansion.

MAHATHIR AND THE RESHAPING OF THE UMNO PARTY

Mahathir as Prime Minister waded a path through opposition to his rule including criticism by the former Prime Minister Tunku Raman who became a dissenting voice via an occasional newspaper column.⁷⁶ As the UMNO coalition grew in the 1980s, the array of opinions to be accommodated increased, as did the degree of factionalism. In 1987 the discord came to head and presented Mahathir with the greatest test of his

⁷⁵ Mahathir, due to his controversy as a political figure in Malaysian history, has had few accounts of his career produced that do not either engage in excessive flattery or harsh criticism. Perhaps the most considered and useful biographical work is Boo Teik Khoo, *Paradoxes of Mahathirism: An Intellectual Biography of Mahathir Mohamad*, Oxford University Press, Kuala Lumpur, 1995. For a discussion on the Malay cultural traditions of political leadership see Chandra Muzaffar, *Protector?*, Aliran, Pulau Penang, 1979.

⁷⁶ Some other critiques of Mahathir are found in David Martin Jones, 'What Mahathir Has Wrought', *The National Interest*, Spring, 2000, 101-117; Ian Stewart, *The Mahathir Legacy: A Nation Divided, a Region at Risk*, Allen & Unwin, Crows Nest, 2003.

leadership. Facing strong opposition from the UMNO membership, he set about reconstructing the party around himself. From the UMNO General Assembly of October 1987, Mahathir began a purge both of opponents within the core party leadership and senior figures from several state administrations. The Prime Minister's next step, through legalistic engineering, was to dissolve UMNO and reconstitute it on his terms. Registered as UMNO *Baru* (*new*), Mahathir rebuilt the party almost entirely to his own liking.⁷⁷ UMNO the party and government were now also institutions of Mahathir's rule. His dominance, whilst a result of his political skill and manoeuvring, was also made possible by continuing industrial growth under the NEP and after 1991, the National Development Policy framework. The sale of profitable state assets and infrastructure to favoured UMNO officials further enhanced Mahathir's support.⁷⁸ While Malay wealth increased, Mahathir was able to act decisively and maintain support from his party. Assisting the government was the economic web linking UMNO and the industrial economy that continued its rapid growth in the 1980s.

MAHATHIR AND INDUSTRIALIZATION

Whilst all Malaysian political leaders depended upon personal leadership to influence government decision making, Mahathir set a new benchmark for 'personalized politics'.⁷⁹ It is impossible to discuss Malaysian politics in the 1980s and 1990s without consideration of Mahathir's central role. His leadership significantly altered the way in which the modern Malaysian state - notably the civil service - developed and shaped the industrial economy. His was a very personal mission: to single-handedly lead, indeed drag Malaysia into the ranks of the industrialized nations of the world. The institutions of the state would be consciously used as instruments to bring about continued industrial development. A key state agency that moved closer to Mahathir in the 1980s was the Capital Issues Committee (CIC). Its independence became compromised in 1985 when its chairman, Tan Sri Aziz Taha, who was also the Governor of Bank Negara, was forced out by the Finance Minister and Mahathir ally

⁷⁷ Hwang, *Personalized Politics: The Malaysian State under Mahathir*, p.164. In the coming months, Mahathir effectively dropped the 'new' tag. Further, the symbols of the old party were recycled. The chief difference between old and new concerned the loyalty of the membership to their leader.

⁷⁸ Anne Munro-Kua, *Authoritarian Populism in Malaysia*, Macmillan, Houndsmill, 1996, pp.106-111

⁷⁹ Hwang, *Personalized Politics: The Malaysian State under Mahathir*, for a discussion of the Malay leadership persona see Muzaffar, *Protector?*,

Daim Zainuddin. The CIC, and its authority over share transactions, became closely aligned with the expansionary policies of Zainuddin and Mahathir.⁸⁰ Closer ties to industry were formed through such manoeuvring and Mahathir himself took responsibility for many business decisions made by state supported companies. His leadership of the development of the heavy industry sector was, as the next chapter will show, was critical to the emerging linkages between the state and business. This interaction did not necessarily mean dominance by business interests over the state. Mahathir maintained a great deal of control over policy implementation, hence the new economy. For the Malaysian state, the most significant impact of industrialization was the development of institutions that could manage and regulate the new state supported industrial companies. This process of change affected those beyond the UMNO network, notably the parties of ethnic Chinese and Indian Malaysians. They remained important, but their character and roles changed greatly in the years following 1969.

OTHER MALAYSIAN POLITICAL PARTIES

In the post independence era and well into the 1970s, Malaysian political parties were defined by the ethnicity of their constituents. Industrialization and the new wealth it created was to break down ethnic divisions and began to alter the membership and nature of major political parties. The MCA was and continues to be the chief voice of ethnic Chinese interests in Malaysia, but it struggled to remain united over the years, particularly during the period of rapid economic development. Many within the Chinese community often had differing views, indeed as Pek Koon Heng points out, Chinese interests in Malaysia have often been portrayed in monolithic terms.⁸¹ Established as a political party in 1949, the MCA based itself upon the tradition of Chinese political organization on the Malay Peninsula with ties to the Chinese diaspora business community. Drawn into the Alliance coalition in the post independence period, the MCA encountered its greatest challenge in the aftermath of the 1969 riots. Following the NEP the MCA were forced to renegotiate the coalition with the ruling UMNO party, in the hope of retaining support from Chinese Malaysians who were

⁸⁰ Searle, *The Riddle of Malaysian Capitalism*, p.48.

⁸¹ Pek Koon Heng, *Chinese Politics in Malaysia: A History of the Malaysian Chinese Association*, Oxford University Press, Singapore, 1988.

increasingly concerned about their future as equal stakeholders in Malaysia. Support for the party declined in the 1970s as UMNO dominated the BN.⁸² Yet even as support declined, the BN's legitimacy required Chinese representation. With UMNO assuming the role of a business network as well as representative of Malay interests, and with the rapidly expanding system of patronage, the MCA was less able to rely upon the Chinese business community for support, who were often happy to directly engage with UMNO in return for economic favours.⁸³ The MCA, like UMNO, became less defined by its ethnic constituency, and more by its connection with economic favours, advantages and networks. This shift in party representation reflects the changing interests of political parties: less defined by ethnicity and increasingly shaped by their constituency's relationship to the industrial economy.

The third partner in the ruling coalition, the Malaysian Indian Congress (MIC), functioned along similar lines, as a patron of its particular ethnic group.⁸⁴ It too was influenced by the changing economic landscape. Many Indian Malaysians, as they drifted from working on rubber plantations, came to change their political affiliations, away from the MIC.⁸⁵ Other important parties included the mostly ethnic Chinese Democratic Action Party (DAP), which though not exclusively ethnically aligned, gained votes from people deserting the Alliance and BN.

Opposition parties emerged in the 1970s, as the economy transformed and the UMNO controlled state cemented its authority. Outside of the ruling coalition, opposition parties were able to be more outspoken and critical in contrast to the centrist position of the BN coalition government. An oppositional stance presented problems for political parties in Malaysia, for, as John Hilley argues, to be on the outside meant dysfunction, for it was to be outside the formal institutions of rule and outside the Malaysian industrial project.⁸⁶ With the BN having an effective monopoly on ethnic representation, Malaysian opposition parties espoused an alternate set of policies around a rather different framework. The DAP and the People's Progressive Party

⁸² Ibid., p.265.

⁸³ Ibid., p.269.

⁸⁴ See for example Paul D. Wiebe and S. Mariappen, *Indian Malaysians: The View from the Plantation*, Carolina Academic Press, Durham, 1979. See also Means, *Malaysian Politics: The Second Generation*, pp.153-4.

⁸⁵ Wiebe and Mariappen, *Indian Malaysians: The View from the Plantation*, p.132.

⁸⁶ John Hilley, *Malaysia : Mahathirism, Hegemony, and the New Opposition*, Zed Books, London, 2001, p.13.

developed a platform based upon a less ethnic definition of representation. They developed a counter vision of Malaysia's future, arguing that the BN was overly dominant and a barrier to the development of a democratic system. Yet despite a generally oppositional stance, on many core issues there was often agreement with the BN. The social problems generated by industrial development contributed to the emergence of common interests across groups that previously opposed one another. The belief in the importance of fair and equitable economic growth was maintained, as was the need to build elements of a welfare state capable of attending to the health and education of all Malaysians, regardless of their ethnicity. Industrial growth and the opportunities it offered often eclipsed differences between parties. As the previous Norwegian case demonstrated, maintaining industrial growth became a policy objective for all Malaysian political parties. By taking such a stance, the regulation of the industrial economy by management of its components became politically acceptable. This consensus had a major impact upon the development of the Malaysian state, as state supported companies and UMNO's industry policy received support from all parties in the 1980s and 1990s.⁸⁷ While growth continued, few organizations took an interest in destabilizing the political order.

INDUSTRIALIZATION AND ITS IMPACT ON POLITICAL PARTIES

UMNO, by virtue of its dominant position in government and the leadership of Mahathir, became first and foremost a party of business. Chinese supporters of the MCA chose to interact with UMNO for economic gain, breaking down the explicit ethnic divide. Enjoying the benefits of industrialization required that political parties function within the UMNO network. As a result of economic growth and the resulting changes in the political landscape, Malaysia's political parties became increasingly defined by their constituent's role in the new industrial economy. Ethnic division between the major political parties diminished, to be replaced by a growing economic class divide. Exacerbated by the privatization process of the 1980s, wealthy business

⁸⁷ A counter to UMNO led domination emerged in the 1970s with the revival of religion as a political force. The formal expression of this movement was Parti Islam Se-Malaysia (PAS) formed in 1951 as an ethnic Malay party that tended to remain outside the BN coalition despite negotiations to coopt it permanently. The Islamic Malay perspective, in contrast to the mainstream version, was hostile to the concept of an inclusive Malaysian nationalism. PAS later moderated this approach, accepting this version of nationalism was counter-productive. By the 1970s the growth of the Malay student population and an Islamic revival movement increased the size and power of PAS and other Islamic political organizations.

leaders enjoyed close relationships with government and bureaucratic officials. Wealth and connections within the UMNO network shaped Malaysian politics with only a veneer of ethnic identity maintained by the major parties within the BN. As discussed further in the next chapter, especially close ties were built between businesses and the bureaucracy through the industrialization process. As a consequence of this close relationship, the other key group in an industrialized society, that of labour, was often subjected to harsh treatment by the state through legislation and the use of force. The next section will show, how in sharp contrast to the Norwegian example, the influence of organized labour in Malaysian industrialization was limited. The analytical approach will identify some important distinctions, yet also show that Malaysian trade unions were far weaker than their Norwegian counterparts for reasons other than coercive pressure from government laws and controls.

ORGANIZED LABOUR IN INDUSTRIALIZING MALAYSIA

The first organization of workers took place in the rural plantations on the Malay Peninsula, in particular in the rubber and later the oil palm industry. Prior to WWII, workers tended to be organized in guilds with a modern union movement emerging with independence and only then with British assistance and approval.⁸⁸ The main organization in the rubber sector, the National Union of Plantation Workers (NUPW) has represented plantation workers throughout the course of Malaysia's industrial development. Agriculture remained an important industry for the Indian Malaysian population. In wages and conditions, the agricultural sector did not enjoy the same improvement that occurred elsewhere. Plantation workers remained the largest element of the Malaysian Trades Union Congress. The effectiveness of the NUPW as a union was limited as much of the leadership became increasingly engaged in their own business operations, making for a grey area of loyalty. The growth of the palm oil export sector led to many business opportunities that union leaders were often well placed to exploit. As the NUPW evolved in the 1980s into a conciliatory agent rather than confrontational, membership declined.⁸⁹

⁸⁸ Crouch, *Government and Society in Malaysia*, p.89.

⁸⁹ See Selvakumaran Ramachandran and Kris Arjunan, *Human Resources Development and Trade Unionism in the Malaysian Plantation Industry*, Industrial Relations Research Centre, University of New South Wales, Kensington, 1993.

The rapidly growing manufacturing and electronics sectors in the 1970s experienced the least organization among workers. To attract foreign capital for the manufacturing sector, the government ensured the compliance of workers through a variety of legislative means, at times using the draconian Internal Security Act (ISA) against unions.⁹⁰ The heavy involvement of UMNO party members, via holding companies, in business activities worked to the detriment of organized labour.⁹¹ Unionization was forbidden for many years in the electronics industry, and was permitted only to a limited degree in the 1980s.⁹² Those sectors where unionization was allowed were subject to tight controls on activity. Strikes required a secret ballot, advance public notice and only after other avenues of negotiation with the employer had been exhausted. In the 1960s, the restrictions placed upon unions were often claimed as necessary due to the legacy of the communist insurgency in the 1950s. Whilst this may have been the case in the early 1960s, by the late 1970s it was apparent that unionization in factories represented a threat to low labour costs rather than any Communist infiltration. Suppressing unions became state policy to keep wages low to encourage foreign investment.⁹³ This was achieved in the 1980s by encouraging immigrant labour and establishing government controlled in-house unions for industry to weaken the independent national labour movement.⁹⁴

A test of the government's resolve occurred following the strike by employees of Malaysian Airline Systems in 1978. Dragging on for many months, the strike ended when the leadership was arrested and imprisoned under the ISA.⁹⁵ The limited role of unions during industrialization is due largely to such state pressure. Yet union membership remained low due to other factors. After independence, union membership was dominated by Indian Malaysians; thus unions tended to be associated with one ethnic group at the exclusion of others.⁹⁶ The union association with Indian Malaysians proved just as powerful, if not more so than any emerging

⁹⁰ The most complete text on Malaysian trade unions is K. S. Jomo and Patricia Todd, *Trade Unions and the State in Peninsula Malaysia*, Oxford, Kuala Lumpur, 1994.

⁹¹ Elizabeth Grace, *Shortcircuiting Labour: Unionising Electronic Workers in Malaysia*, Institute of Social Analysis, Kuala Lumpur, 1990, pp.6-9.

⁹² *Ibid.*, p.10.

⁹³ K.S. Jomo, *Trade Unions and the State in Peninsula Malaysia*, p.149.

⁹⁴ *Ibid.* pp.150-1.

⁹⁵ See Jomo and Todd, *Trade Unions and the State in Peninsula Malaysia*, pp.142-3.

⁹⁶ Crouch, *Government and Society in Malaysia*, p.90.

class consciousness.⁹⁷ This factor, along with the strong family linkages between Chinese business in banking, trade and manufacturing, resulted in the development of fragmented guilds and associations, rather than a centrally organized and led trade union system. The weakness of organized labour further galvanised cooperation between business groups and the government, who shared common interest in maintaining low wage growth and limiting disruption of the labour supply.

THE CIVIL SERVICE

Malaysia inherited a public service structure and tradition from Great Britain that was maintained post-independence.⁹⁸ Under government direction, the bureaucracy's role and size in the 1970s began to shift from a system maintaining set of institutions, staffed by socially well connected Malays, to a meritorious organization tasked with implementing the NEP.⁹⁹ Industrialization led to the expansion of the bureaucracy; the diverse activities under the NEP required additional management staff.¹⁰⁰ For such an ambitious policy to have an impact, a more professional workforce was required. Even prior to the 1970s the need for a competent, motivated and well trained public service was recognized by political leaders; pride was sufficiently swallowed to permit external assessments and reports as well as favourable internal reporting.¹⁰¹ Yet the major growth in public sector employment and the new industrial policies led to inefficiency and at worse, corruption, as the private sector became recipients of state funding and the largesse of bureaucrats.¹⁰² This problem became apparent under the

⁹⁷ See Clare Boulanger, 'Ethnicity and Practice in Malaysian Unions', *Ethnic and Racial Studies*, 19:3, 1996, 660-680.

⁹⁸ See Johan Khasnor, *The Emergence of the Modern Malay Administrative Elite*, Oxford University Press, Singapore, 1984.

⁹⁹ For a history of the early post-independence Malaysian civil service see Robert O. Tilman, *Bureaucratic Transition in Malaya*, Duke University Press, Durham, 1964; R. S. Milne, *Government and Politics in Malaysia*, Houghton Mifflin, Boston, 1967, pp.152-56. See also Martin Rudner, *Nationalism, Planning, and Economic Modernization in Malaysia: The Politics of Beginning Development*, Sage Publications, Beverly Hills, 1975, pp.18-24.

¹⁰⁰ State employees (not including police or military) increased in numbers from 139,000 in 1970 to 521,000 by 1983. K. S. Jomo, Khoo Boo Teik and Chang Yii Tan, *Vision, Policy and Governance*, World Bank, Private Sector Development Department, Washington D.C., 1995, p.14.

¹⁰¹ An early example of such external auditing is found in John Dickey Montgomery and Milton J. Esman, *Development Administration in Malaysia : Report to the Government of Malaysia*, Kuala Lumpur, 1966. An example of internal reporting is Government of Malaysia, Prime Minister's Department and A. H. Ahmad Sarji, *The Civil Service of Malaysia: A Paradigm Shift*. Kuala Lumpur, Government of Malaysia, 1994, a tome of close to 1000 pages reporting on 1993 alone.

¹⁰² The Malaysian system is often associated with such processes. Much literature on modern Malaysia makes at least a passing reference to cronyism. For examples of specific cases studies and accounts see

leadership of Mahathir who sought to corporatize and even privatize many civil service functions in the 1980s.

INDUSTRIALIZATION AND CIVIL SERVICE REFORM

The reform effort was led by Mahathir, who saw the stereotype of the 'lazy Malay' as an obstacle to the civil service's successful implementation of the NEP and heavy industries.¹⁰³ Modernizing the public service became a stated government objective and an essential instrument to effectively managing state owned and controlled companies.¹⁰⁴ Minor changes such as the introduction of a punch-card attendance system to improve staff efficiency took effect. In the mid 1980s, Peninsula Malaysia altered its time zone by half an hour in order to integrate with Sabah and Sarawak. These changes, whilst seemingly trivial, introducing a theme of constant change and improvement.¹⁰⁵ By the mid 1980s, the civil service was becoming the management centre of industry. The transformation of attitudes and motivation among staff proved even more significant than the expansion in size that took place during the 'Confrontation' period of the mid 1960s.

A growth in training and postgraduate education continued to enhance the management capacity of the bureaucracy into the 1980s.¹⁰⁶ Such developments were necessary, especially as the civil service in the 1980s became tasked with managing a growing number of heavy industrial projects. Building a heavy industry sector required that state controlled holding companies receive greater managerial and administrative attention.¹⁰⁷ A consequence of Malaysia's industrialization and government policies, especially the NEP, was a heavily politicized bureaucracy in the

Koon The, 'Money Politics in Malaysia'; K.S. Jomo (ed.), *Privatizing Malaysia: Rents, Rhetoric and Realities*; Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*. Searle's is perhaps the most complete recent book on the topic.

¹⁰³ Mahathir had viewed certain cultural traits among Malays as a problem to be addressed far earlier. His controversial *The Malay Dilemma* contained numerous passages discussing such issues.

¹⁰⁴ For a later example see Government of Malaysia, Prime Minister's Dept. and, A. H. Ahmad Sarji, *Towards a Quality, Productive and Accountable Civil Service in Malaysia : Development Administration Circulars 1991, 1992 and 1993*, Kuala Lumpur. Government of Malaysia, 1993.

¹⁰⁵ Jomo, Khoo and Chang, *Vision, Policy and Governance*, p.22.

¹⁰⁶ Jomo, Khoo and Chang have a mixed assessment, concluding that the Malaysian civil service moved between various levels of competence and ability, see *Ibid.*, p.35.

¹⁰⁷ Noore Alam Siddiquee, 'Public Accountability in Malaysia: Challenges and Critical Concerns', *Journal of Public Administration*, 28:1, 2005, 107-129, p.111.

1980s.¹⁰⁸ Close relationships between business and government often came at the expense of the civil service by lessening their administrative power, particularly under Mahathir's leadership.¹⁰⁹ A powerful executive dominated the bureaucracy in the 1990s with ministry staff taking direction from government on day-to-day activities and enjoying little autonomy. Yet as will be detailed in the next chapter, this shift in power towards the executive was halted to a degree by the 1997 economic crisis that revealed underlying problems of corruption and political interference.¹¹⁰ The regulatory and administrative power of the bureaucracy, particularly the central bank, was increased by the need to bail out banks and financial institutions in 1998. In keeping with the 'developmental state' tradition of the region, the bureaucracy was able to assert its managerial abilities over the industrial economy and facilitate the process of recovery.

CONCLUSION

This chapter has presented an analysis of Malaysian industrialization as both an economic and social process of change. It focused first upon the economic process: the pre-industrial economy of Malaysia; the impact of foreign investment and the growth of the new industrial economy based upon the export of manufactured goods and services. It described how the economic changes wrought by industrialization reshaped Malaysian society. The rapid growth of manufacturing and the services required to support it left no part of the Malaysian economy untouched. Like Norway, foreign investment and the growth of an export orientated manufacturing sector had consequences for business, organized labour and political parties. The new economy impacted upon these organizations, changing the way they operated and interacted with each other. The next chapter will demonstrate the intimate link between industrialization and state building.

Japanese investment engaged the Malaysian economy with the East Asia region. The growth of the fossil fuel, timber and light manufacturing sectors connected economic

¹⁰⁸ See Crouch, *Government and Society in Malaysia*, p.45-55. See also Siddiquee, 'Public Accountability in Malaysia: Challenges and Critical Concerns', p.111.

¹⁰⁹ Crouch, *Government and Society in Malaysia*, p.54.

¹¹⁰ Ho Khai Leong, 'Malaysia's Civil Service Reform: Mahathir's Legacies and Abdullah's Challenges' in Saw Swee-Hock and K. Kesavapany (eds.), *Malaysia: Recent Trends and Challenges*, Institute of Southeast Asian Studies, Singapore, 2006, p.202.

actors within Malaysia who in turn became linked to the world economy through trade. The impact of foreign investment and the rise of manufacturing were the development of a modern economy that required an increase in cooperative interaction between suppliers and producers and the development of services to support manufacturing. The most important of these sectors was that of finance. An expansion of the credit supply is essential to an industrial economy and Malaysia was no exception. The influx of foreign capital and the growth of domestic credit had far reaching consequences for the state, requiring a major regulatory response. With industrialization social organizations too underwent change. The most significant development was the formation of a large network comprised of business, politicians and civil servants. This network, with the UMNO party at its centre, was the interactive heart of the industrial economy, especially following the NEP.

In 1969 the major political parties were dependent upon their ethnic constituencies for support, whilst the leadership of each party sought to cement their own niche role in the Malaysian economy. Ethnicity shaped the identity of political parties and their political activities. Industrialization led to a breakdown of these old organizational structures. UMNO, MCA and the MIC's once singular ethnic constitutions were reshaped by the new economy and their constituency's emerging economic interests. Industrialization made political parties the key organizations in the state arena because they formed a link between the state and economic activity. UMNO was central to this process, adopting a structure that developed intimate connections with business groups and the civil service. Membership, or close connection with UMNO was a necessity for business success as it became the centre of Malaysian political and economic life. By the end of the 1990s its members were less defined by ethnicity and increasingly by economic status as business leaders filled its senior positions.

This is perhaps the single most significant shift that occurred as a response to industrialization. Business groups developed in close partnership with UMNO; industrial development rested on the close relationship, between politicians, bureaucrats and business people. Labour groups attempted to organize but their efforts were stymied by a state intent on attracting foreign investment and keeping labour costs low. The bureaucracy, for its part, was transformed from a small system maintaining organization to a large, professionally run and managed administrative

apparatus, tasked with shaping and directing the Malaysian economy and in particular, state owned enterprises.

Industrialization necessitated cooperation between producers, credit providers, labour and others involved in increasingly complex economic activity. Cooperation formed linkages that solidified into organizations that in turn began to interact with state institutions, influencing them and impacting upon them. The increased economic interaction between society and state institutions may be described as the most significant transformative effect of industrialization. Interaction resulted in both social conflict and cooperation. It is this dynamic that informed the institutional development of the Malaysian state. The mechanisms established to manage conflicts and regulate the industrial economy, and the manner in which they function will, as this thesis draws to a conclusion, point to a conceptual model of the modern state which places the intimate state – industrialization relationship at its heart.

The next chapter will analyze three episodes of modern state development and its relationship with industrialization. It will identify how the state, through interaction with key social actors developed new institutions of regulation and management over the industrial economy. State building from 1969 to 1999 was also shaped by a deliberate policy of government intervention to encourage industrial development. Whilst in Norway in the inter-war years the state made tentative steps in this direction, in Malaysia, industrialization was an explicit aim of government policy. The new economy created problems and opportunities for the Malaysian state. By analysing the points of interaction between the state and the leading economic players, the chapter will elucidate the interactive mechanisms that shaped modern state development. This analysis will then contribute to building a conceptual model of modern state development and its relationship with industrialization in Part Three.

CHAPTER SIX

The Development of the Modern Malaysian State

INTRODUCTION

The framework developed in Part One made interaction between society and state the centrepiece of analysis. The previous chapter showed how industrialization resulted in greatly increased interaction between economic activity, credit providers and social organizations. Such interaction influenced political parties that began to represent the economic interests of their constituencies toward government. This chapter will analyze three episodes of interaction between the state, society and foreign capital. It will demonstrate how interaction contributed to modern state development through: the NEP, initiated in 1971; the establishment of the Heavy Industries Corporation of Malaysia (HICOM); and the state response to the 1997 Asian economic collapse. Each episode illustrates how modern state development was shaped by conflict arising from the industrialization process and how the state, as a set of institutions, sought to regulate and manage economic change. The question addressed in this chapter is: how did state institutions develop in response to interaction with society and how did they influence the industrialization process through increased regulation and management of its components? Regulation and management of industrialization in the case of Norway, was often the result of problems that emerged suddenly or unexpectedly, as was the case with the labour strikes of the 1930s. In Malaysia state action often assumed a more pre-emptive and deliberate hue. This factor is an important differentiation between the two case studies. In the late 1960s the problem of economic underdevelopment was central in the minds of policy makers and had to be addressed. A pre-industrial economy and the poverty it entailed constituted, alongside ethnic division, a problem capable of destabilizing the state itself.

THE CRISIS OF 1969 AND THE NEW ECONOMIC POLICY

The late 1960s was a period of disunity within the ruling coalition, culminating in the divisive election of 1969 and the subsequent violence. The ethnic riots are a turning point in modern Malaysian history they initiated a new approach by the state to reshape the economy.¹ Industrial development had hitherto taken place sporadically with the state maintaining a distance from economic activity.² The NEP, implemented in 1971 as a part of the Second Malaysian Plan, initiated direct intervention in economic activity through policy and institutional development. Central to the NEP was the plan to rapidly industrialize the economy. To provide a suitable background to the NEP, this section will briefly examine the crisis of 1969 and its significance.

Despite its dominant position following the 1964 elections, the Alliance government struggled to maintain cohesion, particularly when the Malay Chinese Association (MCA) party began to lose support from its ethnic base.³ Furthermore, the 1969 elections were the first to include the Borneo states of Sarawak and Sabah, introducing new imponderables into an already unstable political environment. It was uncertain whether the Alliance would retain the two-thirds majority required to make constitutional amendments. Ethnic divisions defined many unrelated issues during the campaign, with parties and their leaders exploiting prejudice. This technique was not new in Malaysia, but never before had the stakes been quite so high.

The May 1969 election resulted in a major defeat for the MCA party and gains for the Chinese aligned Democratic Action Party. The Alliance coalition was returned to power, albeit with a reduced majority. In the aftermath, the ethnic divisions inflamed during the five-week campaign were played out in the capital. On the night of the thirteenth of May, Malay gangs began a rampage, attacking Chinese owned businesses and homes. Chinese community groups, often supported by Indian Malaysians, responded in kind. The predominantly Malay police were in instances involved in the

¹ One writer has dramatically referred to 1969 as 'year zero' for the modern Malaysian state. Jones, 'What Mahathir Has Wrought', p.4.

² See Drabble, *An Economic History of Malaysia, C. 1800-1990: The Transition to Modern Economic Growth*, pp.195-6; Rajah Rasiah and Ishak Shari, 'Market, Government and Malaysia's New Economic Policy', *Cambridge Journal of Economics*, 25, 2001, 57-78, p.59.

³ Felix V. Gagliano, *Communal Violence in Malaysia 1969*, Centre for International Studies, Ohio University, Athens, 1971, p.11.

mayhem.⁴ Official government reports in the aftermath indicate a death toll of 196 people, mostly in Kuala Lumpur, with many hundreds more injured.⁵ The rioting continued for several days, with the government and police for a period unable to exercise control.⁶

The government declared a state of emergency after the first night of violence. A curfew was imposed and soldiers deployed to restore order. Within government, senior figures accused 'communist insurgents' and 'anti-nationalists' as the culprits.⁷ A National Operations Council was established with Deputy Prime Minister Abdul Razak as its head to oversee the emergency. Razak adopted 'supreme' powers above those of conventional ministers, with Prime Minister Rahman effectively replaced.⁸ The crisis had permitted the deputy Prime Minister to wrest control from the conservative and moderate rule of Rahman. The change of leadership was to lead to major change in economic and social policy.⁹

THE AFTERMATH OF MAY 1969 AND THE NEP

As calm returned it was clear to the government leadership, particularly Razak, that Malaysia was facing critical social problems.¹⁰ The foremost problem was the ethnic divisions, now worse than ever as political parties were defining themselves along these societal divides. Most significantly, the Chinese, who made up thirty-four per cent of the population in 1970, dominated the most productive economic sectors.¹¹ The

⁴ One of the best non-partisan accounts of the riots is John Slimming, *Malaysia: Death of a Democracy*, John Murray, London, 1969. Many reports of the violence are often regarded as biased or partisan, with government documents frequently criticized for blaming the suggesting the violence instigated by 'Communists' (who were typically of Chinese background).

⁵ National Operations Council, 'The May 13 Tragedy: A Report', Government of Malaysia, Kuala Lumpur, 1969.

⁶ Gagliano, *Communal Violence in Malaysia 1969*, p.20.

⁷ National Operations Council, 'The May 13 Tragedy: A Report', p.71. See also quotes from then Prime Minister Rahman ('anti-nationalists') and deputy Prime Minister Razak ('communist insurgents') *Far Eastern Economic Review*, May 22, 1969, p.438.

⁸ 'Far Eastern Economic Review' May 29 1969, p.481.

⁹ Wu argues that Razak represented the 'state bourgeoisie' whilst Rahman's continuing leadership was unacceptable to this group. This argument hardly fits with the fact that the 'bourgeoisie' if that category is useful in the post-colonial Malaysian context, were predominantly ethnic Chinese, the primary victims of the riots and the NEP that followed. Wu, *Class and Communalism in Malaysia : Politics in a Dependent Capitalist State*, p.149.

¹⁰ See National Operations Council, 'The May 13 Tragedy: A Report'.

¹¹ Crouch, *Government and Society in Malaysia*, p.14. For specific material on the Chinese in Malaysia see James V. Jesudason, *Ethnicity and the Economy : The State, Chinese Business, and Multinationals in Malaysia*, Oxford University Press, Singapore, 1990. The small business ethic is synonymous with the ethnic Chinese of South-East Asia, and despite the correlation often in reality a stereotype, there is

ruling Alliance coalition, controlled by UMNO, was faced with deep societal divisions exacerbated by poverty and underdevelopment.¹² An economy based upon subsistence agriculture, with the small productive sectors confined to one ethnic group was not able to breed stable social and political relations. The government's First Malaysia Plan, launched in 1966 outlined the economic problems and suggested a policy framework to encourage investment in manufacturing. But it was unable to instigate change in Malaysian economic relations. What investment capital there was lay in Chinese hands who tended to invest within their ethnic group through kinship. These relationships also extended beyond Malaysian shores. With an extensive Chinese diaspora throughout South East Asia, ethnic Chinese business networks often transcended national borders, that is, their development did not mirror the development path espoused by government policy. In many respects, Chinese economic activity lay outside the scope of government control. Protected by the guarantees of the consociational 'bargain' Chinese businesses employed few Malays, doing so only to the extent necessary to maintain influence with the state.¹³ With investment capital available from offshore and through kinship networks, interaction between Chinese and Malays was limited and an ongoing source of tension. In turn, much of the Malay rural population lacked investment and the skills to turn toward increased production.

The government's response to these problems was the NEP, launched on the back of the Second Malaysia Plan in 1971. In a major change of policy, the NEP made the state central to industrial development. The new approach was outlined by Prime Minister Tun Razak:

The Plan is a blueprint for the New Economic Policy. It incorporates the two pronged objective of eradicating poverty, irrespective of race, and restructuring Malaysian society to reduce and eventually eliminate the identification of race

evidence to partially justify it. Among the more chauvinistic explanations of Malaysian society, the Chinese have been portrayed as overly dominant and in control of almost the entire economy. It is certainly the case that ethnic Chinese did control a proportion of the Malaysian economy in the early years of independence far greater than their share of the population. Chinese Malaysian share ownership in 1970 stood at twenty-seven per cent, rising to forty per cent by 1990. The major decrease over this period was in foreign share ownership in Malaysian companies. See Gomez, Leng and Hing, 'Malaysia', p.63.

¹² Crouch, *Government and Society in Malaysia*, p.13.

¹³ James V. Jesudason, *Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia*, Oxford University Press, Singapore, 1990, p.64.

with economic functions...It will spare no efforts to promote national unity and promote a just and progressive Malaysian society in a rapidly expanding economy so that no one will experience any loss or feel any sense of deprivation of his rights, privileges, income, job or opportunity...To achieve our overall objective of national unity, Malaysia needs more than merely a high rate of economic growth. While devoting our efforts to the task of achieving rapid economic development, we need to ensure at the same time that there is social justice, equitable sharing of income growth and increasing opportunities for employment.¹⁴

The NEP constituted state intervention aimed at dramatically restructuring Malaysian economic relations.¹⁵ To implement the NEP the state had to begin interacting with marginalised Malays at an economic level. An unsophisticated view of the NEP is that it was a straightforward attempt by the state to intervene in the economy. Heavy industrialization, price controls, import substitution, capital flow restrictions and the nationalization of banks and financial services are the policies commonly associated with such an approach. Many post-colonial states of Africa and post-World War II Latin America followed similar policy paths. The NEP too set ambitious goals of industrial development, targets for the reduction of unemployment and an array of economic aims.¹⁶ But a standout feature of the NEP distinguishes it from the economic policies of many other post-colonial states of the period. The NEP sought to both expand the economy through manufacturing and exports, and undertake a shift of wealth by advantaging the poorest economic group in society.

Industrialization policy had been developed prior to the 1969 riots; solving the problems of unemployment and poverty was central in the minds of policy makers.¹⁷ But beyond the declared intention to move away from the production of mineral and agricultural products and into manufacturing, little else detailed this policy before

¹⁴Tun Abdul Razak, 'Forward' in Government of Malaysia, 'Second Malaysia Plan 1971-1975', Kuala Lumpur, Government Press, p.v.

¹⁵ Khoo Kay Jin, 'The Grand Vision: Mahathir and Modernisation' in J. S. Kahn and Kok Wah F. Loh (eds.), *Fragmented Vision : Culture and Politics in Contemporary Malaysia*, Allen & Unwin, Sydney, 1992, p.48.

¹⁶ Government of Malaysia, 'Second Malaysia Plan 1971-1975'.

¹⁷ See for example, Government of Malaysia, *First Malaysia Plan, 1966-1970*, Government Press, Kuala Lumpur, 1965. See also Rasiah and Shari, 'Market, Government and Malaysia's New Economic Policy' p.59.

1971.¹⁸ The NEP therefore heralded a new approach by the state to leading an economic transformation and planning a process of modern state building. Not only was the state to encourage private investment but it sought to establish nationally owned companies, offered financial incentives to Malays and adopted legislation designed to build a Malay property owning middle class. The following section analyzes how the NEP attempted to integrate ethnic Malays into an industrialized economy.

THE NEP AND STATE DEVELOPMENT

The policies pursued during Rahman's leadership were predicated on the assumption that private economic growth *on its own* was sufficient to propel Malaysia into the modern era.¹⁹ The state, through the bureaucracy, was to facilitate favourable conditions but did not directly attempt to initiate an industrial 'take-off' or redistribute wealth. Political activity was confined to law-making that maintained the existing order; a continuation of the British colonial past. The civil service drew its members from the elite families of Malay society; the concept of a modern bureaucracy employing staff on merit was yet to emerge. Government was an instrument of the Malay elite to maintain the status quo: to rule rather than govern. And while Malaysia had some of the essential institutions of a modern state such as a central bank, a department of statistics and an organized military and police force, these institutions maintained the existing system, as opposed to a transformational role: they had little interventionist role in the economy.²⁰ The ability to bring about economic and political change through the implementation of policy was not yet the role of the state.

¹⁸ The First Malaysia Plan had already set the policy scene for economic growth in 1966. Its approach however, in policy terms, was of a more liberal bent, advocating regulatory reforms and state assistance as opposed to major and direct intervention. See Government of Malaysia, 'First Malaysia Plan, 1966-1970'.

¹⁹ Rudner, *Nationalism, Planning, and Economic Modernization in Malaysia : The Politics of Beginning Development*, p.71.

²⁰ The State Bank of Malaysia (Bank Negara Malaysia) was established as the sole issuer of currency in 1959. The Department of Statistics was established under British rule in 1949, was significantly enhanced under a new government Act in 1965, and began to establish regional offices from 1971. See S. Y. Lee, *The Monetary and Banking Development of Malaysia and Singapore*, Singapore University Press, Singapore, 1974.

Just Faaland, an advisor to the Malaysian government at the time, argues that the NEP signified a major change in purpose for the state.²¹ The NEP located the state at the centre of the Malaysian economy; a major shift from the pre-1969 position. The state now sought to establish private enterprise, provide low cost investment credit to Malays and legislate to advantage them against the business interests of Chinese Malays. A challenge of implementation was whether the state and its institutions could control the industrialization process and effectively manage it.²² Building modern state institutions to manage industrialization was a requirement of the NEP.²³ The Malaysian state had to undergo change; it required reform to support an industrial economy that it was becoming responsible for managing.²⁴

Divisions within the civil service emerged followed the announcement of the NEP. Two major schools within the bureaucracy developed with divergent views as to how Malaysia's economy was to be reshaped. The Bank Negara (Central Bank of Malaysia) supported Economic Planning Unit (EPU), maintained a policy that emphasized economic growth over other priorities. Incorporating conservative budgeting and avoiding deficit financing, this view considered ethnic divisions could be overcome indirectly, through rapid economic development.²⁵

In opposition to the fiscal conservatism of the EPU was the Department for National Unity (DNU), which enjoyed close ties to the Prime Minister's office. Accepting that economic growth was necessary, the DNU also argued that the major imbalance in the Malaysian economy, that of the poor financial situation of the Malays, had to be urgently attended to as well. Further growth, if left unmanaged, would only maintain and reinforce the ethnic divisions. Industrialization had to be directed toward eliminating the association of economic class with ethnicity, and only a policy that directed economic assistance and incentives to ethnic Malays could achieve this. Malays were to be encouraged, in some cases by law, to equally participate in the

²¹ Just Faaland, J. R. Parkinson and Rais Saniman, *Growth and Ethnic Inequality : Malaysia's New Economic Policy*, St. Martin's Press in association with Chr. Michelsen Institute, London, 1990, p.25.

²² Ibid., p.37.

²³ Ibid., p.57.

²⁴ See Department of National Unity, *Directive*, March 1970, in Ibid., pp.317-18.

²⁵ Faaland, Parkinson and Saniman, *Growth and Ethnic Inequality : Malaysia's New Economic Policy*, pp.28-31.

economic life of Malaysia.²⁶ The DNU perceived the NEP to be a policy for a state led project of industrial development and modern state building.

The NEP's implementation was greatly influenced by the DNU. This direction was to have important implications for the Malaysian state. The DNU's intentions were to transform the economy and build a modern state in the process.²⁷ Complex in construction and ambitious in aim, the transformative approach required more than just directed financial resources toward nascent industries. The NEP was also an attempt to put Article 153 of the Constitution into practice.²⁸ At the time of its writing, this article acknowledged the special place of indigenous Malays, and the importance of maintaining their position of privilege; it was in essence, the 'Great Bargain' enshrined in law. But it was law that was never translated into interventionist policy until 1971. The state had done little to actively build a Malay middle class: the NEP was to change this approach.

Industrialization of the economy was not only a goal in terms of economic development, but intended as a vehicle for the political transformation of Malaysian society and the Malaysian state.²⁹ Allocating resources toward state industrial projects went hand in hand with the formation of new institutions to manage and direct the new economy.³⁰ The combined leadership of Razak, the DNU and civil service chiefs responsible for the NEP's implementation believed that the private sector had to become the engine of industrial growth. As the Second Malaysia Plan stated:

²⁶ Ibid., pp.31-4

²⁷ Department of National Unity *Directive* March 1970, in Ibid., p.318.

²⁸ Article 135 clause 2 states: '...ensure the reservation for Malays and natives of any of the States of Sabah and Sarawak of such proportion as he may deem reasonable of positions in the public service (other than the public service of a State) and of scholarships, exhibitions and other similar educational or training privileges or special facilities given or accorded by the Federal Government and, when any permit or licence for the operation of any trade or business is required by federal law, then, subject to the provisions of that law and this Article, of such permits and licences.' The remainder of the article states that the Government may act to ensure that these conditions are met. See also Ibid., pp.36-7.

²⁹ William Shaw, *Tun Razak : His Life and Times*, Longman, London, 1976, pp.232-45.

³⁰ See Seong Chee Tham, *Malays and Modernization : A Sociological Interpretation*. Singapore University Press, Singapore, 1983, pp.184-5. See also Abd Paridah, *Tun Abdul Razak, a Phenomenon in Malaysian Politics : A Political Biography*, p.113.

‘Direct controls over private production, trade and finance have been imposed infrequently and sparingly. Private investment, both domestic and foreign, has been actively encouraged.’³¹

The NEP placed the institutions of the state at the managerial centre of an industrial economy that was to be grown by the private sector. A major legislative mechanism was the Industrial Coordination Act of 1975 that brought all manufacturing businesses under government control in order to implement the NEP’s thirty per cent Malay ownership target.³² Private investment, be it domestic or international, was encouraged in later years as the conditions of the Act were relaxed, with consideration concerning where investment was placed as opposed to its source. The private sector was essential to providing the investment for industrial growth but it could only serve the NEP’s aims when under state direction. Capital, once located within the purview of the state could therefore be managed. The private sector was increasingly incorporated into a regulatory regime.

Ethnic Chinese had traditionally been dominant in building as well as banking and manufacturing. The state, in accordance with the NEP, now entered these sectors.³³ The Urban Development Authority (UDA), the public arm of the construction industry, was one of the first institutions established under the NEP mandate. A state financed holding company, the UDA was the preferred contractor for public construction tenders.³⁴ The government saw state controlled business and selective tenders as the best way to implement the NEP and in 1971 established the National Corporation to pursue insurance and construction business. Malaysia had numerous government agencies and statutory authorities established in the 1960s to support industry. These bodies now became orientated toward direct NEP implementation through credit, advisory services and research and development for Malay industry.³⁵ Existing state agencies were also directed toward implement the provisions of the NEP, among them

³¹ Government of Malaysia, Second Malaysia Plan 1971-1975, p.82.

³² The Industrial Coordination Act of 1975 is a good example of the state developing regulatory control of industry. See also Shaw, *Tun Razak : His Life and Times*, p.235. See also Faaland, Parkinson and Saniman, *Growth and Ethnic Inequality : Malaysia's New Economic Policy*, pp.57-8.

³³, Edmund Terence Gomez, *Chinese Business in Malaysia : Accumulation, Ascendance, Accommodation*, University of Hawaii Press, Honolulu, 1999, pp.68-9.

³⁴ Abd Paridah, *Tun Abdul Razak, a Phenomenon in Malaysian Politics : A Political Biography*, pp.114-5.

³⁵ Taylor and Ward, ‘Industrial Transformation since 1970: The Context and the Means’, p.120.

the Bank Bumiputera Malaysia and the Federal and Industrial Development Authority which both predated the NEP.³⁶ Malay businesses were able to borrow money at favourable rates from state supported banks to pay for state tendered construction projects, building the network between UMNO and the state. The NEP built linkages between state institutions and social groups that became more binding and formalized as favours and debts were owed and contracts were signed. Capital was being directed by the institutions of the state in a way that integrated ethnic Malays with the modern industrial economy.

By establishing industrial companies, the state could direct capital towards potentially profitable new industries and in favour of ethnic Malays through preferential loans and commitments of investment. Several state agencies assumed new powers to manage investment under the NEP mandate. The aforementioned CIC, Ministry of Trade and Industry and Foreign Investment Committee were granted power to oversee investment. Selected bureaucrats and powerful figures within government sat on several committees, gaining considerable economic and political power. As well as the awarding of government contracts to favoured and well-connected Malay businesses within the UMNO party, It also extended lines of credit to Malays who wished to establish their own businesses, often then coming under the guidance and control of a state authority. As well as cheap capital, the NEP created licences and incentives for industry, often to arrange joint ventures with foreign companies attracted to Malaysia's export processing zones.³⁷ The major shareholders were typically UMNO members who then established links into the private sector, with the aim of building a Malay capitalist class. This interaction between the state and the emerging Malay business groups - a relationship considered to be one of 'cronyism' - was founded under the NEP. The closeness of the relationship, and the central role of UMNO, was a key development of the modern state that developed in the 1980s and was later accelerated during the Mahathir era.

³⁶ Indira Ramanathan, *China and the Ethnic Chinese in Malaysia and Indonesia, 1949-1992*, Sangam, London, 1994, p.51. Bank Bumiputra had been established earlier in 1966 as a UMNO controlled bank. Following the NEP it was directly tasked with implementing the policy of developing Malay businesses. See also Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, p.74.

³⁷ Gomez, *Chinese Business in Malaysia : Accumulation, Ascendance, Accommodation*, p.69.

The manner of the NEP's implementation is somewhat at odds with many of the then prevailing orthodoxies of planned industrialization.³⁸ The state did not swallow up the private sector through the nationalization of industry. The absence of nationalization policies is conspicuous in both the Second and Third Malaysia Plans.³⁹ Rather, led by forceful leadership and the support of several key regulatory agencies, ministries and UMNO, the state directed the development of a Malay private sector via a corporatist project. The NEP's primary goal was to reconstruct Malaysian economic relations; to ensure that thirty per cent of the nation's wealth was in the hands of the *bumiputeras* by 1990. This policy was however entirely dependent upon accelerating and maintaining industrial growth across the country. Building a Malay middle class required wealth creation, without which the policy of redistribution would be even more unacceptable to the Chinese Malaysians, who were invariably the victims of the NEP.

THE IMPACT OF THE NEP ON MALAYSIAN SOCIETY

Whilst nationalization and appropriation of property were not key elements of the NEP, it was not always clear just how far certain aspects of redistribution would be enforced, as directives were often made at a whim from the Prime Minister's office.⁴⁰ Government statements that redistribution would be achieved with growth, whilst reassuring, were also ambiguous. Almost from the inception of the NEP, the first challenges for Chinese businesses emerged, as the state began to establish companies that intruded into sectors hitherto controlled by ethnic Chinese.⁴¹

Yet whilst many Chinese groups reacted to the NEP with dismay initially, the responses to the NEP varied considerably after the initial shock.⁴² The Industrial Coordination Act proved the most contentious, requiring large businesses to include

³⁸ See for example Jan Tinbergen, 'Problems of Planning Economic Policy', *International Social Science Journal* 11:3, 1959, 351-360; Albert O. Hirschman, *The Strategy of Economic Development*, Yale University Press, New Haven, 1961. See also Montgomery and Esman, *Development Administration in Malaysia: Report to the Government of Malaysia*, for a Malaysia specific report.

³⁹ See Government of Malaysia, 'Second Malaysia Plan, 1971-1975'; Government of Malaysia (1976). *The Third Malaysia Plan 1976-1980: A Plan for National Unity*. Kuala Lumpur, Jabatan Penerangan Malaysia, 1976. See also, Government of Malaysia, 'Malaysia Marches On: Mid-Term Review (1979): Third Malaysia Plan', Kuala Lumpur, Jabatan Penerangan Malaysia, 1979.

⁴⁰ Mahathir for example was reputed to hold the bureaucracy in low regard, and as a result of this mistrust made decisions at a policy level well below those typically deemed to be worthy of the attention of a prime minister. See Mark Beeson, 'Mahathir and the Markets: Globalization and the Pursuit of Economic Autonomy in Malaysia', *Pacific Affairs* 73:3, 2000, 335-351, p.341.

⁴¹ Gomez, *Chinese Business in Malaysia: Accumulation, Ascendancy, Accommodation*, p.67.

⁴² Gomez, Leng and Hing, 'Malaysia', p.67.

thirty per cent Malay ownership, which frequently involved a significant percentage of Malay employees at management level also.⁴³ Such state-enforced employment requirements were understandably seen as a regulatory burden. Nevertheless there are examples of Chinese businesses that began to thrive under the new conditions. The Berjaya Group owned by businessman Vincent Tan, a major ethnic Chinese owned business that developed close ties with senior government and UMNO figures, is a case in point.⁴⁴ Part of the group's success was the way in which it developed a relationship with the state. Accepting the NEP's requirements opened up new opportunities for companies; state intrusion also allowed access to lucrative government contracts and licences.⁴⁵ Economic incentives created by the NEP compensated for the regulatory handicaps. The shifting economic relationship between capital and the state was also reflected in the changing political allegiances between UMNO and non-*bumiputera* groups. By extending the state into previously isolated economic activity, the response from some Chinese business groups was to interact with state controlled companies and the civil service.⁴⁶ The new policy environment provided both constraints and opportunities; whether business took advantage of the latter was important to modern state development; it engaged and connected previously isolated businesses to the institutions of the state via the industrialization process. The divide between state institutions and social organizations was narrow ring; if private business, especially construction and property was to grow, becoming enmeshed and dependent upon the state was necessary. The growth of political and business connections in the 1980s demonstrates this development. It also explains how government leadership was able to use the state as an instrument to reshape the national economy, not necessarily in ways supported by the most powerful economic groups, but as part of a project of modern state building through regulation of economic actors.⁴⁷

Managing the NEP process was a challenge for state institutions that had not previously faced such a task. Yet with the combined support of senior bureaucrats

⁴³ This requirement was part of the Industrial Coordination Act of 1975. The late 1970s saw the act receive several amendments, aimed at providing a more flexible approach with regards to the legislation's enforcement. See Gomez, *Chinese Business in Malaysia : Accumulation, Ascendancy, Accommodation*, pp.70-1.

⁴⁴ See Ibid., pp.112-27.

⁴⁵ Ibid., *passim*. See especially Chapter 4.

⁴⁶ Gomez, Leng and Hing, 'Malaysia', p.69.

⁴⁷ Rasiah and Shari, 'Market, Government and Malaysia's New Economic Policy', pp.74-5.

aligned with government and business leaders, the state was able to bludgeon through the NEP at times, whilst suppressing objections from the MCA within the governing coalition.⁴⁸ The close bureaucracy and government collaboration has been well addressed in the existing literature but emphasis must also be placed on the engagement of business activity with the state. The statist account of East Asian industrialization accords great importance to the independent management role of bureaucracy and its ability to remain separated from certain social pressures.⁴⁹ But in Malaysia, the linkages that developed between the state and Malay and later Chinese business groups through interaction within the UMNO network were equally significant in shaping the state and the industrial economy. Industrialization resulted in an orientation by key economic groups towards the state through increased interaction. Businesses sought out roles in UMNO and became involved in the state development process as they had much to gain by cooperating with the state. Though much of this interaction has been labelled cronyism, it did engage Malays into the management of state institutions, which in turn sought to coordinate and direct economic activity. Much interaction occurred on the basis of personal ties. Even Chinese businesses, initially victims of the NEP, sought out connections with politically well placed Malays who were major players in UMNO or the bureaucracy itself.⁵⁰ The state development process was shaped by interaction between the state and society, contrasting it with perspectives of the state that see it as separate or quarantined from society and developing in isolation.⁵¹

THE NEP WINDS DOWN

As the NEP continued into its second decade it proved politically unsustainable. The NEP was appropriate for the circumstances of the early 1970s. But twenty years on, its relevance to contemporary Malaysian society had declined. By the end of the 1980s it had served its purpose, even if its primary target of thirty per cent *bumiuputra* share

⁴⁸ See Case, *Elites and Regimes in Malaysia*. Crouch also to a degree argues from this perspective, see Crouch, *Government and Society in Malaysia*, pp.24-6.

⁴⁹ Peter Evans is the most notable exponent of this view. See Evans, *Embedded Autonomy: States and Industrial Transformation*.

⁵⁰ Gomez, Leng, and Hing, 'Malaysia', p.69.

⁵¹ This is a conclusion of Searle, in that Malaysian industrialization blurred the categories of state, political party and the private sector. See Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, p.243.

ownership had reached only twenty per cent.⁵² Despite the shortfall, a danger lay in continuing the NEP and its wide reaching intervention. The restructuring of Malaysian economic society required an end point, in that the NEP sought to restore a balance of inter-ethnic ownership, but not enforcing this in perpetuity. According to Mahathir, the responsibility for maintaining equality had to be turned over to all Malaysians. A dependence upon state finance was important to avoid; Mahathir was aware of the danger of creating a hand-out mentality among ethnic Malays who had been advantaged by the NEP.⁵³ Faced with the rapid economic growth of the previous years and the consequentially different circumstances for policy making, the state had to alter its approach.

An additional problem emerging in the 1980s was the cost of the NEP to the state. Twenty years of concessions, tax breaks and borrowing had boosted public debt to fifteen per cent of GNP according to the World Bank.⁵⁴ The state sector, consisting of almost half of Malaysian GDP by 1981, was involved in a vast array of activities, some more profitable than others. Much investment capital was borrowed from abroad, and the government recognized a need to begin shifting debt from the public to the private sector. Whilst tentative steps toward privatization were made in the 1980s, the process accelerated in 1991 with the launch of the Privatisation Master Plan, which set out to shift state industries into the hands of Malaysian citizens.⁵⁵ A related problem to the high public debt was the ever growing public sector workforce: employment by the state was expanding faster than the private sector as the state took upon new economic

⁵² By 1990 the figure was 20.3 per cent.

⁵³ Mahathir had long been a critique of certain aspects of Malay culture that he felt were a handicap to economic growth. The early presentation of his views is found in Mohamad Mahathir bin, *The Malay Dilemma*. D. Moore for Asia Pacific Press, Singapore, 1970.

⁵⁴ World Bank, *Malaysia: Matching Risks and Rewards in a Mixed Economy Program*, p.4.

⁵⁵ There were few in Malaysia that opposed the sale of state assets, but it was the nature of the process that resulted in perhaps some of the biggest business and political controversy. The Master Plan, whilst emphasising the importance for the fiscal condition of the state, also considered privatisation, if carefully managed, as a means to which by further the advancement of a property owning Malay class. See Uzir A. Malik, 'Privatisation: The Malaysian Response to National Debt and Economic Restructuring', *Managerial Finance*, 22:6, 1996, 70-86. See also Government of Malaysia, 'Privatization Masterplan' Kuala Lumpur, Department of Prime Minister, 1991. Privatisation was built upon Mahathir's idea of 'Malaysia Inc'. Its aim was to increase both ownership and in turn, the sense of responsibility among those still outside the state space, toward the national goals of continued economic development. As the state divorced itself from the direct control of assets, its reach spread further. Industries that had been controlled by government were now relocated into a wider setting, still under however the purview of officialdom and thus the state, in that they were regulated, taxed, and subject to laws. For a perspective that lauds Mahathir's approach see, Matthew Hensley and Edward White, 'The Privatization Experience in Malaysia', *Columbia Journal of World Business* 28:1, 1993, 70-83.

roles.⁵⁶ Over the years the bureaucracy expanded to manage the many public companies and investments. The privatization drive now sought to withdraw the state from light manufacturing industries that it had so quickly developed and reduce public employment. State dominance of the economy was to be avoided with a preference for regulation and oversight of a vibrant private sector. This was an important change away from the active intervention that had typified the first decade of the NEP. Modern state development now required a bureaucracy capable of operating in a more complex economy with a growing and diversifying private sector. The end of the NEP signified a shift away from blanket state intervention to a more selective and sophisticated industrial policy.

By 1980 the Malaysian economy was growing at almost five per cent each year. It was beginning to develop a manufacturing sector whilst exports of primary goods continued to expand.⁵⁷ In this environment, the state sought a new direction in industrial policy; one that would absolve it of direct control of small and light manufacturing industries and toward activities requiring larger investments of capital.⁵⁸ Such a direction would also move the Malaysian state into a more managerial role with less direct responsibility for establishing individual businesses. Under the NEP, the management of capital toward investment in light manufacturing had been a priority. Under the Fourth Malaysia Plan, the planned heavy industrialization process was a more complex and ambitious undertaking, requiring the increased coordination of labour, capital both domestic and foreign, and Malaysian and foreign companies. The following section analyzes how a heavy industrial sector was built by the Malaysian state. A heavy industry policy had major ramifications for Malaysian manufacturing and a considerable impact upon the state itself.

⁵⁶See Malik, 'Privatisation: The Malaysian Response to National Debt and Economic Restructuring', p.23.

⁵⁷ GDP growth in the period 1981-5 was 4.7 per cent. Manufacturing growth was higher, at 5.3 per cent. World Bank, *Malaysia: Matching Risks and Rewards in a Mixed Economy Program*, p.4.

⁵⁸ The new direction is outlined in the Fourth Malaysia Plan. See Government of Malaysia, 'Fourth Malaysia Plan, 1981-1985', Kuala Lumpur, National Printing Department, 1981. See also Government of Malaysia, 'Mid-Term Review of the Fourth Malaysia Plan, 1981-1985', Jabatan Penerangan Malaysia, Kuala Lumpur, 1984.

HICOM AND THE PROTON PROJECT

The transition from light manufacturing and assembly to production of heavy industrial goods such as machinery and chemicals is a major advance in the industrialization process.⁵⁹ It is a progression from activities that can operate independently from other economic enterprises to larger scale production that requires greater coordination of resources. Heavy industries require increased quantities of capital and natural resources, skilled labour, and services such as transport, insurance and communications to support them. The complexity of such a sector epitomizes industrialization as representing a major break from the pre-modern economy. The centre of Malaysia's state led industrialization effort in the 1980s was HICOM, the Heavy Industries Corporation of Malaysia. HICOM's standout project was its joint venture with Mitsubishi of Japan to manufacture the Proton car. This section will examine how the HICOM project consolidated the linkages built during the NEP era between the state, foreign capital and local manufacturers, particularly ethnic Malay owned enterprises. In doing so, the Malaysian state developed the institutional capacity to organize and manage a heavy industrial sector. Further, foreign ownership of the Malaysian industrial economy declined as local manufacturers received protection in order to grow. The resulting gap in capital supply created opportunities for local investment at the expense of foreign capital.

Given the economy's expansion at the end of the 1970s why did the Malaysian government wish to pursue a risky project when the economy was already growing rapidly?⁶⁰ Even after HICOM was established, and entering into its first partnerships with South Korean companies, some commentators questioned whether Malaysia should pursue a heavy industry policy.⁶¹ There was some evidence and a widely held belief by the early 1980s among economists and aid donors such as the World Bank,

⁵⁹ This stage is may also be understood as a 'maturing' of the modern economy. See W. W. Rostow, *The Stages of Economic Growth : A Non-Communist Manifesto*, Cambridge University Press, Cambridge, 1990, pp.9-10.

⁶⁰ The average annual GDP growth between 1974 and 1979 was 7.2 per cent, declining only slightly to 6.8 per cent to 1984. Prema-chandra. Athukorala, 'The Macroeconomy up to 1997', p.16.

⁶¹ Raphael Pura, 'Doubts over Heavy Industrialization Strategy' in K. S. Jomo (ed.), *The Sun Also Sets: Lessons in 'Looking East'*, INSAN Institute of Social Analysis, Selangor, 1985, p. 377-80.

that state subsidies to build chemical production and heavy manufacturing industries cost more than they returned.⁶²

The thinking behind the HICOM project was shaped by Mahathir when Minister for Industry and Trade and addressed several considerations.⁶³ Malaysia was now returning to an import-substitution approach to growth, in contrast to the previous decade's policies that had encouraged exports.⁶⁴ Mahathir's aim in building state owned industries in heavy machinery and vehicles was to generate spin off processes.⁶⁵ The manufacturing of motor vehicles for example require spare parts, along with an array of support businesses such as refuelling stations, insurance, driving schools and the like. The potential that such linkages offer is a powerful argument for the pursuit of a heavy industry sector.⁶⁶ By the end of the 1970s, foreign investment remained clustered around the export sector, lessening the spill-over effect of new industries into other domestic sectors. The absence of production links between local and foreign manufactures was a consequence of foreign investment that had remained unregulated or unmanaged by the state.⁶⁷ The HICOM strategy to initiate a heavy industry sector required major state investment as well as the enticement of foreign capital in a coordinated fashion.⁶⁸ If financial losses were to be the short term cost of such an

⁶² One of the most well known critiques of this policy direction is Balassa. *Development Strategies in Semi-Industrial Economies*. By the 1980s the economic development model colloquially known as the 'Washington Consensus' had become orthodoxy. Literature central to this perspective include Bauer, *Dissent on Development : Studies and Debates in Development Economics*, Krueger, 'The Political Economy of the Rent Seeking Society, and Bates, *Markets and States in Tropical Africa : The Political Basis of Agricultural Policies*. See also Toye, *Dilemmas of Development*, especially chapter four for an excellent summary of the intellectual shift that took place in the academy and in multi-lateral organizations such as the World Bank and the International Monetary Fund.

⁶³ The clearest expression of the new approach is found in Government of Malaysia, 'Fourth Malaysia Plan, 1981-1985'. Mahathir established HICOM as Minister for Industry and Trade in 1980, prior to his ascendancy to Prime Minister. In 1981, he moved the project to the control of the Prime Minister's department to continue his oversight.

⁶⁴ Drabble, *An Economic History of Malaysia, C. 1800-1990 : The Transition to Modern Economic Growth*, p.200.

⁶⁵ Ibid., p.200.

⁶⁶ Many developing countries attempted to pursue heavy industry strategies in the post WWII years. For a good general discussion of this approach see Gereffi and Wyman. *Manufacturing Miracles : Paths of Industrialization in Latin America and East Asia*. For a specific case (South Korea) see Ha-Joon Chang, *The Political Economy of Industrial Policy*, Macmillan, Houndmills, 1994.

⁶⁷ Rasiah, *Foreign Capital and Industrialization in Malaysia*, p.199.

⁶⁸ See for example Government of Malaysia *Industrialization Master Plan*, Government Printers, Kuala Lumpur, 1986. A good commentary if the plan is found in K. S. Jomo, *Mahathir's Economic Policies*, Insan, Kuala Lumpur, 1989, pp. 63-8. See also Chee Peng Lim, *The Malaysian Industrial Master Plan*, Pelanduk, Kuala Lumpur, 1987.

undertaking, then the government felt the risk worthwhile, particularly as the private sector had not demonstrated willingness to invest in heavy industry to this point.⁶⁹

HICOM's projects were intended to generate momentum for heavy manufacturing if the private sector was unwilling to initially invest. HICOM's major shareholder was the Ministry of Finance, which selected the board, as well as providing below market rate loans.⁷⁰ The state owned company built steel, cement and paper and pulp plants all under the protection of considerable subsidies and tariffs.⁷¹ The Prime Minister's department and the Prime Minister himself oversaw and monitored HICOM's activities. As Chee Peng Lim points out, even though HICOM's leaders were given a degree of independence in some activities, the government saw to it that it was managed closely in terms of strategic direction and investment.⁷² The bureaucratic control held by the Ministry of Finance was extended by Mahathir himself who made a personal investment in the project. Meeting on a monthly basis with HICOM executives, Mahathir held the state and industry cooperation process to be of paramount importance and closely managed the relationship. Though interaction between directors, the Prime Minister, major business leaders and investors, HICOM was shaped by economic imperatives and the political preferences of the Prime Minister.⁷³ As a result, the Malaysian state, through the HICOM project, was developing the coordination and management mechanisms within the bureaucracy for the heavy industry sector. But despite the combined efforts, HICOM failed to make a profit in its first decade.

HICOM AND THE PROTON CAR

First proposed in 1980 as a way of constructing a national symbol of Malaysian development, and reducing the import bill for civilian transport the centrepiece of the HICOM project was the Proton car. Automotive manufacturing in Malaysia till 1980

⁶⁹ Government of Malaysia, *Industrialization Master Plan*, pp. 23-27.

⁷⁰ C.P. Lim, 'Heavy Industrialization: A Second Round of Import Substitution' in K.S. Jomo (ed.), *Japan and Malaysian Development : In the Shadow of the Rising Sun*, pp.248-9.

⁷¹ In its first eight years of operation, HICOM invested approximately RM2 billion in an array of industrial companies-all of it state controlled capital.

⁷² *Ibid.*, p.249.

⁷³ Raphael Pura, 'Doubts over Heavy Industrialization Strategy' in K.S. Jomo (ed.), *The Sun Also Sets: Lessons in 'Looking East'*, p.380.

had consisted of light assembly and the manufacture of small and simple components such as batteries and filters. The local industry also required significant state protection and was shielded behind local content requirements and import duties.⁷⁴

To build the Proton, HICOM entered into a partnership with Mitsubishi of Japan which hoped to make Malaysia an assembly base for its cars, by utilizing the availability of cheaper labour.⁷⁵ Mitsubishi also made overtures to the Malaysian Government with a view to becoming the dominant car seller in what was now an economically growing region. With a willing prime minister in Mahathir, agreement the project was quickly concluded, with many details remaining secret or yet to be decided upon. Mitsubishi agreed to provide considerable equipment and train local personnel, with the aim of maintaining control over production and sales.⁷⁶ The Malaysian Government however, aimed to export the vehicle to the UK and later the lucrative US market, aims that were perhaps a little too ambitious at the time. In 1985 only 7500 Proton cars were manufactured. Mitsubishi by the mid 1980s was beginning to go cold on the partnership as the project stalled. The Proton continued to struggle to break into overseas sales and remained dependent upon protected domestic markets to soak up production.⁷⁷ It was only in 1989 that the project turned a profit, albeit a subsidised one.⁷⁸ The relationship with Mitsubishi by this stage had turned sour. The parent company in Japan was facing an uncertain future itself, and with the parties in conflict, the Malaysian Government began to pursue relationships with several European firms to manufacture new components. The control the Malaysian state wished to exercise over Mitsubishi's investments was considered excessive by the parent company, which consequently withdrew. The Mahathir Government began to pursue investment capital and technology elsewhere, refusing to be held captive to Japanese interests. Another consideration was Proton's dependence on Japanese capital and the desire to build a degree of independence from the region's dominant

⁷⁴ K.S. Jomo, 'The Proton Saga' in K.S. Jomo (ed.), *Japan and Malaysian Development : In the Shadow of the Rising Sun*, p.264.

⁷⁵ For an account of Japanese car makers operating in the Asian region see Hidetaka Yoshimatsu, 'The State, MNCs and the Car Industry in ASEAN', *Journal of Contemporary Asia*, 29:4, 1999, 495-515.

⁷⁶ See S. Jayasankaran, 'Made-in-Malaysia: The Proton Project' in K.S. Jomo, *Industrialising Malaysia: Policy, Performance, Prospects*, p. 277.

⁷⁷ On subsidies see Shahari Ahmed Jaba, 'Government Support for Private Enterprise', in K.S. Jomo (ed.), *The Sun Also Sets: Lessons in 'Looking East'*. See also Timothy Lim, 'The Proton Saga- No Reverse Gear: The Economic Burden of Malaysia's Car Project', in K.S. Jomo (ed.) *The Sun Also Sets: Lessons in 'Looking East'*, p.391.

⁷⁸ K.S. Jomo (ed.) *Japan and Malaysian Development: In the Shadow of the Rising Sun*, p.287.

economy. While Mitsubishi itself had not contributed much to the venture in capital, large loans from Mitsubishi connected banks in Japan had financed HICOM and thus Proton in its formative years.⁷⁹

While Proton battled to make a profit in its early years, it had important spill over effects on the wider economy. Complex manufactured products such as cars require many components, and domestic Malaysian firms were able to provide parts such as seats and upholstery, plastic fittings and rubber mats to the Proton car that were increasingly locally designed as well as produced. Car assembly in Malaysia before the Proton project was dependent upon only eighteen per cent of local content in the process in 1982.⁸⁰ By 1995, some eighty per cent of the Proton vehicle consisted of locally manufactured parts.⁸¹ In the same year, production had risen to over 120,000 units, making up more than half of all domestic car sales. The complex coordination required between producers built considerable management capacity for the Malaysian Ministry of Finance, HICOM and the many other involved firms. This development was also aided by the foreign partnership process with Mitsubishi. Malaysian engineers and technicians undertook training in Japan, which developed their skills in a range of manufacturing processes and management.⁸² By breaking the partnership with Mitsubishi the state ensured that management of investment remained under its control. The Malaysian state was developing its capacity to organize a large and complex economic sector increasingly financed from domestic sources.

THE COMPLEX HICOM - STATE RELATIONSHIP

Some analysts have portrayed the Proton enterprise as an expensive failure.⁸³ In straightforward economic terms, Proton and HICOM struggled for several years. But

⁷⁹ S. Jayasankaran, 'Made-in-Malaysia: The Proton Project' p.272.

⁸⁰ K. Abdulsomad, 'Promoting Industrial and Technological Development Under Contrasting Industrial Policies' in Rajah Rasiah, K. S. Jomo and Greg Felker (eds.), *Industrial Technology Development in Malaysia: Industry and Firm Studies*, Routledge, London, 1999, p.287.

⁸¹ Abdulsomad, 'Promoting Industrial and Technological Development Under Contrasting Industrial Policies' in *Ibid.*, p.290.

⁸² This training commitment by Japanese companies was sometimes criticized. See for example Wendy Smith, 'A Japanese Factory in Malaysia: Ethnicity as a Management Ideology' in *The Sun Also Sets: Lessons in 'Looking East'*, Jomo, K. S. (ed.), Institute for Social Analysis, Petaling Jaya, 1985, pp.301-2.

⁸³ Chee Peng Lim is a notable critic. See C.P. Lim, 'Heavy Industrialization: A Second Round of Import Substitution' in *Ibid.*, A critique of the Proton project is made by Chee Peng Lim, 'The Proton Saga- No

the Proton project's true impact lay in the way state led industrialization shaped the wider economy, dragging other activities along with it and in turn developing the ability for the Ministry of Finance and the Prime Minister's Department to manage an industrial sector. The interaction between HICOM, the state and the many business interests in the venture built a foundation for cooperation between producers and new regulatory arms of the bureaucracy.⁸⁴ With heavy industrialization creating the linkages between these groups, the Malaysian state, through the civil service and HICOM, was able to engage smaller manufacturers and businesses with each other. By doing so, the Malaysian state was able to manage and centrally regulate capital and business interactions through the civil service and less directly, through the UMNO network.

The impact of the HICOM project on the organization of the modern state was considerable. As well as the personal involvement of the Prime Minister in HICOM's projects, the close interaction between the Ministry of Finance and HICOM was instrumental in integrating a large portion of Malaysian (Malay) society into the growing industrial economy. Heavy industry pursued by HICOM created employment for thousands of people in factories and assembly plants. Much of this employment was initially in simple assembly tasks, but the industrial demands that followed necessitated further training in trade skills and management. Such a pattern is a familiar one in the industrialization process: rural populations relocate to towns and cities for work opportunities, and the division of labour increases as the economy grows more complex. New skills and training is required to support demand. The previous Norwegian case study exemplified such a pattern. But Malaysia exemplified a crucial distinction in that the process involved a deliberate policy by the state to drive the development of heavy industry. HICOM was able to borrow money at reduced

Reverse Gear: The Economic Burden of Malaysia's Car Project', In Jomo (ed.), *The Sun Also Sets: Lessons in 'Looking East'*,

⁸⁴ The early years of the Proton project were heavily influenced by the NEP. HICOM was directed by the Ministry of Finance and the Prime Minister's department to often bypass non-Malay suppliers, and seek components among smaller Malay manufacturers. The Proton car at one stage in the 1980s was dependent upon up to 300 separate domestic suppliers for parts. See H. Leutert and R. Südhoff 'Technology Capacity Building in the Malaysian Automotive Industry', in Rasiah, Jomo and Felker, (eds.), *Industrial Technology Development in Malaysia : Industry and Firm Studies*, p.253. The effect of this state-imposed policy was to build and nurture a network in the Malay manufacturing community which had previously been uninvolved in the heavy industry sector of the economy. The state-led push built a whole new manufacturing sector that only became fully integrated with existing Malaysian (mostly Chinese Malaysian) manufacturing industries later down the track. See Rasiah, *Foreign Capital and Industrialization in Malaysia*, p.107

rates from the Ministry of Finance. In close partnership with government and the Ministry, HICOM formed companies that in turn sourced raw materials, components and services from selected Malaysian companies, typically those in favour within the UMNO network. This continued the process that the NEP initiated in 1971. By encouraging Malays into modern economic roles, the state advanced a modern industrial economy onto the largest segment of Malaysian society. HICOM and the Malaysian state were successful in achieving this, even if major financial losses were incurred in the first years.⁸⁵ HICOM and its activities further consolidated the UMNO, state and business network that developed from the inception of the NEP. Heavy industrialization, by virtue of its complexity and demand for a wide range of inputs and services, led to a deepening interaction between state institutions and business organizations.

HICOM AND MODERN STATE DEVELOPMENT

The founding of such a large public industrial conglomerate required state institutional development to effectively manage it, even though many of HICOM's arms became privatised from 1989. As HICOM was conceived by Mahathir, he brought direct control of it to the Prime Minister's office after 1981. This link between state and private sector was reinforced by Mahathir's personal appointments. The secretary of the Ministry of Trade in the early 1980s, Tan Sri Nasruddin - a close associate of Mahathir - led HICOM between 1984 and 1991.⁸⁶ Senior public officials also headed HICOM industries as well as other state owned businesses after departing the civil service. Nasruddin and his peers were highly sought after by Malaysian companies as consultants and board members as well as by foreign companies seeking to do business in Malaysia.⁸⁷ It was via such links with the UMNO network that the state extended its management of the industrial economy in the 1980s. Frequent interactions between individuals with roles in business and UMNO affairs are a central feature of the

⁸⁵ These processes also permitted the state to tax and regulate Malays most of whom in earlier generations had lived the life of a peasant. A good discussion of the Malaysian tax system is found in Mukul G. Asher, Ismail Muhd Salleh and Datuk Kamal Salih, 'Tax Reform in Malaysia: Trends and Options', in , R. A. Musgrave, C. H. Chang and J. Riew (eds.), *Taxation and Economic Development among Pacific Asian Countries*, Westview Press, Boulder, 1994

⁸⁶ Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, p.90.

⁸⁷ Ibid., pp.91-2.

Malaysian state development process. Cooperation and mutual dependence built the ability of state institutions to manage and regulate the industrial economy. This interaction also guided the private sector in directions that suited the state led by Mahathir and his associates in government and business.

Whilst HICOM was state financed, industrial production required private suppliers and businesses to become part of the manufacturing process. As these economic sectors became integrated with HICOM, the state gained in reach, permitting the economy to be shaped, to varying degrees, by the political and social goals of the government. Better management and organization of the civil service permitted improved planning and oversight of the Proton project. The individuals who had been trained in the bureaucracy to manage large businesses went on to become the next generation of company managers in the private sector, all the while maintaining their relationships with political leaders and state institutions.⁸⁸

The HICOM development, and the Proton project in particular, highlight the role of state policy in Malaysian industrialization, and the emergence of considerable management capacity. The state built a key sector of the industrial economy and then, via privatization that began in 1989, integrated it with the existing private economy and eventually, through the gradual removal of subsidies and supports, into the global economy through exports. Proton was publicly listed on the Malaysian stock exchange in 1992, with HICOM and the Ministry of Finance remaining the largest shareholders, serving to substantially reduce the Japanese ownership share.⁸⁹ Reducing foreign ownership of the industrial sector was a central element in Mahathir's 'Malaysia Incorporated' strategy, and through a controlled privatization process was largely achieved.⁹⁰ As Alasdair Bowie argues, the Malaysian state through the heavy

⁸⁸ Ibid., pp.92-102.

⁸⁹ S. Jayasankaran, 'Made-In-Malaysia: The Proton Project.' in K. S. Jomo, *Industrialising Malaysia: Policy, Performance, Prospects*, Routledge, London, 1993, p. 283.

⁹⁰ Mahathir's ideas for the Malaysian industrial sector were first aired in a memorandum to senior Government officials in 1983. It read: 'The Malaysia Incorporated concept means that Malaysia should be viewed as a company where the government and the private sector are both owners and workers together in this company...A country progresses and prospers with the advancement of businesses and enterprises in that country...The more successful the private sector...the greater the revenue and taxes for government collection.' Jomo, (ed.) *The Sun Also Sets: Lessons in 'Looking East'*, pp.305-6.

Whilst currently still reliant upon tariff barriers to protect domestic sales, Proton in this respect hardly differs from any number of car manufacturers worldwide that enjoy some degree of state protection. See Graeme P. Maxton and John. Wormald, *Driving over a Cliff? : Business Lessons from the World's Car Industry*, Addison-Wesley, London, 1995, for a good overview of the global car industry.

industrialization drive made the huge leap from directing producers *how* to make things, as was the case under the NEP, (in terms of *bumiputera* ownership and labour) to a policy where the state, directed *what* was produced, as exemplified by HICOM and Proton.⁹¹ Industrialization, as a process and a project led by the executive government, directly contributed to the development of a key feature of the modern Malaysian state, namely the close and cooperative network linking state institutions, Malaysian manufacturing businesses and foreign capital. The emergence of this network played a key role in the expanding capacity of the state to regulate and manage the economy. In this regard, the division between the public and private sectors became increasingly blurred in the 1980s and 1990s. Indeed, conceptualizing the Malaysian industrial economy in such bifurcated terms is problematic. A web of relationships that cut across public-private boundaries typified the industrial and even political landscape. Managing heavy industries required considerable interventionist capacity and a willingness by the state to control production. In an environment of rapid growth, such blurred divisions and complex relationships passed without question. Nevertheless, as the following section will demonstrate, the many conflicts of interest, and the risks carried by individuals with feet in many camps became all too apparent in a time of economic crisis.

THE 1997 ECONOMIC CRISIS AND THE STATE RESPONSE

As already indicated, Malaysian society by the end of the 1990s was becoming more diverse and plural, with social and economic organizations increasing their interaction with state institutions through political parties, particularly UMNO.⁹² Industrialization connected the Malaysian economy to the rest of the world in complex ways through increased trade in goods, services and capital. Yet the new economic linkages also created problems of management for the state. The following section will analyze how the state responded to a serious international economic crisis that affected Malaysia

⁹¹ Bowie, Alasdair. *Crossing the Industrial Divide : State, Society, and the Politics of Economic Transformation in Malaysia*. Columbia University Press, New York, 1991. p.112.

⁹² For a good discussion of modernization and industrialization and its impact upon Malays see Abdul Rahman Embong, 'Melayu Baru and Modernization of Malay Society', in Colin Barlow (ed.), *Modern Malaysia in the Global Economy*. See also Tham. *Malays and Modernization : A Sociological Interpretation*. For a popular exposition of the modernization perspective see Fatimah Yeop Sendiri, 'The Malaysian Perspective: One of Dynamic Growth', *Communication World* 10:6, 1993, 12-14.

and the East Asian region in 1997.⁹³ As was the case in Norway, the industrialization process was dependent upon foreign investment, yet this entailed risks that threatened continued economic development. But in contrast to viewpoints that portray dependence upon foreign investment as a threat to state independence, the Malaysian experience of an international economic crisis contributed to increased state control over investment. As a consequence of the financial crisis, the state strengthened its ability to manage foreign capital flows and the domestic financial and banking sector. The key actors in this episode were the Mahathir Government, the bureaucracy, foreign investors and the banking and financial sector. The East Asian economic crisis, whilst originating in Thailand, exacerbated several problems that were already present in the Malaysian economy. These issues are discussed first to provide a basis for analysing the response to the crisis.

THE ECONOMY IN 1997

The privatization of state owned enterprises in the 1980s increased financial liquidity and created a new group of businessmen, who, well connected to political leaders and often the Prime Minister himself, bought shares in the now privatized state companies. The corporate growth expanded the Kuala Lumpur Stock Exchange (KLSE) to the highest valued in the region by the mid 1990s.⁹⁴ The economic boom of the early 1990s also led to the issue of large short-term loans guaranteed by overseas banks as well as

⁹³ There exists an enormous literature on the East Asian economic collapse, the selection below worthy of note. For considered and sophisticated accounts see for example V. V. Bhanoji Rao, 'East Asian Economies: The Crisis of the 1997-8', in *Economic and Political Weekly*, 6 June 1998, 1397-1415; Robert Garran, *Tigers Tamed : The End of the Asian Miracle*, Allen & Unwin, St Leonards, 1998; Morris Goldstein, *The Asian Financial Crisis : Causes, Cures, and Systemic Implications*, Institute for International Economics, Washington, D.C., 1998; Pierre-Richard Agénor, *The Asian Financial Crisis : Causes, Contagion and Consequences*, Cambridge University Press, Cambridge, 1999; W. M. Corden, *The Asian Crisis: Is There a Way Out?*, Institute of Southeast Asian Studies, Singapore, 1999; Eul-Soo Pang, 'The Financial Crisis of 1997-98 and the End of the Asian Developmental State' *Contemporary Southeast Asia*, 22:3, 2000, 570-93; Philippe Riès, *Asian Storm : The Economic Crisis Examined*, Tuttle Publishing, Boston, 2000; V. V. Bhanoji Rao, *East Asian Economies : The Miracle, a Crisis and the Future*, McGraw-Hill, Singapore, 2001; Hal Hill and Yunpeng Zhu, *The Social Impact of the Asian Financial Crisis*, Edward Elgar, Cheltenham, 2001; Francisco L. Rivera-Batiz and Arvid John Lukauskas, *The Political Economy of the East Asian Crisis and Its Aftermath : Tigers in Distress*, Edward Elgar, Cheltenham, 2001; Joseph Stiglitz and Shahid Yusuf (eds.), *Rethinking the East Asian Miracle*, Oxford University Press/World Bank, New York, 2001; Shalendra D. Sharma, *The Asian Financial Crisis: Crisis, Reform, and Recovery*, Manchester University Press, New York, 2003.

⁹⁴ Bank Negara records place the KLSE total capitalization in 1996 at 806 billion RM (Malaysian Ringgits). Michael Yap Meow-Chung, 'The 1997 Currency Crisis and Subsequent Policy Response' in Colin Barlow (ed.), *Modern Malaysia in the Global Economy*, p.45. The equivalent figure for 1990 was 131 billion RM, demonstrating an enormous expansion of paper value.

capital raised on the stock exchange. The Malaysian banking sector was smaller than those of other states in the region, particularly Singapore and provided comparatively less credit to industry, increasing foreign credit dependence.⁹⁵ Further, Malaysia was industrializing rapidly during growth in international currency trading.⁹⁶ On the back of the increased cash supply, the Malaysian economy became dominated by the construction, property and speculative sectors (often closely linked to or protected by the state), with liquidity dependent upon their growing value.⁹⁷ Regulation of banks by state authorities was insufficient to ensure prudent lending and the compromised independence of the UMNO and government controlled bureaucracy lessened financial controls. These factors contributed to an industrialized economy susceptible to crisis if business confidence fell, growth slowed and lenders defaulted.

THE CRISIS STRIKES

The crisis that struck Malaysia in July 1997 began in Thailand and was to also directly affect Indonesia, Korea and the Philippines. Foreign investors withdrew much of their capital from Malaysian companies and the effect was immediately felt on the KLSE as share prices and the value of the currency declined. The Malaysian ringgit, from its high against the US dollar of RM2.47 in March 1997, fell to a value of RM4.88 by early 1998.⁹⁸ The stock market value of many of Malaysia's major companies plummeted, wiping out savings and high valued assets and stock.

⁹⁵ Hamilton-Hart, *Asian States, Asian Bankers*, pp.114-128.

⁹⁶ A recent book on currency speculation and the emergence of hedge funds in the late twentieth century is Ephraim Clark and Dilip K. Ghosh, *Arbitrage, hedging, and speculation : the foreign exchange market*, Praeger, London, 2004.

⁹⁷ K.B. Teik, 'Economic Nationalism and Its Discontents: Malaysian Political Economy after July 1997', in Richard Robison, *Politics and Markets in the Wake of the Asian Crisis*, Routledge, London, 1999, pp.218-9. Another good discussion of the Malaysian economy pre-collapse is found in Prema-chandra Athukorala, 'Malaysia' in R. H. McLeod and R. Garnaut (eds.), *East Asia in Crisis: From Being a Miracle to Needing One?*, Routledge, London, 1998. Athukorala's article was however written in 1998, and is critical of the currency control measures that contributed to the recovery. His is a straightforward classical economic perspective that fails to recognise the utility of government controls and demand led recovery policies that the Malaysian state put to good effect in 1998.

⁹⁸ K. S. Jomo, 'Malaysia: From Miracle to Debacle', in K.S. Jomo (ed.), *Tigers in Trouble: Financial Governance, Liberalisation and Crises in East Asia*, Zed Books, London, 1998, p.181.

The impact of the crisis was more than just economic. It was also perceived as a political assault on the Malaysian development effort; that almost overnight, the wealth amassed since 1970 could disappear due to external factors.⁹⁹ Mahathir went on the attack in the months following, making public accusations against currency traders in the US and Europe, notably US financier George Soros whose hedge fund had been one of the largest and most notorious participants in the global speculative currency trade.

THE STATE RESPONSE TO THE CRISIS

Many of the affected companies and stocks were state owned or controlled. The nexus between the state, business and UMNO was now vulnerable and the impact was felt at the top of government. The response by the government and UMNO controlled companies in the early months of the crisis displayed all the worst excesses of the 'cronyism' that had sullied the Malaysian industrialization experience. One of the most notable corporate collapses and flawed rescue attempts was that of Renong and United Engineers Malaysia (UEM). In early 1998 the infrastructure conglomerate received a state funded bail-out, permitting an unorthodox set of financial arrangements to take place. UEM purchased a large stake in Renong, at a share price twice that of the listed market price.¹⁰⁰ The deal was controversial and saw numerous laws bent or broken. This episode further weakened investor confidence, as the bail-out funds were drawn from politically well connected banks that broke their lending limits to a single customer.¹⁰¹ The deal was characteristic of a Malaysian corporate and banking sector that lacked state administrative oversight or formal control. A very public billionaire victim of the crisis was the son of the Prime Minister, Mirzan Mahathir, who allegedly lost sixty-nine per cent of his total wealth.¹⁰² The Malay business groups that had been the primary beneficiaries of the NEP and government policies in the 1980s were now victims and sought to engineer their recovery through connections. The Malaysian state had become closely engaged with the corporate

⁹⁹ One of Malaysia's premier political economists and commentators in Jomo K.S. went as far as to label the period as one of 'miracle' to 'debacle'. See Jomo, 'Malaysia: From Miracle to Debacle'.

¹⁰⁰ Nesadurai, 'In Defence of National Economic Autonomy? Malaysia's Response to the Financial Crisis', p.90.

¹⁰¹ Jomo, 'Malaysia: From Miracle to Debacle', pp.187-8.

¹⁰² Jomo, 'Malaysia: From Miracle to Debacle', p.187.

sector under the NEP and into the 1990s, but was yet to manage business activities in a modern, regulated way to mitigate problems. Government policies of previous years had contributed to these circumstances. Poorly enforced banking laws and an economy shaped by back-room deals and cronyism had led to many of the problems that came to a head in 1997. Prior to the 1997 crisis, Bank Negara lacked a modern regulatory system for Malaysian banking free from the influence of personal relationships between politicians and business groups.¹⁰³

The Malaysian state response comprised two series of actions. The first brought the austerity measures designed and implemented by the deputy Prime Minister Ibrahim Anwar and officials in Treasury and Bank Negara. The second, and more significant response in late 1998 included currency controls and restructuring of the financial sector. Both responses signified an important shift in how the state went about economic management. As Part One argued, a central feature of the modern state is a complex economic regulatory system managed by the bureaucracy. In the Malaysian case it was the challenge of an economic crisis that heralded a growth in the regulatory and managerial power of the bureaucracy, particularly the central bank. Responsibility fell to Bank Negara as the state institution to respond and devise a recovery plan for the industrial economy. This growing regulatory power began to intrude on the close government - business relationship that had defined Malaysian industrialization since 1969. An outcome of the crisis was a growing regulatory independence of Bank Negara from government as it attempted to stabilize the industrial economy.

Bank Negara implemented austerity measures in 1997. The currency was supported by raising interest rates and other fiscal controls.¹⁰⁴ The aim was to bring stability to the economy in line with policies suggested by the International Monetary Fund (IMF) for other countries in the region.¹⁰⁵ As the world's lender of last resort, the IMF had become heavily involved in addressing the regional crisis by 1998. Yet for Mahathir, IMF aid was an anathema. While Indonesia and South Korea became the recipients of IMF advice, planning and enormous bail-out packages, Malaysia, under the leadership of Mahathir, refused the IMF's assistance.

¹⁰³ Hamilton-Hart, *Asian States, Asian Bankers*, p.124.

¹⁰⁴ Meow-Chung, 'The 1997 Currency Crisis and Subsequent Policy Response' in Barlow, *Modern Malaysia in the Global Economy*, pp.50-1.

¹⁰⁵ Ibid., p.50.

Tensions between Mahathir and his deputy Prime Minister developed around the IMF role. Indeed, the Malaysian executive was fractured during the entire period of economic crisis, and resolution came only with the arrest of Anwar on unrelated charges. Anwar, along with his supporters in Treasury and Bank Negara saw no reason to prevent the IMF from involvement. The friction between the two political leaders was mirrored in disagreements within Malaysian Government agencies. The conclusion of this political and economic stalemate came in 1998, with the formation of the National Economic Action Council (NEAC), which, led by Mahathir's economic lieutenant Daim Zainuddin and officials from Bank Negara, developed a plan that mirrored some of the policies suggested by the IMF.¹⁰⁶ Mahathir compared the NEAC to the NOC established in 1969; drastic state action was again required to assert control, now over a faltering economy.¹⁰⁷ The Malaysian federal budget for 1998 was slashed by eighteen per cent, including a minimum ten per cent reduction for all departments. Large state financed industrial and construction projects were postponed and a tighter regime of information disclosure by corporations was implemented. Yet by mid 1998 the austerity measures were doing little to encourage growth. Foreign investment continued to depart; the flow of investment capital offshore, combined with mounting debts, resulted in GDP declining in 1998 by 7.5 per cent.¹⁰⁸ The austerity efforts were doing little to lift the Malaysian economy out of recession.¹⁰⁹ Bank Negara and the Malaysian government were faced with either maintaining the austerity measures or taking a more active policy direction.

In a new approach led by the Prime Minister, the state implemented foreign capital controls in September 1998 in an effort to prevent capital flight.¹¹⁰ To set the scene for

¹⁰⁶ The 1998 National Action Plan of the National Economic Action Council is available online at http://www.mir.com.my/lb/econ_plan/index.htm (accessed 5 July 2006.)

¹⁰⁷ Athukorala, 'Malaysia', p.97.

¹⁰⁸ Athukorala, 'The Macroeconomy up to 1997', p.16.

¹⁰⁹ Beeson, 'Mahathir and the Markets: Globalization and the Pursuit of Economic Autonomy in Malaysia', p.344.

¹¹⁰ Notable commentary on the capital controls included that by the celebrated economist Paul Krugman in an open letter to Prime Minister Mahathir in *Fortune*, September 28, 1998. Krugman argued that capital controls, whilst advisable, should be used sparingly. See also: Paul Krugman, 'Saving Asia: It's Time To Get Radical The IMF plan not only has failed to revive Asia's troubled economies but has worsened the situation. It's now time for some painful medicine', *Fortune*, September 7, 1998. See also Anita Doraisami, 'The Political Economy of Capital Flows and Capital Controls in Malaysia', *Journal of Contemporary Asia*, 35:2, 2005, 249-263, and Meow-Chung, 'The 1997 Currency Crisis and Subsequent Policy Response'.

the changes, Mahathir dismissed the Bank Negara governor, a notable Anwar ally, in August 1998.¹¹¹ The government formed an emergency fund to purchase stocks from Malaysian shareholders, hoping to restore investor confidence. The new currency controls were severe. The Malaysian Ringgit was pegged to the US dollar and trading of the currency outside of Malaysia was forbidden. The intention was to eliminate the rapid outflow of large sums of capital and encourage domestic borrowing. The effect, argues K.B. Tiek, was to refloat the domestic economy by making cheap credit available to business.¹¹² The Malaysian economy was also sheltered from the global economy behind a new regime of state managed controls and protection. Malaysian companies were not permitted to allow overseas trade in their shares, whilst the proceeds from foreign investments were frozen for a period, ensuring capital was reinvested in Malaysia.¹¹³ These measures greatly modified and extended the regulatory policies put forth by Anwar and bureaucrats within Bank Negara and Treasury. And despite some setbacks, notably the downgrading of Malaysian Government bonds to almost junk status by international credit agencies, the new regime proved effective in stabilizing the economy.

MODERN INSTITUTIONAL REGULATION OF THE FINANCIAL SECTOR

Two new state institutions were established to respond to the crisis: the Asset Management Company (*Danaharta*) and the Special Purpose Vehicle (*Danamodal*). These agencies were tasked with administering bad debts and locating funding to provide rescue packages for failing banks.¹¹⁴ Whilst both institutions remained responsible to the office of the Prime Minister, they enjoyed autonomy from the executive to intervene and manage the economic tasks they had been presented with.¹¹⁵ Bureaucratic power was beginning to be consolidated and formalised over the banking sector: a process of modern state development highlighted by the analytical model constructed in Part One. As already indicated, such control was previously limited or

¹¹¹ Beeson, 'Mahathir and the Markets: Globalization and the Pursuit of Economic Autonomy in Malaysia', p.343.

¹¹² K. B. Tiek, 'Economic Nationalism and its Discontents: Malaysian Political Economy After July 1997' in Robinson (ed.) *Politics and Markets in the Wake of the Asian Crisis*, p.232.

¹¹³ Prema-chandra Athukorala, *Crisis and Recovery in Malaysia : The Role of Capital Controls*, Edward Elgar, Cheltenham, 2001, pp.76-7.

¹¹⁴ Meow-Chung, 'The 1997 Currency Crisis and Subsequent Policy Response', pp.53-4.

¹¹⁵ Nesadurai, 'In Defence of National Economic Autonomy? Malaysia's Response to the Financial Crisis', p.103.

non-existent. As a consequence of the new agencies forming, the Malaysian banking sector underwent a substantial restructure. Mergers were forced upon poorly performing banks with the aim of weeding out small, over extended banks that could threaten financial stability.¹¹⁶ In 1999, Bank Negara sought to consolidate domestic Malaysian banks into stronger groups. The result was a state forced merger and acquisition process that reduced fifty-four banks to just ten.¹¹⁷ Greater regulation and controls became institutionalised by the state over the consolidated banks.

Literature on Malaysia's political economy in the months following the financial crisis often explains the battle that took place between Mahathir and Anwar as one of clashing personalities.¹¹⁸ Yet behind the public political feud, a significant change in the state was taking place. The way the state interacted with the industrial economy was shifting significantly. Anwar and his supporters in Malaysia and within the IMF shared a view of the state's economic role in accordance with dominant contemporary economic thinking in the West.¹¹⁹ Mahathir, whose perspective and policy ideas won out, deemed the state a far more interventionist set of institutions to be used in an instrumental manner and ultimately the response to the 1997 economic crisis reflected this view.¹²⁰ After the Second Malaysia Plan and the NEP, the state had been built around an industrialization project shaped by a close, corporatist relationship between government, foreign and local capital and business groups connected via the UMNO party. The separation of regulatory agencies from the corporatist network never occurred or became compromised by the many personal ties. State institutions, tasked with regulating the activities of the new industrial economy were lacking or in cases were part of the problem as the Renong and United Engineers Malaysia example demonstrated. The regulatory institutions that did exist, notably the Foreign Investment Committee and the Capital Issues Committee, were focussed upon

¹¹⁶ See Bank Negara 'Statement explaining rational for bank mergers.' at http://mir.com.my/lb/econ_plan/contents/press_release/110899merge.htm (accessed 5 July 2006)

¹¹⁷ Economic Analytical Unit, Department of Foreign Affairs and Trade, *Malaysia: An Economy Transformed*. Commonwealth of Australia, Canberra, 2005, p.10.

¹¹⁸ A key example of this singular focus is Stewart, *The Mahathir Legacy: A Nation Divided, a Region at Risk*. For a discussion of the political implications of the collapse see Amy L. Freedman, 'Economic Crises and Political Change: Indonesia, South Korea and Malaysia', *Asian Affairs* 31:4, 2005, 606-632.

¹¹⁹ In a speech made to the US Council on Foreign Relations in April 1998, Anwar remarked that state intervention in the economy always carried risk, no matter how well intentioned or conceived. See Nesadurai, 'In Defence of National Economic Autonomy? Malaysia's Response to the Financial Crisis', p.98.

¹²⁰ *Ibid.*, pp.97-8, 105-6.

ensuring the requirements of the NEP were followed.¹²¹ The risks associated with such informal economic management had been revealed in the months following the crisis of 1997. A stable, modern, industrialized economy required management, regulation and control by the state, through a regime of laws and formal institutions: developments that became reality following the turmoil. The state built new institutions to manage the domestic banking sector, beginning to move away from the informal and personal relationships between business and government that had previously structured the economy.

The economic crisis, and the resulting banking problems predicated upon bad loans, led to greater regulatory oversight of financial affairs through institutional development. The post 1999 reforms of the banking sector are outside the scope of this study, but the analysis to this point has shown that central to the recovery was the implementation of strict capital controls and a new regulatory regime for the banking sector, permitting an expansionary fiscal policy. Infrastructure projects were restarted and state spending was increased in targeted areas to compensate for weak private investment.¹²² Despite criticism of capital controls from commentators, Malaysia recovered from the 1997 crisis better than any other affected country in the region.¹²³ The personal and often secretive relationships that had shaped the Malaysian financial sector were now subject to erosion by a formalized and institutionalized framework of state financial regulation. As with the banking crisis in Norway, the Malaysian example saw regulatory control by politicians passed into the hands of the increasingly professional bureaucrats in Bank Negara and Treasury.¹²⁴

The expansion of regulatory control over private banks was brought about by a financial crisis that threatened the industrial economy. Industrialization had created, as it did in Norway in the 1920s, an economy that was vulnerable to banking collapses instigated by an international financial crisis. The effects of one bank collapse, if large

¹²¹ Doraisami, 'The Political Economy of Capital Flows and Capital Controls in Malaysia', p.251.

¹²² Meow-Chung, 'The 1997 Currency Crisis and Subsequent Policy Response', p.55.

¹²³ A mild criticism of the controls is found in Athukorala, 'Malaysia', For a harsher account see Simon Johnson and Todd Mitton, 'Cronyism and Capital Controls: Evidence from Malaysia', *Journal of Financial Economics*, 67:2, 2003, 351-382. For a discussion of the recovery and the role of capital controls in this process see Ethan Kaplan and Dani Rodrik, 'Did the Malaysian Capital Controls Work?', *NBER Working Paper*, 8142, 2001.

¹²⁴ Johnson and Mitton, 'Cronyism and Capital Controls: Evidence from Malaysia'. Johnson and Mitton take a view that capital controls and state support was exercised in a politically selective manner. The evidence assembled however is, as the authors acknowledge, not conclusive. See p.377.

enough, could pass through the system, to threaten producers, manufacturers and other lenders. Such a crisis could also result in mass and sudden unemployment, further destabilizing the state. As a result of political leadership and support from the major groups in the industrial economy, the state came to intervene via specialized institutions. The state became a lender of last resort, or took on the role of guarantor for debts. The institutions established - the Norwegian Banking Inspectorate and revitalized Norges Bank, and the committees formed in Malaysia as well as the increasingly independent Bank Negara and Treasury - were dedicated to maintaining the stability of the banking and financial system to ensure secure credit to industrial producers. Significantly in Malaysia, the post-crisis state institutions were increasingly detached from the close UMNO, government and business group relationships that had defined the Malaysian economy until 1997. This separation was not total, and the bail-out of some banks in 1998 raised suspicions of political influence dictating Bank Negara policy.¹²⁵ On the other hand, the actions of Bank Negara, and the specialist institutions tasked with resurrecting the Malaysian economy were freer of political interference, compared to the system of the previous decades.¹²⁶ Significant modern state change occurred as a response to the East Asian economic collapse. Building the institutions to better manage and regulate the financial sector that served industrial production were important examples of modern state development, in Malaysia as it was in Norway. The emergence of such institutions demonstrates how the state became closely linked to the industrial economy in a manner inconceivable in a pre-industrial context. The growth in the economy and the greater need for financial stability and regulation saw the state in both case studies develop a formal financial management role through their central banks and other dedicated institutions.

CONCLUSION

Industrialization in Malaysia was subject to considerable state intervention, a factor that in turn transformed state institutions. The NEP was the first major attempt by the

¹²⁵ Hamilton-Hart, *Asian States, Asian Bankers*, p.127. See also Sook Ching Wong, K.S. Jomo and Kok Fay Chin, *Malaysian "Bail Outs"? : Capital Controls, Restructuring and Recovery*, Singapore University Press, Singapore, 2005, p.128.

¹²⁶ Even the IMF begrudgingly admits that the Malaysian state response contributed to a strong recovery. See Kanitta Meesook, Il Houng Lee, Olin Liu, Yougesh Khatri, Natalia Tamirisa, Michael Moore and Mark H. Krysl (eds.), *Malaysia: From Crisis to Recovery*, International Monetary Fund, Washington D.C., 2001.

government to build an industrial economy to reshape the economic and social structure. State companies were established to build an industrial economy to then be shifted to the private sector. But in farming out public companies, the state retained a measure of control - via the many personal ties through the UMNO network - of the state. The NEP integrated the economically marginalized ethnic Malays with a growing state directed industrial economy. Integration was achieved through interaction between private business and the state with the UMNO party functioning as an intermediary. The role of state institutions under forceful leadership in this process sets it apart from the pre-industrial state: the state integrated the largest labour pool into a modern industrial economy and thereby integrated ethnic Malays within the regulatory control of state institutions.

The management requirements of a large state owned and financed industrial economy during the NEP period directly contributed to the development of a modern bureaucracy. Tasked to manage the heavy industrial projects of HICOM, civil servants often proceeded to manage companies once they had become privatized. Such transitions supported the close ties between state and business that shaped many industries. Support from the Ministry of Finance and continued close management of HICOM by government led to increased management by the state over suppliers and connected firms. The Malaysian bureaucracy, because of the requirements imposed upon it by government, came to develop considerable capacity to regulate and control yet remained subject to the dictates of government. It was this problem that became evident as a result of the 1997 economic crisis. In order to stabilize the economy and continue industrial development, a more formalized state regulatory system was required to emerge. This development resulted in bureaucratic agencies, particularly Bank Negara and the specialized financial management institutions, as they did in Norway, advance their power and become increasingly separated from government, reflecting Weber's argument of the rise of bureaucratisation to oversee the modern economy. This development is a key characteristic of the civil services of both case studies.

Two distinct but intimately related processes had transformed Malaysian society by 1999. The first, industrial development, was shaped by foreign investment, export orientated manufacturing and direct state intervention. The second dynamic of change

was the development of modern state institutions that advanced their ability to regulate and manage the industrial economy. This second process was driven initially by government policy, but as the events of 1997 showed, by a necessity to protect the industrial economy from harm. The relationship between the economic and political processes was inseparable. The modern Malaysian state's development was directly shaped by the industrial economy it had built. The NEP began the building process by integrating Malays into the industrializing economy. The HICOM project then directly integrated foreign investment with Malaysian manufacturing whilst state control was maintained. In doing so, the state under Mahathir's leadership built a bureaucracy to manage and coordinate foreign and domestic capital, resources and labour. State coordination was directed at heavy and complex manufacturing, representing an important advance by the state in its ability to effectively intervene in such a multifaceted area of economic activity. And finally, following the East Asian economic crisis, the state developed a formal regulatory regime over the financial and banking sector, a key component of a sustainable industrial economy. To resurrect the financial sector, the state forced banks to merge and enforced new regulations upon the sector. It is these characteristics of the Malaysian state that define it as modern; none of these abilities and the institutions that wielded them existed prior to the industrialized economy developing. Such regulatory control can only occur in the context of a complex economy with formal, cash based transactions. As such an economy grew in size and complexity, the risks to social and political stability grew. The consequences of a poorly regulated industrial economy became most apparent after 1997, and in Malaysia, the problems were amplified by the corporatist relationship between the state and the economy which made formal regulation more difficult, but also necessary if industrialization was to be sustained.

The final chapter now turns to conclusions about the modern state building processes of Norway and Malaysia. It will examine how a sharper understanding of the impact of industrialization upon the state alters the very conceptualization of the modern state. It will address several of the key analytical approaches canvassed in the first part of this thesis and assess them in light of the two case studies.

PART THREE

CHAPTER SEVEN

Industrialization and the Building of Modern States

INTRODUCTION

Industrialization dramatically reshaped the economic landscapes of Norway and Malaysia. It generated new industries and services, and drew in local and foreign capital investment. Emerging industries employed more people in factories and workshops. As the industrialization process advanced, more labour was employed, more capital was required for investment, and more resources were needed to produce goods and services. Industry gave rise to new social organizations and changed existing ones. Most significantly, new linkages formed between these organizations as they became increasingly interdependent. This chapter will revisit the conclusions of Part One and consider them in the light of the case studies. It will examine how the findings from the cases can contribute to a modified account of modern state development and the utility of this thesis' method of historical analysis. It presents an opportunity to examine the modern state through a lens that, using industrialization as the context, sharpens our understanding of the modern state's emergence, characteristics, functions and distinguishing evolutionary trajectory. Through an analysis of several key social organizations: political parties, business groups and trade unions and their interaction, Part Two demonstrated how industrialization impacted upon and changed social and political organization in Norway and Malaysia.

The analysis of the state arena and the organizations within it accompanied an analysis of how state institutions responded to the changes wrought by industrialization. The analysis of interaction between the state and social organizations revealed how the modern state evolved. Through the development of new institutions, the state increased its capacity to manage and regulate key sectors of the new economy. The method developed in Part One and applied in Part Two demonstrated how several

modern institutions of the Norwegian and Malaysian states developed as a consequence of industrialization. In addition, the same institutions actively shaped economic change. In both case studies, the state influenced economic development by investing and directing capital in selected industries, and regulating economic activity. The Malaysian example showed how this process was influenced by an explicit political project on the part of the state. It is this consideration that distinguished modern state development in the case studies as a process shaped by state action as well as economic change – an assessment derived from the interactive analysis utilized.

PRE-INDUSTRIAL AND PRE-MODERN STATES

As this thesis has argued, to understand the modern state, its relationship with industrialization is a central factor in doing so. The interaction between state institutions and society is the dynamic that shapes modern state development. As outlined in Part One the key characteristics of the modern state – the regulatory and managerial capacity of its institutions, the emergence of powerful and structured social organizations; and the complex interaction between them over issues arising from economic activity – are absent in the pre-industrial state. Based upon the findings in Part Two, it is possible to undertake a comparison between the pre-industrial circumstances of Norway and Malaysia and their respective circumstances after three decades of economic change.

Pre-industrial states feature institutions that are comparatively limited in their capacity to interact with society. Small in size with minimal resources, the bureaucratic arms of the pre-industrial state lack reach and power. In the state arena, social groups are informally organized and struggle to take on a political role through engagement with the state. The Norwegian and Malaysian case studies showed that in the pre-industrial context, social organization was small in size, limited to particular issues and liable to fragmentation. Guilds for example functioned as protective organizations for their members, but they rarely interacted with the state nor sought political influence over government. In the modern industrial state, key social organizations developed that

wielded political power by virtue of their influential role in the industrial economy.¹ Interaction between the state and social organizations increasingly took the form of formalized negotiations over specific matters related to the industrial economy. The analytical method identified the particular forms of social organization that emerged from the industrialization process. It also demonstrated that social organizations in the modern state arena are politically salient. Involvement in the industrial economy gave such groups political power, and they were able to exercise it through interaction with the state. Such influence became channelled through political parties that became the formalized intermediaries between society and the state. It is now necessary to revisit the crucial distinctions between pre-industrial and modern social organizations to clarify their roles and their import in modern state building.

PRE-INDUSTRIAL LABOUR ORGANIZATION

When much of the population is engaged in subsistence agriculture, the labour supply is not impacted in a way comparable with the influence exercised by modern trade unions in the industrial age. Pre-industrial Norway had no organized trade unions. Agricultural labourers banded together over specific issues, as in the case of the Thranite movement in the 1850s. But the Thranites had no enduring structure and, led as they were by a charismatic leader, had no sustainable organization following his departure. A dispersed population engaged in small scale agricultural production lacked the motivation and the means to organize to express political views. The guilds and societies of the nineteenth century rarely sought to negotiate with employers over wages and conditions as they consisted mainly of self employed artisans and merchants. Such organizations typically emerged as a form of security against the influx of cheaper labour from rural areas and took the structure of informal associations that did not require regular payments by members.² Nor did such groups normally enjoy a permanent secretariat to manage their affairs. These factors led to pre-industrial labour organizations exacting little loyalty from members and having little potential to act in an advocacy role towards the state.

¹ Blumer, Maines and Morrione, *Industrialization as an Agent of Social Change : A Critical Analysis*, p.45.

² Galenson, *Labor in Norway*, pp.7-8.

In Malaysia, the development of trade unions took a very different path, shaped by the colonial experience and diverse ethnic population. In pre-industrial Malaysia social organization primarily occurred on the basis of ethnicity and kinship. Indian labourers on rubber and later palm plantations organized into cohesive unions, but the dispersed nature of their industry lessened the incentive of workers to cooperate as interaction with one another was limited.³ Well documented state restrictions on organization had an impact, but other factors, such as employer resistance and a large and transient labour supply, also lessened union membership.⁴ Despite their different circumstances pre-industrial Norwegian and Malaysian societies had no organized labour groups. People did not work alongside each other on related tasks and consequently had fewer shared interests to organize into formal associations. The absence of such incentive for labour is a feature of the pre-industrial state. As the Norwegian case demonstrated, labour organizations grew in importance as they negotiated working conditions with businesses and the state. Modern labour unions, because of their role, were able to influence the labour supply - its cost and availability to industrial production. In Malaysia, the developments of influential unions was deemed a threat to low labour costs and were subject to suppression by the state. Their negotiating power was severely curtailed, although they were at times, as the Malaysian Airlines pilot strike demonstrated, able to wield a degree of power in specific industries.

PRE-INDUSTRIAL BUSINESS ORGANIZATION

Business organizations functioned as guilds and associations that were localised and small in the pre-industrial state. In Norway, ship owners often collectivized to provide services such as insurance, but such organizations stayed within the bounds of their sector of economic activity and did not attempt to extend their services to other industries. Pre-industrial Malaysia featured similarities in scale. Formal business organizations and employer representative groups did not exist to a significant degree. Major exceptions were the Chinese Malaysians who organized collectively as bankers

³ A history of Indian plantation workers is found in Wiebe and Mariappen, *Indian Malaysians: The View from the Plantation*.

⁴ For a consideration of the several factors contributing to low union membership even in the 1970s as the manufacturing sector took off see P. Arudsothy and C. Littler, 'State Regulation and Union Fragmentation in Malaysia', in S. Frenkel (ed.), *Organized Labor in the Asia-Pacific Region: A Comparative Study of Trade Unionism in Nine Countries*, ILR, Ithaca, 1993.

and traders, but such organization was built along shared family and ethnic ties.⁵ With no large scale manufacturing activity in pre-industrial Norway and Malaysia, labour was not brought together in large groups. As a consequence, employers had little incentive to mount a response to organized labour. The new industrial economy organized business people and groups on the shared basis that they all used capital to invest in production and employed labour. The actual goods produced diminished as a common bond between employers as diversification of production took place and competition increased. Industrial businesses shared common requirements in capital, labour and raw materials that motivated their collective organization that formed the basis of their growing political importance. The NAF and the Malaysian Business Council became centres of a growing business network that connected employers with each other. Through their collective power they were able to influence wage demands, labour conditions and increasingly negotiate on behalf of individual employers. In Norway, the NAF became the peak employer body and membership required that employers cede a degree of their bargaining power with trade unions to the NAF. Malaysian businesses became closely engaged with UMNO and consequently, the highest echelons of government. Business groups had direct influence upon government because they directly shaped the fortunes of industry. Their ability to lobby and influence government decisions made their place in state development significant.

PRE-INDUSTRIAL POLITICAL PARTIES

Political parties in pre-industrial Norway and Malaysia were bastions of select social elite. Party membership was small and limited to those with inherited wealth or land holdings. The *Høyre* and *Venstre* parties, neither of which sought to have government directly intervene in economic activity, controlled Norwegian politics. Industrialization began to break down this stable system. The *Venstre's* membership became drawn increasingly from the business community at the end of the nineteenth century, reflecting the new sources of economic and political power. The Labour Party only emerged in 1887 with industrialization as workers began employment in factories

⁵ Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?*, p.74. points out the ownership profile of Malaysian banks. Prior to the NEP, the banking sector was almost exclusively Chinese owned, bar the state owned Bank Bumiputra.

and workshops. By contrast, political parties were structured by ethnicity in pre-industrial Malaysia. With industrialization party constituencies began to change, and party membership became shaped by economic position. Ethnicity as the key division between political parties began to wane in significance and was gradually supplanted by economic standing. UMNO, due to its unique position at the centre of Malaysian political life, began to interact with Chinese Malaysians engaged in business. While emerging from different experiences, political parties in Norway and Malaysia underwent comparable evolutions as they were subjected to the impact of industrialization.

Two developments primarily shaped political parties in both case studies. The first, that of their expansion in size and the economic homogeneity of their membership, is evident. The second, in the way political parties began to interact with other social groups and state institutions in a manner shaped by economic interests, is comparably significant. Parties drew in support and became the primary social institutions that translated economic interests into political power and directed it towards government. Pre-industrial political parties were comparatively disconnected from major economic activities including agriculture, because of their small and exclusive membership. In both cases, party members derived their power from land holdings and family wealth. This provided parties with a stable membership and an entrenched conservatism. The business of government remained the preserve of a few and it too was comparatively disengaged from economic and social life. In both case studies, pre-industrial political parties were not the places of political contest that would emerge in the industrial age. They were responsive to a select group of people and had no incentive to expand either their membership or purpose. The emergence of industry, with its reliance upon capital and the employment of skilled labour upset these organizational foundations and changed the makeup of party membership. With increased membership and the need to interact with other groups that emerged with industrialization political parties acquired a new importance in modern state development. With the coming of industry, political parties therefore became the primary pathways linking the modern state and society. Not quite state institutions, nor social organizations in the same sense as unions or business groups, political parties in the industrial age assumed a uniquely political role squarely between the two. In the debates and contests within parties it is possible to discern the interactions that shaped the modern state. The

demands of people, whose lives had been changed by the new economy, began to exert political influence via the modern mass political party.

UNDERSTANDING MODERN STATES

Part One devised a set of analytical tools to explore the relationship between industrialization and modern state development. It suggested that to understand the workings of the modern industrializing state it was necessary to elucidate the state as an arena and a set of institutions *simultaneously*. The political interaction between these two realms held the key to clarifying the relationship between industrialization and the state. Such an approach led to an interactive analysis of politically significant social organizations that emerged and of state institutions that developed over the same period. This analysis identified characteristics of the modern state and the factors contributing to their development. Through the course of this study it became evident that Norway's and Malaysia's industrialization experience could be understood as both an economic process and a political project shaped by the actions of government and bureaucracy and directly influenced by social organizations. In Malaysia, the state articulated specific economic goals and utilised the bureaucracy as an instrument to implement change. The Norwegian case differed in that the state, by its interventionist actions, sought to mitigate the politically undesirable impacts of industrial development. Only after the Great Depression did the state begin to articulate policies that sought to engineer economic growth by direct means. A commonality between the two case studies lay in the way both states sought to harness industrialization with the intention of managing it to suit the political purposes of government leaders and increasingly leaders of business and other social organizations. The analytical model identified how industrialization changed state institutions and advanced the managerial and regulatory control over the economy they assumed.⁶ This was carried out through a growing regulatory regime, exemplified by institutional developments in central banking, financial controls and labour management. Combined with advances in record keeping and surveillance of economic activity, the state's ability to

⁶ A recent work that addressed a related question is by Dani Rodrik. See Dani Rodrik, 'Why Do Open Economies Have Bigger Governments?' *The Journal of Political Economy*, 106:5, 1998, 997-1032. Rodrik argues that there is a correlation between open, trade dependent economies and the size of government. Government size, understood as arms of the bureaucracy and spending, is a risk compensation mechanism.

intervene in economic transactions grew. By examining bureaucratic development, we were able to identify how the state expanded its ability to manage and control domestic and foreign capital, the labour supply and business activity. Investment became variously subject to restrictions and incentives to direct it toward preferred economic sectors. Wages and conditions increasingly were influenced or dictated by the state as it sought to mitigate the effects of industrial unrest in Norway and encourage growth in Malaysia. Economic activity became subject to a growing raft of regulations and laws, implemented by bureaucratic institutions established for specific tasks.

Yet industrialization, as well as transforming state institutions, also shaped the development of political parties, businesses groups and labour unions. The state arena and the institutions of the modern state were dramatically altered by industrialization. The interactive analytical model demonstrated how industrialization shaped the modern state in ways that other models of state development have not always clearly identified.

In Part One it was argued that much literature on the state and its development does not highlight the unique characteristics of the modern state, nor clearly distinguish it from the more general category of the state. The modern state was demonstrated to be far more complex and formally organized than its pre-modern version. Specifically, the modern state features institutions that have the ability to regulate and manage society, and therefore, the economy. As Part Two showed, the modern state has a close and often intimate relationship with a particular form of economic activity, namely the industrial economy. The war-making perspective of state formation discussed in Chapter One primarily draws upon the experience of continental European states in the seventeenth and eighteenth centuries. This perspective highlighted the establishment of secure territorial borders as central to state development. It emphasized the development of institutions such as professionally organized military and police forces to defend borders, and an administrative regime tasked with the extraction of resources from society to pay for security. But the case studies considered in Part Two do not sit well with such a model. The defining modern state institutions - those tasked with economic regulation and management - were not always born of

war; rather, they emerged as a result of economic growth and political instability arising from industrialization.

Norway and Malaysia were directly or indirectly engaged in wars, particularly in the years following their independence. But in assessing its impact, war was not the sole or principal factor dictating their development. WWI did not have the decisive impact upon the Norwegian state that the war-making perspective would suggest. The expansion of the civil service took place in order to support the nascent industrial economy first and foremost. Malaysia's confrontation with Indonesian supported groups in the 1960s as well as the preceding 'Emergency' period had a major impact upon the organization of the federal political system. It also led to major increases in authoritarian state power, notably the Internal Security Act. But significant institutions that developed after 1969 did so as a result of the NEP and the government stipulated aim to expand and manage an economy that grew more complex each year.⁷ The war-making perspective of state development does not clearly identify all the modern characteristics of the state apparatus as it developed in Norway and Malaysia. This is not to obscure the significant social and political differences separating the Norwegian and Malaysian experiences. Major differences in population, culture, religion and economy set Norway and Malaysia apart. So too the geo-political circumstances of the respective periods studied, suggesting both were exposed to unique pressures from within their respective regions. Nevertheless, industrialization set each state on a path that shared a number of commonalities. The model employed suggests that industrialization and the modern state form are closely entwined.

Marxist and structuralist analyses of the state focus primarily upon capitalism as a process that shapes the institutions of states and their development. World system perspectives highlight the significant role of capital investment that moves across state boundaries as a factor in political change. Such perspectives, valuable though they are in illuminating the role of capital, maintain a view of capital as dominant over the state, implying that the state tends to adopt a largely subordinate, almost passive role. Yet both case studies demonstrate that foreign investments were subjected to controls that suited the political aims of the state and its leadership and not necessarily the sources of foreign investment or the interests of recipient business groups. A world

⁷ See Stubbs, 'The Malayan Emergency and the Development of the Malaysian State'.

systems perspective of the state alone does not offer an adequate explanation of the way Norwegian and Malaysian state institutions actually developed. It is plain that foreign capital was of great importance to Norwegian and Malaysian industry. But the historical evidence surveyed in this study does not bear out the predictions of world system theory. Concepts that get closer to usefully illuminating the interaction between the state and investment capital may be drawn from the 'elite led', bureaucratic and 'developmental state' perspectives of state development. The Weberian tradition has over time built an understanding of the state that emphasizes the importance of its institutions and their evolution. In line with the aim of this thesis, a Weberian derived perspective of state institutions was developed that located them in the dynamic context of industrialization. Their interaction with social organizations that developed an influential role in the new economy became the focus of analysis.⁸ In the context of industrialization, the institutions of the modern state and the policies, laws and practices associated with them were identified as influential and instrumental in shaping economic change.

The development of the industrial economy enabled, as argued in Chapter Two, a major break with the past and transformed the economic landscapes of Norway and Malaysia. Prior to the development of an industrialized economy, both states had capitalist economic systems. Nevertheless, economic activity was almost entirely based upon agriculture, primary products and a few services. As outlined in Chapter Two and described and analyzed in Chapters Three and Five, the industrial economy differed from the pre-industrial period by the complexity of production, the specialization of labour and the greatly increased levels of interaction between economic actors. Economic change led to different and more complex forms of social and state organization. Industrialization and the state's interaction with social groups made the Norwegian and Malaysian state institutions increasingly complex, organized, much more closely integrated with their respective societies. The complexity of the developing industrial economy was reflected in the growing complexity of social organization with the state serving as a critical point of connection between the two.

⁸ A brief piece that directly addresses the relationship between industrialization and modern state development, yet in a nineteenth century context is Allan Cochrane, 'Industrialisation and Nineteenth-Century States' in J. Anderson (ed.), *The Rise of the Modern State*, Edward Elgar, Brighton, 1986. In his introduction, Cochrane states that the relationship between the two is so often considered close that it is deemed unproblematic and thus unworthy of attention.

Because the state and society are so entwined in the industrial age, the relationship of social organizations to politics requires attention. A pluralist perspective of power points to social organizations as significant actors. While they were subject to increasing centralization and control by the state, some developed an enhanced capacity to shape political and economic life, which made their relationship with the state both pervasive and enduring.

THE MODERN NORWEGIAN AND MALAYSIAN STATES

Prior to industrial development, neither Norway nor Malaysia could be regarded as *modern* states. Both were nevertheless states, in that they enjoyed independence and clearly defined territorial boundaries. Each featured centralized institutions of rule with a virtual monopoly on the legitimate use of violence. These institutions included a basic governing apparatus of government and bureaucracy along with a police force and military, and a judicial system. As discussed in Part One, such attributes are commonly accepted requirements of statehood.⁹ But prior to industrialization, Norwegian and Malaysian state institutions had a relationship with the economy and social organizations that differed markedly from what would follow the onset of industrialization. They were *pre-modern* states. Part One identified the critical dimensions of change to chart the emergence of the modern state in the industrial era. First, social organizational change: business organizations, labour unions and political parties emerge or change dramatically to become more complex and formally organized. Second, the nature and extent of social interaction: the manner in which social groups interact with each other and state institutions increases in scale, intensity and complexity. And finally, state institutional change: subject to pressures from the industrial economy and their own agency, state institutions attempt to manage the industrial economy through intervention and the exercise of regulatory control. In order to do so, state institutions increase interaction with social organizations over conflicts arising from the industrializing economy. The literature surveyed in Part One identified many of the characteristics of modern state institutions: their specialist functions and unique attributes. The most significant of these modern institutions

⁹ Indeed the Montevideo Convention on Statehood of 1935 is straightforward almost to a point of simplicity in its list of requirements for statehood.

were concerned with the management of a secure labour supply, the establishment and ongoing management of state owned corporations and the regulation of investment capital and business. These key components of the industrial economy became subject to a growing regime of rules, laws and regulations, implemented and enforced by specialized bureaucratic institutions. As Part Two demonstrated, in the context of an industrializing economy a set of related social consequences were crucial in shaping the development of state institutions. Interaction, over conflicts arising from the new economy, revealed the relationship between industrialization and the modern state. Analysis of state-society interaction allowed us to chart the dimensions of change outlined in Part One.

FOREIGN CAPITAL MANAGEMENT

The pre-industrial banking sector of Norway featured a multitude of small banks, offering loans and deposit services to individuals and small businesses. Banks remained localised, rarely developing a branch system.¹⁰ The Norwegian banking system was entirely unregulated in the nineteenth century, and the Norges Bank functioned only as an issuer of currency. There existed no framework of regulation or guidelines for banks to follow, and with limited capacity for information gathering there was little prospect of the banking system functioning as an integral part of the state.¹¹ The need or capacity for surveillance and regulation of the banking sector by the state was limited.

The Malaysian pattern differed, in that a central bank was established in 1958 and had greater oversight and powers than its Norwegian counterpart in the equivalent pre-industrial setting.¹² Bank Negara was mandated to monitor the activities of commercial banks, to issue currency, and provide loans to government. But its reach was limited too with low demand for its services. In the pre-industrial setting,

¹⁰ Lafferty, *Industrialization, Community Structure and Socialism : An Ecological Analysis of Norway, 1875-1924*, p.76.

¹¹ The Norwegian state's capacity to shape and understand banking and other previously private activities emerged in the late nineteenth and early twentieth century. Slagstad argues that this shift denoted a movement from liberalism in the English sense to a specific 'planned liberalism'. See Slagstad, 'Shifting Knowledge Regimes: The Metamorphoses of Norwegian Reformism', pp.68-9.

¹² For a rather technical account of the founding of Bank Negara see Lee, *The Monetary and Banking Development of Malaysia and Singapore*, pp.19-25.

currency instability and unrecoverable private debts were not sufficiently large or severe to cause repercussions through the financial system. The private banking sector in Malaysia was also small and struggled to develop when credit was easier to come by from banks based in Singapore and elsewhere.¹³ The domestic commercial banking sector did not expand without an industrial economy demanding capital investment.

Both Norway and Malaysia required foreign capital to stimulate their industrial economies, for neither had sufficient local capital. Both governments, particularly Malaysia's, permitted and welcomed foreign investment, for it was recognised by the political leadership as a necessary condition of industrial growth. Detrimental consequences, in that foreign capital interests dictated policy choice, sometimes emerged. The Malaysian government's lobbying of Japanese companies, notably Mitsubishi, demonstrates the power of foreign capital over government policy.¹⁴ Dependence upon foreign capital also required governments to make concessions and develop financial incentives to retain overseas investment. Nevertheless, both states developed bureaucratic mechanisms to manage foreign capital and direct it towards selected sectors. As a consequence, Norway suffered no significant capital flight following the Concession Laws; rather, the laws built a formal mechanism of negotiation between the state, investors and business groups. The Malaysian government negotiated with Japanese companies to encourage their investment, but also excluded them when arrangements no longer accorded with the state's political agenda. In both Norway and Malaysia, industrialization in its early stages was dependent upon foreign investment, particularly in the capital and equipment intensive sectors of manufacturing. But such investment saw both states build institutions to manage and control foreign capital movements. The ability to regulate investment capital and to encourage its continuation is, as we have seen, a key function of industrialized modern states.

The regulation and management of foreign investment became an essential function of the Norwegian and Malaysian states. The Concession Laws evolved to become a regulatory rather than restrictive instrument of control over foreign investment. Through negotiation, foreign investment continued to flow, while Norwegian state

¹³ Hamilton-Hart, *Asian States, Asian Bankers*, p.107.

¹⁴ On this topic, albeit concerned with Latin America see Ray, 'The Dependency Model of Latin American Underdevelopment: Three Basic Fallacies', pp.10-13.

control was maintained over waterfalls and mines. Malaysia's Proton project illustrates how foreign ownership was harnessed to satisfy the political objective of building local manufacturing industries. The two examples are quite different: HICOM was a consciously planned state owned company, while the Norwegian Concession Laws constituted a reaction to a perceived takeover of resources by foreign interests. In each case, notwithstanding the varying circumstances, the influx of foreign capital set in train the development of regulatory institutions needed to manage investment.

REGULATING THE FINANCIAL SECTOR

A commercial financial and banking sector is an essential requirement of the industrial economy. Large industrial projects require considerable investment capital to pay for equipment and labour and this pre-industrial Norway and Malaysia initially lacked. While foreign capital played a large role in funding the early stages of industrialization, the demands of the new economy led domestic banks to supply credit in ever larger quantities. A modern financial sector in both cases emerged because of demand from private and public industry, a notable contrast with the historical period that supports a war-making perspective of state development. For much of the early modern period of European history, governments were the biggest borrowers of capital. As has been well documented, states in this era typically borrowed the greatest sums to pay for wars.¹⁵

Industrialization changed the patterns of capital flows as private industry began to borrow heavily. But the growth of lending from banks to private enterprise on a large scale posed a significant problem for the state. Major shifts of capital could have a major (often detrimental) impact upon the state if businesses collapsed or unemployment increased. Both Norway and Malaysia experienced dramatic financial problems during their periods of rapid industrialization. The Norwegian banking crisis of the early 1920s was the legacy of excessive borrowing and spending on

¹⁵ As Mann points out, even by 1900, around forty per cent of major European state's budgets were devoted to defence. Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, p.733. A history of the relationship between war and finance, especially borrowing, is found in Ferguson, *The Cash Nexus : Money and Power in the Modern World, 1700-2000*, pp.40-50., and Mathias, *The First Industrial Nation: An Economic History of Britain 1700-1914*, pp.46-8.

imported goods after the boom of WWI. Malaysia's 1997 crisis that began in Thailand was to impact upon the entire East Asian region. Such crises occurred because of the transnational nature of industrialized economy. A further challenge lay in a domestic banking and financial system that had yet to be regulated by the state through formal bureaucratic processes rather than at the whim of politicians. It became evident to both governments that continuing industrial growth required a stable financial system.

The financial sector became a key area of state intervention during industrialization. The Norwegian state, in the grip of the country's banking crisis, began to intervene in the financial sector as never before. The Norges Bank was directed by the government to bail out, support and restructure private banks. In turn, private financial institutions were forced by law to report on their activities to a new Banking Inspectorate, permitting oversight and regulation of the financial sector. In doing so, the Norwegian state took on an important modern quality. Industrialization and the challenge posed by expanding capital flows prompted the state to impose an enforceable regulatory framework. Such a system emerged to regulate the movement of investment capital and to implement a stabilising regime over the industrial economy.

It emerges from both case studies that increasing bureaucratic control over economic life became a dominant trend. This process combined a reactive response by state institutions, and, in Malaysia's case, an interventionist policy stance that aimed to actively reorganize the economy. The collapse of many Malaysian banks and companies after 1997 heralded a change in the previously close yet informal relationship between business and government. Pertinent in this regard is Pempel's articulation of 'regime shift' discussed in Chapter Two. Crisis necessitated a change in the relationship between the state apparatus and economic activity. In doing so, it altered the nature of the Malaysian state. Control and management of the banking and financial sector were increasingly located in Bank Negara, the Ministry of Finance and the dedicated state institutions established to deal with the economic fallout. State institutions were needed to regulate the banking sector and thus manage capital movements within the state arena and that arriving from other states. Informal economic relationships began to succumb to a formalized regulatory framework - a characteristic of the modern state outlined in Part One. We see during this period an increasingly formalized and legally regulated set of controls implemented by the state

that permit it to exercise oversight over economic activity. It is precisely the relationship between industrialization and modern state development that reveals much about the nature of the modern state. Each process impacted upon the other. Economic development heralded institutional development that in turn influenced the trajectory of industrialization. The new economy and the modern state were increasingly interdependent.

MANAGING LABOUR RELATIONS AND SOCIAL ORGANIZATIONS

Managing labour relations became a central function of the developing modern state in Norway. Trade unions gained significant political power because of their ability to influence the labour supply to industry. The state periodically attempted to intervene in conflicts between unions and business groups during the inter-war period. Many of these attempts failed initially; neither party wished the state to play an intermediary role and the state lacked leverage of its own. As governments changed in the 1920s and 1930s, and strikes worsened, the state pressed harder, eventually enforcing a permanent negotiating mechanism between organized labour and business.

The Malaysian pattern differed considerably in that trade unions were suppressed by the state: initially to curtail a perceived political threat and later to limit wage demands. The traditional organized labour base was contained by coopting their leadership into the ruling political network. The largest labour pool in Malaysia - that of the ethnic Malays - was actively, even forcefully integrated into the industrial economy. Without this central aspect of the NEP, economic growth would not have been shared with a majority of the population. The NEP required that the state interact with Malay society to integrate it into the new industrial economy: the state institutions established around UMNO established the conduits for this interaction. As a result, state owned corporations emerged as key points of interaction between state institutions and social organizations.

Industrialization heralded the emergence of the modern mass organized political party, which would go on to occupy a unique place between state institutions and society. As both case studies demonstrated, political parties grew in importance

because of their constituency's role in the new economy. Party membership was shaped by the new economy: salaried workers joined the Norwegian Labour Party, and UMNO became attractive to business people. Parties took on a hue according to their constituency's stance on industrialization, while parties with pre-industrial heritage such as the Norwegian *Venstre* Party gradually declined in relevance as their members shifted allegiances. Such parties no longer represented a cause or purpose that was relevant in the industrial age. The mildly reformist aims of the *Venstre* became supplanted by a radical agenda of the Labour Party and it ceased to be a force in Norwegian politics. In such an environment, parties became the direct institutional link between economic interest groups and government. Industrialization changed how society was politically organized. The engagement of groups and individuals with shared economic interests necessitated formal organizations, notably mass political parties that sought power via government. Such parties were defined by their constituency's position in the new economy. No longer solely the subject of a charismatic leader or a pre-industrial social class, political parties were now shaped primarily by their relationship to the economic stratification of society. That an electoral process determined which party formed government in each case study is incidental. Political parties, because of their role in the industrial economy, influenced the industrial state whether they held office or not. Their power lay in the ability to influence the critical components of industrialization, namely capital and labour.

BUILDING MODERN STATES: CONCLUSIONS AND REFLECTIONS

It is worth restating the utility of this thesis' method; one that seeks to make better sense of the modern state and distinguish it from the pre-industrial version. Part One identified a number of useful analytical perspectives by drawing upon a large body of literature on the state, especially its modern incarnation, to address the question central to this thesis. The discussion highlighted the issues that can arise when using the conceptually isolated categories of society and state to understand modern state development and sought to resolve this problem. The analysis of Part Two utilized a modified perspective of the state that addressed the growing interaction between state and society. Locating state development in the context of industrialization, combined

with an informative framework of analysis offers a revealing picture of the historical process.

The interaction of state and society and its significance are conceptually difficult to represent, proving a challenge of Part One. First, the very categories of state and society required attention and reassessment. Considering the state as constituting simultaneously an arena and a set of institutions offered a satisfactory solution. Second, the use of an interactive framework revealed the relationship between society and the state as a two-way street. Such a framework sacrificed a degree of tidiness in categorical demarcation in return for an expanded analytical grey area amenable to fruitful exploration.

In pre-industrial societies the points of contact between state and society are limited and therefore the interactive relationship is weak and sporadic. Existing concepts of the state have often narrowed their focus upon the institutions and features of the state associated with its policing and military functions and the establishment of sovereign boundaries. Such institutions form, the argument goes, because of conflict or the threat of conflict: war becomes the most important catalyst for institutional innovation. Illuminating as it is, such a perspective does not always clearly identify the patterns of state development that occur with industrialization. Problematically, many of the approaches canvassed in Part One imply a one way causal relationship between institutional development and a given social or economic process. Nevertheless, consideration of war as fundamental to state formation allows space to consider states as agents of social change. Such a conceptual point of departure offered a promising avenue of inquiry in Part Two when analysing the emergence of the industrial economy and its particular demand for social and political coordination. Both states actively shaped their arenas where key decisions on economic management became the subject of regular contestation and negotiation.

The respective modernization experiences of Norway and Malaysia were not directly shaped by war. Armed conflict figured in their modern history and influenced the political process, but it was not decisive in shaping their modernization paths. The conflicts that mattered more were ones of social contestation that led to rapid political and organizational change. The modern state - the cluster of new institutions that

interacted with important social organizations and groups - became more complex and formalised as it evolved.¹⁶ It developed the capacity to manage and regulate resources, be they people, capital or materials, with a view to advancing the industrialization process. Modern state institutions regulated and managed the components of the industrial economy through increased record keeping, monitoring and compliance, supported by the enforcement power of the state. The bureaucracy played a key role as a developing regulatory mechanism, and in the case of Malaysia, directly oversaw the growth of the industrial economy. It may be concluded that modern statehood, as exemplified by the two studies, was considerably shaped, if not determined, by industrial development.

An interactive analysis in the context of industrialization offers insights into the particular patterns of change experienced in both states under examination. Industrialization in Norway and Malaysia brought the state and society closer: institutions formed as a consequence of and reinforced interaction. In this respect, revisionist perspectives of East Asian political economy that locate the state in the driver's seat with industry following suit under direction or duress also stand in need of correction. The Malaysian state certainly had authoritarian tendencies and social organizations that did not fall into line were often subject to sanction. Yet UMNO and the Malaysian government were also shaped by the need to compromise and placate social forces that - had industrial growth stalled - might have upset the delicate political balance between rival ethnic and economic groups. The linkages and dependencies within the new economy made for growing interaction between state and society, suggesting that the possible growing autonomy of modern state institutions must be qualified by virtue of increasing interdependence of these institutions with the industrial economy. Both case studies demonstrated instances where their states exercised control over capital and influential social organizations and occasions when the state was highly constrained in its ability to influence economic activity and thus adopting a reactive position. Institutional developments were also subject to international pressures, as the rapidly growing economies in both case studies absorbed considerable foreign investment. The circumstances of geography and the fortunes of powerful neighbours were significant in both case

¹⁶ This is a central conclusion of Blumer. See Blumer, Maines and Morrione, *Industrialization as an Agent of Social Change : A Critical Analysis*, pp.156-9.

studies. The boom in the Norwegian shipping industry was a consequence of rising demand elsewhere in Europe and North America, while Malaysia was fortunate to be the recipient of extensive investment from Japan for its burgeoning industries. In this sense, this thesis has highlighted the limits of the explanatory power of certain theories. While qualification and caveats can muddy an analysis, they emphasize that each historical example follows its own pattern subject to circumstances as well as deliberate actions by governments, business and other social actors.

Different actors and organizations instigated interaction in sometimes unpredictable ways, necessitating a close examination of the historical evidence. Social organization in the industrial age was irrevocably changed, becoming more formally organized, reflective of particular economic interests and orientating toward greater interaction with the state with a view to translating economic interest into political influence. Pre-industrial social organizations were often fleeting, unstable and had limited interaction with state institutions. Industrialization reshaped social organizations, which, increasingly defined by the new economic circumstances, directed their emergent economic and political interests towards the state. Norwegian union leaders also sought cooperation with business with a view to gaining political influence with government, often to the chagrin of union members. Interaction between groups was also pushed too by the state as it attempted to manage conflict arising from industrialization; it mitigated threats to continuing economic growth.

The degree to which industrialization was expressed as an explicit goal by political leaders, business groups, and trade unions offers a point of contrast between the Norwegian and Malaysian experiences.¹⁷ The numerous inter-war Norwegian governments all recognised economic growth as a boon, and sought in diverse ways to oversee the distribution of benefits. While the state sometimes facilitated economic activity and took a coordinating role with regard to labour and business, it only began directly to encourage investment and specify economic directions in the 1930s. In contrast, Malaysian industrialization can be understood as a transformative political project that gained momentum and social support in the 1980s and 1990s. Whilst initially a process promoted by leading politicians and supportive members of the

¹⁷ See Blumer, Maines and Morrione, *Industrialization as an Agent of Social Change : A Critical Analysis*, pp.165-7.

bureaucracy, other social organizations increasingly buttressed state policy and actions as they benefited from growing wealth and patronage. It is this phenomenon - the binding of previously disparate social organizations to each other and to state institutions as a function of industrialization - that is often neglected by pluralist perspectives and developmental accounts of the state. Government policies certainly shaped the new economy, but they also represented a response to societal pressure upon them. A conclusion emerging from Part Two is that state institutions and social organizations do not operate as self-contained entities in the industrial age. Leaders and organizations make choices, but these may be constrained by the fact of rising interdependence. Changes in the structure and functions of the state are the result of political negotiation between individuals, social organizations and governments trying to steer a path variously subject to agency of choice and developing economic and political constraints. As Part One indicated, plotting a plausible conceptual course that simultaneously consider the economic structures established by industrialization and the changing agency located in individuals, institutions and organizations is an elusive task to say the least. As Mann points out, it has always been difficult to trace a path between the extremes of Marxist and Weberian analysis of political change.¹⁸

The thesis advanced here is that industrial development was directly shaped by the political process. State institutions, through their emerging regulatory power, influenced economic outcomes. Such management and regulation was an inherently *political* process, admittedly subject to competing domestic and external pressures and interests within the state arena. Industrialization and the economic growth it entailed was a central policy aim of the state and the institutions to which it gave rise. It was intimately related with modern state development.

CONCLUSION

Conceptually separating the state from society and analysing each in isolation from the other is highly problematic in the context of industrialization. It is tantamount to ignoring or distorting historical reality. To understand the implications of the trends

¹⁸ Mann, *The Sources of Social Power Volume 2: The Rise of Classes and Nation-States, 1760-1914*, p.736.

surveyed requires a perspective on the modern state that collectively incorporates the development of new social organizations and increased capital investment flows. The modern state in the industrial age is better understood when conceptualized as an arena and a set of institutions, with the relationship between them a defining factor in charting the nature, pace and impact of political change. The economic break with the past that industrialization provided marks a transition from the pre-modern to the modern state; the political form which first emerged in Western Europe and was later emulated elsewhere with varying degrees of success.

This study began by examining macro concepts of state development: those that provide a historical perspective on socio-economic and political change. Part Two demonstrated how industrialization had a unique impact upon society and remade the political arrangements of the state. Industrialization's impact increased foreign and domestic investment flows and economic growth created conflict and increased interaction and cooperation between previously isolated social organizations, economic agents and the state. Increased conflict and cooperation were different sides of the same coin in that both emerged from the same processes of economic and political change. Conflict and consequential cooperation and conflict resolution in Norway and Malaysia were catalysts for the establishment key regulatory and managerial state institutions that characterize the modern state. The analysis presented here has emphasised the constraints of structural imperatives and the influence of state institutions directing economic traffic, sometimes in isolation from social pressures and forces. The result is a complex picture, but a perspective of modern state development with a historical method as its basis is bound to highlight oddities and aberrations in order to discern general patterns. Industrialization's impact led to an increasingly complex society and economy with the political organizational response proving a reflection of this.

To extrapolate a universally applicable pattern of historical change from the experiences of two states is not the purpose of this thesis. Indeed the search for a singular explanation of the modern state remains an unattainable objective. Here we can but reaffirm the inherent limitations of this study as stated in Part One. It was confined to two small states on the economic peripheries of Europe and Asia that rapidly industrialized their economies following independence at different periods of

the twentieth century. Industrialization was *the* significant factor in the development of the modern state in the studies at hand: this proposition may not hold for all other states in other periods of history. Nevertheless, the evidence of Part Two suggests that trends in political change may be discernable in the experiences of other industrializing societies. It is clear that the mode of social and political interaction and the institutional form it takes is closely related to economic change, with industrialization bringing these linkages to a head. It is this expanding web of linkages that gives form and content to modern state institutions. Industrialization creates conditions whereby the state and society grow in interdependence. To analyse each in isolation, in the context of an industrializing economy, is to create but a partial impression.

Norway and Malaysia currently enjoy the rewards that industrialization provided. Both states are now also dealing, in a variety of ways, with the consequences. Modern state development and industrialization were intimately related: both states made a transition to modern statehood because of the coordination requirements and social consequences of industrialization. The story of each state demonstrates that the pattern of modern state development is complex, sometimes unpredictable and subject to a multitude of factors: industrialization and modern state development were intertwined political processes of societal conflict, negotiation and choice. Whether pre-modern states in the twenty-first century follow a similar path is hardly certain.

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