The Next Global Stage

CHALLENGES AND OPPORTUNITIES IN OUR BORDERLESS WORLD

KENICHI OHMAE

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To Ron Daniel, who showed me the global stage when I was a young, aspiring consultant.

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First, I would like to thank Stuart Crainer for his invaluable help in developing my script for the global stage.

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ABOUT THE AUTHOR

Kenichi Ohmae is one of the world's leading business and corporate strategists. Born in 1943, he earned a doctorate in nuclear engineering from the Massachusetts Institute of Technology, and subsequently worked as a senior design engineer for Hitachi. He then joined McKinsey & Company, becoming a senior partner, developing and running the company's Japan operations for a number of years. He gained an unrivaled knowledge and sensitivity to developments in a wide range of business sectors.

Many of his books have been translated into English, including *The Mind of the Strategist* (McGraw-Hill), *Triad Power* (Free Press), *The Borderless World* (Harper Business), *The End of the Nation State* (Free Press), and *The Invisible Continent* (HarperCollins). He is a frequent contributor to many of the world's leading newspapers and news magazines, including *The Wall Street Journal*, *The New York Times*, *Harvard Business Review*, and *Newsweek*. He lectures on entrepreneurship at the Attacker's Business School, which he founded in Japan.

He is the founder and managing director of a number of flourishing businesses in Japan, including Business Breakthrough Television (a 24/7 business channel); Ohmae & Associates; EveryD.com Inc.; Ohmae Business Developments Inc.; and General Services, Inc., a cross-border business process outsourcing company in China.

For Kenichi Ohmae, the world has become truly unified with the advent of telecommunications technology. As a scientist and consultant, Ohmae has always been alive to the role that technology can play in breaking down barriers and the implications this has for business and society. He has developed a number of platforms in areas such as distance education, the home delivery of groceries, and an address book database. These include "Air Campus," which facilitates distance learning, and "Everyday dot-com," which delivers groceries using micro bar codes on the Internet or mobile phones. His advice and unique insights are constantly sought by both government leaders and businessmen.

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INTRODUCTION

Ideas do not emerge perfectly formed. They are awkward amalgams of experience, insight, hopes, and inspiration. They arrive on stage blinking under the bright lights, hesitant, unsure as to the audience's likely reaction. They evolve and develop, alert to changing reactions and circumstances.

I have been rehearsing the arguments that form the backbone of *The Next Global Stage* for more than two decades. My previous books, including *The Borderless World* and *The Invisible Continent*, examined many of the issues I am still exploring. Ideas, as I say, do not emerge in a state of perfection.

In its genesis, *The Next Global Stage* has been shaped by two forces.

First, it bears witness to changing circumstances. Over the last two decades, the world has changed substantially. The economic, political, social, corporate, and personal rules that now apply bear scant relation to those applicable two decades ago. *Different times require a new script*.

The trouble is that, far too often, we find ourselves reading from much of the same tired script. With the expansion of the global economy has come a more unified view of the business world. It is seen as a totality in itself, not constricted by national barriers. This view has been acquired not by the traditional cognitive route of reading textbooks or learned articles. Instead, it has come directly, through exposure to the world, frequent travel, and mixing with the world's business people. Paradoxically, perhaps, this breeds a similarity of outlook. Opinions and perspectives are shared; the type of developments in the political and economic worlds that are held to be important are shared, too. With shared outlooks come shared solutions. But a common view of the world will not produce the unorthodox solutions and responses required by the global stage.

Over the last 30 years, I have traveled to 60 countries as a consultant, speaker, and vacationer. Some countries, such as the United States, I have visited more than 400 times; Korea and Taiwan 200 times each; and Malaysia 100 times. Recently, I have been averaging six visits a year to China and have started a company in Dalian, as well as producing 18 hours of television programs seeking to explain what is really happening there in business and politics. I also spend a lot of time on the Gold Coast in Australia and in Whistler, Canada. Of course, as a Japanese national, I live in Tokyo and travel extensively within Japan.

As you can see, I believe that nothing is more important than actually visiting the place, meeting with companies, and talking to CEOs, employees, and consumers. That is how you develop a feel for what is going on. For some of my visits, I have taken groups of 40–60 Japanese executives so they can witness first-hand regions that are attracting money from the rest of the world. I have taken groups to Ireland to see how cross-border business process outsourcing is reshaping its economy. I have taken them to see Italy's small towns that are thriving on the global stage. We have also visited Scandinavian countries to find out why they have emerged as the world's most competitive nations, and Eastern Europe to see how they may be positioned in the extended 25-member European Union. The group has also visited China and the United States twice, as well as India, Vietnam, Malaysia, Singapore, the Philippines, Korea, and Australia.

The executives who join me on these trips change their views of the world. Even in the days of the Internet and global cable news, walking around, listening, looking, and asking a question is still the best way to learn. Seeing what is happening in the world firsthand changes perspectives. Having witnessed the global stage, executives then begin to read newspapers and watch television with different eyes. Gradually, their views broaden and they feel comfortable in their roles as actors on the global stage. It does not necessarily come easily; new skills are required.

The second defining force behind *The Next Global Stage* is that, over the last 20 years, I have witnessed some of the pioneers of the global economy firsthand.

One of the first business leaders to be sympathetic to the notion of the truly global economy was the former CEO of Smith Kline Beecham, Henry Wendt. He saw cross-border alliances as a potential savior for the American pharmaceuticals industry and recognized that internationally based strategic alliances would become important, if not vital.

Henry realized that there were three dominant markets in the world: the United States, Japan and the Far East, and Europe. No *single* company could deal with and service all these markets effectively, no matter how powerful and dominant it might feel. No corporation could hope to cover a market of 700 million people that had a per-capita GNP income of more than $10,000.

Companies traditionally used a marketing strategy that depended on a sequential penetration of each market, whether it was a region or a country. When you established yourself and your product in market A, then (and only then) you moved on to market B. But Henry Wendt proposed that when you have a good product, you have to adopt a sprinkler model, penetrating various markets *simultaneously*. One way to achieve this is through strategic cross-border alliances.[1]

Henry Wendt entered into negotiations with Beecham, a company with a particularly high reputation in R&D and a strong presence in Europe, and, in time, these negotiations led to a merger. Not only did he opt to go down the merger path, but also, with powerful symbolism, he moved the company's corporate headquarters from Pittsburgh to London.

Henry Wendt had foresight and vision. His notion of cross-border alliances was truly innovative. In those days, such alliances and mergers were difficult because each large company was embedded in its domestic markets. These companies were also under the thumb of their respective domestic governments, with which they were closely linked and closely identified. It is very difficult to abandon your home turf. (Witness the more recent outcry about outsourcing.) For one thing, there may be government resistance (as we have seen in merger talks across Germany and France). There are also media commentators, like mammoths or dinosaurs stuck in a freezing swamp, who describe such moves as unpatriotic and unprincipled. They tend to report on one or other side "winning" in any merger, as with Daimler Chrysler.

In a world where borders were weakening, cross-border alliances were the only way for a company to survive and prosper. In the pharmaceuticals world, drugs were becoming more standardized. The important and potentially profitable compounds and formulas became less distinct. This was accompanied by an astronomical rise in the cost of R&D. New regulations piled on both costs and delays. Yet the amount of money invested in R&D had only an indirect link to the level of success that could be achieved. A company could build up the best-equipped laboratories, staffed with the optimal mixture of experience and youthful brilliance. This never guaranteed success. There was still an element of chance determining whether the right leads would be pursued and the breakthroughs realized.

The dilemma is that when the R&D is successful and a superdrug is born, you might not have adequate sales forces in the key markets of the world. So the amortization of R&D money is less, and, at the same time, you might have to keep expensive people in the field even when you don't have drugs to sell. This is the problem with industries such as pharmaceuticals, where high fixed costs demand size to justify them. That is why you need to seek strategic alliances and sometimes to go one step further to total cross-border mergers. In the mid-1980s, examples were few and far between. But now, we see examples of cross-border alliances and M&As almost daily in banking, airlines, retailing, power generation, automobiles, consumer and business electronics, machinery, and semiconductors.

Size and capitalization did play a part. A medium-size pharmaceuticals company might well spend $1 billion in R&D and have no results, but a larger company might be able to sink $3 billion into R&D. It could afford to miss the target more often and still remain profitable. Cross-border alliances allowed more companies to do this. It was only possible, though, once they saw beyond their home markets. Today, the concept of cross-border alliances is no longer a novelty. Henry's path-breaking role deserves recognition.

Another early pioneer of the global economy was Walter Wriston, former chairman of Citibank. He saw globalization as an imperative not because of management or business theories, but because of technological breakthroughs. He prophesized that competition between banks would no longer be based on banking services, but on acquiring better technology. Effectively, the company able to make decisions quicker, often in the fraction of a nanosecond, would be the winner.

Walter Wriston understood the future shape of banking—and of the global economy. It was to be based in a world without borders; it would float around decisions made in a split second, sometimes by nonhumans. Technology was to be the key to success in banking, so the person at the helm of Citibank had to be technology savvy. But his vision left him in a minority. Twenty years ago, most top bankers were traditionalists. They saw relationships of trust and confidentiality forged among business and governmental hierarchies as the key to success, not technology. Technology was all good, but it was for whiz kids, not bankers.

John Reid, Wriston's handpicked successor as head of Citibank in 1984, was not a product of the traditional East Coast banking establishment. Reid was a technologist. An MIT graduate, he had been working in Citibank on ATM applications and other electronic banking projects. At the time of his appointment, he was virtually unknown within the corporation. Some even greeted his appointment with the question "John Who?."

Walter Wriston defended his decision by saying that it was very hard to teach technology to an established banker, but relatively easy to teach banking to a technology specialist. As for relationships, these would develop over time. Under Reid's stewardship, Citibank became the largest bank in the world. Along the way, he astutely led Citibank through the Latin American financial crisis.

Yet another business leader who was ahead of his time was Akio Morita, co-founder of Sony. The original business was called Tokyo Tsushin Kogyo or Totsuko (TTK). This name, even in its abbreviated form, was too difficult for Western markets. So Morita came up with the four-letter *Sony* to represent the quality of sound from his transistor radios. For Morita, the world was one big market, with few or no barriers. He thought big but was no megalomaniac. He famously advised companies to "Think Globally, Act Locally." This philosophy was christened *glocal* by the Japanese magazine *Nikkei Business* and led to the coining of a new word, *glocalization*.

These visionaries shared many of my views about the then-emerging global economy, explained in such books as *Triad Power* and *The Borderless World*. I was fortunate enough to exchange views with all three of them and many others in the mid-1980s and beyond. However, discussions on the importance of the region-state proved more elusive and troublesome. I had to wait until the developments within China post-1998 to gain any sort of useful practical perspective on this issue.

Some Stage Directions

In *The Next Global Stage*, with these intellectual antecedents in mind, I begin by looking at the state of the world and how we make sense of it. Part I, "The Stage," looks at some of the areas of explosive growth (Chapter 1, "The World Tour") and identifies some of the characteristics of the global economy. It then looks back at the birth point of this new era (Chapter 2, "Opening Night"). This part ends with an examination of the failure of traditional economics—and economists—to make sense of the global economy (Chapter 3, "The End of Economics").

In Part II, "Stage Directions," I examine the major trends emerging on the global stage. In the opening section of Chapter 4, "Playmakers," I explore the development of the nation-state and the dynamics of what I call the region-state, the most useful and potent means of economic organization in the global economy. I go on (in Chapter 5, "Platforms for Progress"), to introduce the idea of platforms, such as the use of English, Windows, branding, and the U.S. dollar, as global means of communication, understanding, and commerce. Finally, I explore what parts of business have to change in line with the emerging economy. These include business systems and processes (Chapter 6, "Out and About") and products, people, and logistics (Chapter 7, "Breaking the Chains").

In Part III, "The Script," I provide analysis of how these changes and trends will impact governments (Chapter 8, "Reinventing Government"), corporations, and individuals (Chapter 9, "The Futures Market"). I look at some of the regions that might be the economic dynamos shaping the world beyond the global stage (Chapter 10, "The Next Stage"). In the final section, I revisit my book, *The Mind of the Strategist*, and think through the need for changes in the frameworks we use in developing corporate strategy on the global stage.

The Next Global Stage makes sense of the world as I see it. Twenty years ago, globalization was a term, a theoretical concept. Now it is a reality. *The Next Global Stage* is part of a process of understanding the new rules that apply in this new world—and often, there aren't rules to adequately explain what we now experience on a daily basis. It is not an endpoint, nor is it a beginning, but I hope it is an important step forward for companies and individuals, as well as regional and national leaders.

Kenichi Ohmae
Tokyo
September 2004

Notes

[1] I explored this theme in *Triad Power: The Coming Shape of Global Competition* (New York: Simon & Schuster, 1985).

THE PLOT

We live in a truly networked and interdependent world, united by a global economy. In the past, business and economics were like plays (maybe by the same author) performed in separate theaters to discrete audiences. Their actors and actresses were distinct, and their manner of performance was often influenced by the individual theater's tradition. Now the drama takes place on one enormous global stage. The players on this stage are sometimes in competition for the audience's attention, but movements across the stage are free-flowing, no longer obstructed by obsolete stage furniture. The global stage is in a state of perpetual motion. *The Next Global Stage* provides a script to negotiate your route through the shifting plot lines.

This has been made possible by advances in information technology. Data now passes freely from one side of the world to the other, along fiber-optic cables or satellite transmissions. Information defies barriers, whether physical or political. It is facilitated by the establishment of platforms for streamlining the application of technology to definite tasks. Powerful search engines, such as Google, make it possible to find and combine unrelated pieces of information in the digital labyrinth. In the analog society, discrete pieces of information had to be humanly spliced together to draw out meaning. Now, mindless robots running through millions of interconnected computers are capable of putting together the synthesized information and implications in a matter of milliseconds. Information from 8 billion Web pages (as of January 2005) is amalgamated to draw a synthesized perspective and knowledge in a split second. In the past, it took a wise man or an experienced journalist to relate one piece of information with another, but now any layperson can find relationships among many seemingly unrelated events and incidents by throwing multiple words into a search engine.

In the past, chemists searched relevant articles in *Chemical Abstract*, an authoritative and massive collection of all the work by chemists around the world. Stock buyers and traders searched key information using Bloomberg, Reuters, Telerate, Nikkei, or other influential sources in their particular country. Now Google or other such search engines are the common portal. Chances are, most of the information—or, at least, the clue to the information—you are looking for exists in digital form. So, mankind has migrated into the borderless and digital world without an official opening ceremony at the new global theater.

The global theater has many world-changing implications, some already being put into effect in countries such as China, Finland, and Ireland. The global economy ignores barriers, but if they are not removed, they cause distortion. The traditional centralized nation-state is another source of friction. It is ill equipped to play a meaningful role on the global stage, whereas its component regions are often the best units for attracting and retaining prosperity. The region-state is the best unit of prosperity on the global stage, but this can be enhanced by coming together informally in larger umbrellas, such as the European Union, which can enhance free trade, consistency of governing laws, and market integration.

The revolution in data-transfer technology has already had an impact on the nature of money and capital movement. Money can flow unrestricted to the areas of highest return. Old notions about corporate value are challenged by the growing influence of multiples and derivatives. A lot of traditional thinking on economics depended on national policy. In countries where outside world influences strongly affect the domestic economy, old economic theories do not hold up.

Consider the two very different economic crises in Argentina over the last decade. The first put the whole country, as well as plenty of outsiders, into a state of panic; the second did not. By the time of the second crisis, most people associated with Argentina, both insiders and outsiders, depended less on its domestic currency, the *new peso*, because most of them had converted their assets into the dollar, a global standard for savings and settlement.

If, as I believe, the global economy is powered by technology, then knowledge is its precious metal. India's strength, for example, can be substantially attributed to the sheer volume of its Ph.Ds in science. Emerging nations can propel economic growth through education. An area no longer has to be endowed with mineral wealth or a large population, or a strong military, to become a major player on the global economic stage. It can acquire its wealth and know-how through investment from the rest of the world beyond its borders. This must no longer be seen as a threat, but as a source of immense opportunities.

Although the global economy presents opportunities, there are also challenges to be faced by government, businesses, and individuals. These can only be met by adopting flexibility and pragmatism.

4

PLAYMAKERS

Finding Your Bearings on the Global Stage

Our landscape has changed radically. The world is beset by a world war between the shibboleths of the old economic thinking, with its allied baggage, and the global economy. We have already examined some of these obsolete notions and fading nebulae of the old economic order. Now we will examine the way in which we look at the world and how we divide it into discrete geographical and political entities is being undermined by the global economy. Although our thinking is dominated by the atlases of the past, with their maps of continents containing a collection of different-colored political units, the global economy is strange and alien. When we start to jettison the straightjackets of this old thinking, the global economy not only makes greater sense, but it is seen as one grand continent of opportunity whose exact contours still remain vague in places but that will amply reward brave exploration.

For me, the geographical and economic unit of the global economy is the region. Let us imagine a region as a theater. It may be a slightly smaller, more intimate theater than the Bol'shoy in Moscow or La Scala in Milan. The stages of these theaters are designed for big spectacles, whose value is often caught up in shortsighted impressions. The productions are, to paraphrase Shakespeare's *Macbeth*, full of strength and fury but signify nothing. A smaller stage can be far more useful. A good producer knows that the actors won't get lost on it; there will be a more direct and intimate contact between performer and spectator. With a smaller production, a producer can make changes from performance to performance when and if something goes wrong or doesn't go according to plan. There are more opportunities for concentrating on the science of acting rather than on choreography.

Putting regions at center stage demands some radical rethinking of the way we view the world. The global stage is borderless. This means that a lot of our nice cozy concepts about geography are going to have to be discarded. The most obsolete of these notions is the nation-state.

We have seen that the study of economics has been bound up with the nation-state. Economics and the idea of the nation-state grew up together. The nation-state was the arena for political and economic activity, and for over a century after its birth, the discipline of economics was labeled *political economy*. The nation-state and economics have seemed inseparable, but they are not related biologically or scientifically. Indeed, one has had a very bad influence on the other.

The nation-state has become firmly embedded in the intellectual, cultural, and political landscape. But it is a smooth-talking squatter rather than a rightful resident. This has been due to a process of ingratiation. The nation-state concept presented itself as an organic development, a natural development of human organization. The nation-state protects, it provides, it is the source of solutions to its own problems. How can we live without it?

Because it seems so immutable, many people think that it is very old. This is a mistake. In the parade of human history, the nation-state is a recently arrived interloper.

It was first defined by Jean Bodin, a French lawyer in the middle of the sixteenth century. Bodin looked at the myriad of small political entities that were often at loggerheads with each other. The reasons for disputes were many and varied, and often very trivial. In Bodin's time, differences over religious worship injected real bitterness into these contests.

Some of the political entities of Bodin's time were little more than city-states with some attached countryside—places such as Genova in Italy. Similarly, Venice had originally been a region-state, very badly endowed by nature. By the end of the medieval epoch, it had established its own empire, though by Bodin's day this was starting to fall to pieces. Bodin knew there was a political institution that was broad in its geographical scope: the Holy Roman Empire. Even at the time, this inspired the joke that it was neither holy, nor Roman, nor an Empire. Whatever strength it had came from its mass, the unity of its parts. This was combined with an ideology, something capable of attracting and keeping loyalty, not dissimilar to a contemporary brand. The concept of a universal emperor was something that commanded both recognition and respect. If a lesser ruler could find some type of unifying ideology, his own distinct political brand, based on common origins or language or tradition, maybe he could have the same type of recognition, respect, and power as the emperor. This was attractive to some rulers, who thought it would bring not only loads of prestige, but also greater wealth.

There were a number of technical problems with Bodin's idea. Most of them have been solved over time. The first was the lack of a big bureaucracy. Without this, a nation-state was a paper tiger, a cozy concept—no more. A real nation-state had to be staffed, policed, and defended, but courts and armies had to be paid for. The most effective means of getting money was taxation. This, in turn, needed tax officials, as well as custom and excise personnel. There was a need for policemen to assert the state's uniqueness, as well as soldiers to guard its borders. So, early on, it was apparent that the nation-state was an expensive ideal. As devotees of big government have discovered to their cost since then, the bigger the government, the more expensive. No matter how much they are paid, some of the money that should be going to the center is rerouted into collectors' pockets.

European exploration and colonization grew after the sixteenth century. So if nation-states were successful, they could become very wealthy. There was still a need to assert their power economically. This was done by the mercantilist system. People went from the mother country to exploit the treasure chest of the New World. They then sent these riches back home for processing and resale. But those settling down in the far-off territories were never permitted to produce anything tradable themselves or to trade with any other country or colony. They were entirely dependent on the mother country for all their finished goods and equipment. The development of indigenous industry and trade was prohibited. This signaled the arrival of one of the nation-state's most long-lasting and pernicious economic "assistants": protectionism. If you rule a nation-state, you must protect its interests, including the nation's economy; it was mistakenly believed that the best way to this was to establish a system of regulations and tariffs limiting or excluding the products and services of other nation-states from those of the mother country. This doctrine may not be as popular as it once was, but it is certainly far from redundant in today's world. Calls for protection also inspired the notion common in the writings of some early economists that the state was the ultimate arbiter of its own problems. The state had to solve these as best it could. There was an external world beyond its borders, but its role in the solution of economic problems was, at best, secondary and indirect. The rest of the world was quite literally foreign. The concept of the closed economy was born long before John Maynard Keynes.

Mercantilism in practice was a big blunder. It led to the American Revolution in 1776. Mercantilism sought to protect the economies of the mother countries. Instead, as with any prolonged form of protection, it led to inefficiency, high taxation, and ultimately the bankruptcy of the nation state.

In the nineteenth century, the concept of the nation-state discovered a new lease on life by attracting greater ornamentation and symbols. This form still haunts our world today. Each state had its own flag, its symbols—such as the American eagle and the Russian bear—and its national anthem. These were meant to inspire loyalty and near religious devotion, a sense of oneness. They can be viewed as a further part of the nation state's brand creation. But the parallel with modern branding breaks down with the fact that those involved sought to lock people into loyalty. There was no room for choice or "shopping around."

Another vitally important part of the nation-state brand was "national territory." Particularism and regionalism were seen as bad, pernicious, and invidious to the state ideal. Shadows of these thoughts are still with us.

In the economic sphere, the nation-state had its own unique currency and, to protect it, a national central bank. The German economist Friedrich List wrote a blueprint for the nation-state's economic activities. National economies were to deliberately look inward; they were to be shielded from the shrill winds of competition by high tariffs. One of the countries where List's theories were received and applied was the United States. They were also applied throughout Latin America well into the twentieth century, with ultimately fateful results. In the twentieth century, each nation-state had to have its own "national" airline, its "flag carrier." Most of these could not make money because their markets were too small. It is hardly surprising that many of these flag carriers have now gone bankrupt or have merged with other carriers.

Another "must-have" for the nation state was an army—the bigger and better equipped, the better. At this time, the nation-state attracted a very dangerous element to its entourage: nationalism. The two got on very well. The state was an embodiment of a "national spirit" that was found (and only to be found) in people of a particular ethnic group and speakers of the national language.

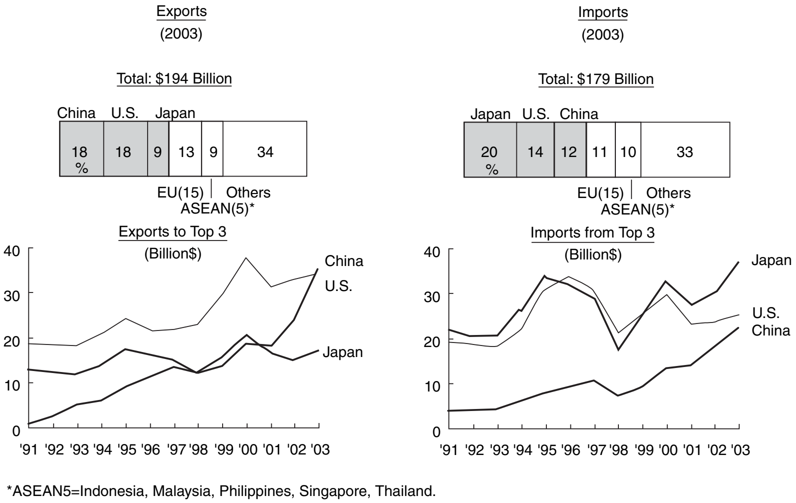
From the late nineteenth century, the idea of a nation-state was exported from its European homeland. It became prominent in Latin America, where a number of small, sometimes miniscule political entities had grown up. All claimed to be distinct. But their ruling castes all spoke Spanish (Portuguese in Brazil). That did not stop them from drawing maps to emphasize *their* territory, and fighting costly and disastrous wars when these were breached. Their economies were dominated by exports of a limited number of primary goods. In the twentieth century, each one tried to strengthen its economy by building up uneconomic and uncompetitive domestic industries to supply substitutes for imports. Exporting was discouraged as the state unrealistically turned its back on the outside world. But the more they industrialized, the more dependent they became on outside capital. They discovered the importance of the rest of the world through a very bumpy, costly, and, in some cases, bloodstained journey.

In Asia, the nation-state brand was viewed as the height of political sophistication. Rulers saw it as a way of consolidating their power. It smelled of modernity and progress. Only by conforming to the nation-state concept could rulers be viewed seriously by Europeans and Americans. When Japan opened up to the West in the late nineteenth century, the country's rulers borrowed the centralized form of government used then in France and Germany. It has never been seriously changed.

Consider Korea, where the nation-state ideal remains very influential. Many people in South Korea dream of the emergence of a Great Korea, stretching from Cheju Island in the south to the Yalu River in the north. This will come about when North Korea opens up (or falls) to the South. This will happen when its economy responds to its internal contradictions and collapses, with either a bang or a whimper. The Koreans believe that the rising of the curtain on the Korean peninsular will usher in great business and commercial opportunities from which Korea will emerge as a true rival to both China and Japan. It will have a combined population of nearly 70 million people and might also have nuclear weapons at its disposal. But while Korean nationalists may look forward to "reunification," what they really hope is that the communist North will become an economic colony ready for a process of modernization to be carried out, naturally enough, by South Korean companies such as Samsung and Hyundai. Appetites are already being whetted by talk of undertaking joint ventures and establishing facilities in new industrial parks. It is as if there is an undiscovered pot of gold, whose discovery is simply a matter of time. By looking north, South Koreans are able to avoid competing with countries to the west and east. South Korea can opt out of the future because it believes it has its own rosy destiny.

This sentimental vision blinds many in Korea. While they look only to their north, Korea's real strengths lie in its position in the Yellow Sea region, facing the markets of China, Japan, and the United States across the Pacific Ocean. These are the zones that should attract more Korean attention (see Exhibit 4.1). The Yellow Sea may be vibrant, but it is not a nation-state. It cannot stimulate the same irrational emotions, no matter how powerful the economic forces at work are.

At the moment, trade between China and Korea is growing steadily. But because of their myopic insistence on looking north all the time, Koreans do not realize that a "hollowing out" is occurring, in which Korean businesses are increasingly relocating outward from Korea toward China. Products exported from China by Korean companies are all reassembled in the port of Pusan and then are exported officially out of "Korea."



Source: KITA.org.

Exhibit 4.1 Korea's trading partners.

How Nation-States Retard Economic Development

Modern abuse of the nation-state concept can be seen in the Soviet Union, which inherited the Czarist conquests of Central Asia. Stalin paid lip service to the notion of national self-determination, and ethnically based socialist republics were carved out. These seldom bore much relation to the nationalities they were supposed to represent.

When the Soviet Union collapsed in 1991, these republics had independence and sovereignty foisted upon them. They were completely unprepared for it. Having formerly been intimate members of the highly entwined Soviet economy, they were cast adrift in a completely foreign ocean. Their new rulers (usually the former communist bosses) acquired all the previously mentioned trappings of the nation-state: flags, symbols, national anthems, and currencies (often worthless) and national banks. Integration of their respective markets has been delayed by personality differences among the rulers, as well as by border disputes. Ethnic differences are magnified to absurd proportions. Vast natural resources are left untapped or are inefficiently exploited by one nation-state acting independently. In fact, nobody knows how many nation-states have been born out of the former

USSR. The same is true of the former Yugoslavia. If an overarching dictator emerges in the future, these "regions" could once again be united as "one nation."

But it is in Africa that the nation-state concept has had the most disastrous consequences for people and economies. In 1885, the European powers met in Berlin to carve up the continent among them. The entities they created are still with us. They were not making states at all in Berlin; they were establishing colonies or protectorates. When a growing tide of African resentment forced the rulers of Western Europe to concede independence and political self-government to their African holdings, it was agreed that the border demarcations drawn up in Berlin should serve as the borders of the new crop of nation-states. This was to avoid border conflicts and the incipient risk of conflicts. Nation-states were born that made no sense. They had territories comprising few natural resources, a food production sector dominated by subsistence cultivation and chronically vulnerable to natural calamities. Not surprisingly, many of these states have remained at the bottom of the world's GDP league.

Apart from the economic myopia of these policies, ethnic and religious borders were ignored. Many of the new states contained festering internal conflicts. In the case of Nigeria and the Congo, these have spilled over into bloody civil wars with predictable impacts on resources. Other areas that had the potential for growth, such as the Niger Delta region, were divided between two separate nation-states (Nigeria and Cameroon), neither of which was interested in cooperation—both wanted only total control.

The Nation-State Fetish

All of this matters because nation-states continue to hold sway over our thinking. Look again at economics. The nation-state produces statistics known as national accounting aggregates. These include tables of the gross domestic product or aggregate demand, and are supposed to show the economic health of a particular nation. When the GDP is divided by the state's population, another magic number is found: GDP per capita. This figure can act like a combination to a safe. When it is above a figure of U.S.$10,000, the country's rulers believe that they have arrived as a state, that they are no longer dirt poor, and that they are important players in the world's economic game. This allows them to become members of the Organization for Economic Cooperation and Development (OECD).

Gross domestic product, a nation's total value added per year, is a very bold measurement. It relies on information supplied by a population, mainly as a result of tax receipts or shipment records. Of course, few people like paying tax. For some, it becomes a matter of duty and honor to pay as little as possible. A separate arena of economic activity emerges—a "black economy" that may be as big or bigger than the legitimate one.

As its name implies, a GDP is domestic, looking at activities that take place within a state's borders. The figure of gross national product (GNP) is more relevant because it includes economic activities by the state's citizenry beyond its borders. As we have seen, the global economy does not respect national borders. Both the GDP and the GNP include only finished products and services. Many goods and services can be initiated in one country, but they are completed in another. If we look at cross-border business process outsourcing, we see that much of the back-office work involved in the provision of a service is carried out in a low-cost environment. Only the finished service is consumed in the "host" country, yet the contribution made by people in another country is not properly registered.

GDP and GNP figures offer only averages for a whole nation-state. The major engines of economic activity in the global economy are not nations, but regions. The contribution and vitality of a particular region will not be discernible in a nation's accounting aggregate figures. The growth level of China averages around 9 percent per annum. But this is a figure for the whole country. It embraces vibrant region-states such as Dalian and Guangzhou, whose growth rates were between 13 and 15 percent per annum for 2003, and regions farther west such as Ningxia and Gansu, which are still enmeshed in poverty. There are China watchers who like to pour cold water on China's continued economic growth trends, stating that it is impossible for the country as a whole to maintain growth rates of 9 or even 7 percent. But such responses fail to take account the reality that it is not China as a whole that is growing, but certain regions within it. The concept of the totality of the Chinese People's Republic exists at the political level only.

So, whether China continues to grow at a high pace depends on whether it can grow the number of megalopolises or region-states, along with the growth rate of such regions. China produced 146 new cities with more than one million people in the 10 years between 1990 and 2000 (see Exhibit 4.2). There is no reason to believe that it cannot repeat this. There are, after all, still 800 million people living in the Chinese countryside as farmers.

Sadly, these inadequate numbers are used in assessing a state's economic health. If they show growth compared to the previous year's figure, this is evidence of a strong and healthy economy.

As another example of using outdated theorems to explain the global stage, consider the conventional supply/pricing curve. If you plot the capacity of suppliers on the X-axis, in the order of lowest to highest producers, and the cost of production on the Y-axis, you can explain the pricing curve and how it is going to drive out the weakest suppliers as price competition becomes tougher when demand shrinks. Usually, this supply curve is constructed only using domestic suppliers. Increasingly, you now have to construct the curve for the entirety of the EU or North America. The curve is increasingly meaningless if it is construed simply in insular terms. For example, we are now witnessing China's demand pulling Japan's marginal producers' supply and getting mordant plants to wake up. So, here again, the national model needs to be modified to reflect the semi-permeability of borders.

Chinese Cities over a Million People

Population in Millions	Number of Cities	
	1990	2000
1-3	17	156
3-5	3	4
>5	0	6
Total	20	166

Source: Chinese Statistics on Population, 2001.

Exhibit 4.2 Chinese cities with more than one million people.

Strong States

Similarly, a strong currency is given more importance than it now deserves. The logic is that a strong currency suggests a stable economic base. Such a nation would find it relatively easy to borrow. Funds might be accessed from international financial institutions, or government securities and bonds would find ready buyers. It might even have a good credit rating. Its currency would be desirable.

But a nation with such a "strong" currency soon finds that its currency is overvalued. If its economy relies heavily on the export of commodities, its exports are too expensive. At times, the Japanese yen is strong against the dollar, but although the Japanese economy is not in the best of shape, its exports are still very tradable. The reason is that these exports are largely branded, manufactured goods, not commodities. A strong yen, though the bane of the Japanese *Keidanren*, means that import of materials and components is cheaper.

In the world of near instant communications, the nation-state is irrelevant. One of the outward symbols of its existence is the national border, staffed by uniformed officials checking papers and manning barricades. But what use are such border controls in the world of the Internet, for example? Does a stream of data passing along a fiber-optic cable stop at each national border it crosses so that it can be inspected for contraband?

The nation-state promised much but delivered little. In today's world, far from making things better, it threatens to make them worse. It has the potential to hold back human development through artificial compartmentalization of skills and markets. Quite simply, the world has moved on.

Our world is now interdependent to a greater degree than ever before. But global interdependence is *nothing* new. The idea of a hermetically sealed nation-state fully self-sufficient in all its needs is absurd. There has always been trade. Throughout human history, technology has made trade possible over greater distances. Now technology and improved logistics allow trade to occur at greater speed.

By breaking up the world's population into supposedly self-sufficient entities, nation-states have stymied the realization of interdependence. Political entities, whether large or small, still believe that, at the end of the day, they can survive on their own, though things might be a little tough. Confrontation rather than cooperation has followed in its wake. It sets a high price on a specious and nonexistent uniformity. This can be achieved only at the cost of great human suffering. Economies and societies thrive on diversity. If we look at a city such as Dubai in the United Arab Emirates, we see a prosperous metropolis. It is situated in a part of Arabia on the shores of the Persian Gulf, but many of those who work there and contribute to its prosperity are not Arabs. They may be managers from Western Europe or taxi drivers from India or Pakistan. Its nightclubs are adorned by beautiful Eastern European girls. In fact, it is so dependent on managers and workers from India that its airport offers direct flights to 15 Indian cities. The same diversity is at the heart of Singapore's continued success.

In Asia and Africa, the benefit of new European technology has sometimes been resented. In some countries in Africa, it became government policy to reject all aspects of Western "civilization" while holding on to the trappings of power, which were largely inherited from the West. This was sometimes done on the grounds of self-styled nationalism or Africanism (it has had many titles). It was often accompanied by government takeovers of the factors of the economy—once more, in the name of the nation-state. Development and poverty alleviation have often been set back decades.

The Rise of the Region

We must look for the new centers of growth in our world, and we can find them easily enough in the regions. Some of these regions are component parts of old nation-states; others spill over existing borders.

In the opening chapter, I mentioned how the global economy has infused new life into regions around the world, whether it is the Shandong peninsular or Finland. Some old-style nation-states are lucky and are small enough to act like region-states. These include Ireland, Finland, Denmark, Sweden, Norway, and Singapore, though they have more going for them than size alone.

The ongoing development of the global economy will lead to an inevitable undermining of the nation-state in favor of the region. This is anathema to those who believe in a big, centralized state as *the only way* to run politics, society, the economy, and culture. For many such "statists," the concept of the national centralized government was, in its day, progressive and forward looking. The regional could too easily be the seat of the local, the parochial, and the inward looking. Limited areas bred limited horizons. Those who thought in terms of small units could never think big. But this has changed, thanks largely but not solely to technological breakthroughs. In the twenty-first century, the opposite is true. It is the nation-state itself that is anti-progressive and introspective, and it is often the regions of the state (though, admittedly, not every region) that are outwardly mobile and that work and think within a truly global and borderless perspective. They no longer think in terms of states as political monoliths, but of states that are amalgams of regions. They also look to the rest of the world for capital, technology, and markets. They do not need to possess all the elements of economic prosperity, as long as the world works for them and with them. For this reason, the global economy acts to discipline governments and to streamline regions. Borders are nothing but a burden for old nation-states. In this context, it is amazing to see how many border disputes continue to rumble on.

What is happening is that economics and technology are enforcing a new scale on geopolitical organization. There will remain boundaries, but these will be transparent and will represent opportunities and supporting diversity. The demise of the nation state will not usher in a bland, one-dimensional, monocultural world.

A region-state is not a political, but an economic unit. Some region-states are equal to political units. Singapore, for example, is more like a city-state than a sovereign state, with its minuscule area. The Republic of Ireland is also fortunate to be open to the global economy and, at the same time, retain the traditional trappings of statehood. But these are accidents of recent economic history and geography.

The notion that region-states can act as foci of prosperity is not a novelty. I mentioned Venice; this great city was originally a region-state that grew in the later medieval period into an empire. Italy was studded with such centers: They were the cradles of the Renaissance and other contributions to our world, including double-entry bookkeeping. Farther north in Europe was the Hanseatic League, a collective of trading cities on the shores of the Baltic and the North Sea. These centers, such as Riga, Tallin, and Danzig, were the region-states of their day. They looked outward for their prosperity rather than looking to central government with their hands outstretched.

Regions are already sizable economic players in the world. If we look at Japan, we see that the Shutoken metropolitan area (the Tokyo, Kanagawa, Chiba, and Saitama prefectures) has a gross national product of $1.5 trillion and that is in the top three in the world. The Kansai area centered on Osaka has a GNP of $770 billion, which occupies seventh place in the world, after China. Both these areas are entitled, by numbers at least, to qualify for membership of the G7. Of course, in reality, the level of local decision-making allowed to them by the centralized Japanese political system is miniscule.

Defining the Region-State

We must be careful not to define region-states too tightly, especially in terms of population. True, many region-states share characteristics, but these should be seen as points of reference rather than hard and fast definitions. No aspiring region-state can attain success by merely marshalling a set of ingredients, as in a recipe for a cake or a specification for a piece of equipment.

Population size is important but not crucial. This is an elastic variable.

In many ways, size is a state of mind. A region must have a sizable domestic market to attract internal investment, so a lower floor of half a million or, better still, a million is desirable. If there are too many inhabitants, it may be impossible for investors to maintain a clear marketing focus. The often-intangible sense of solidarity, a fabric holding and motivating its population, may also be absent. The ceiling, on the other hand, seems to be around 10 million people, although Shutoken around Tokyo has 30 million inhabitants but is still a natural community, thanks to its excellent commuter networks.

There are no magic numbers. An area might have the "right" population level—the same as other successful region-states—but still be mired in poverty. Similarly, an area that seems a gargantuan parody of intimacy might be a successful region-state.

An international airport and at least one large and efficiently functioning harbor capable of handling international freight, as well as a good transport infrastructure, are necessary, too. A sprinkling of forward-looking universities and research facilities capable of attracting good students and turning out highly trained workers and graduates is very important.

But the most essential element of any successful region must be openness to the outside world. The rest of the world must be viewed positively, as the source of prosperity. Xenophobic notions must be expunged. The concept of native versus foreigner must be erased, so rules limiting foreign investment or foreign ownership of land or capital must be abolished.

Pernicious antiforeign measures have to go, too. These include laws prohibiting cabotage (such as tariffs) in the carriage of goods, either by land or by sea. There must be no barriers to companies from outside the region coming in and either taking over local enterprises or setting up joint ventures. In today's business world, mergers and acquisitions are a very cost-effective means of entering a market or augmenting market share.

When I discuss company structures, one of the points I will make is that it no longer matters where a company is based or "headquartered," so this reality must play a role in attitudes toward outside investment. It may well be that more "big players" start to relocate their headquarters to region-states. This might be aided by laws allowing easy company registration. This already exists in the United States. If we see its 50 states as constituent region-states, then Delaware already enjoys preeminence for company registration. Its separate business courts system is also attractive to those wanting to do business there.

Not only must a region-state be a good place to do business, but it also must be an attractive place to work and to raise kids. This is important, as can be seen by the constant attempts in areas such as Singapore and Dalian to enhance the physical environment through the maintenance of beaches and parks. Although "eye candy" is important, it is meaningless on its own. Much of the promotion of regions carried on in the past has focused on such issues. Glossy brochures attempting to attract inward investment were produced singing the praises of an area and displaying its natural beauty and landscapes, so much so that all the separate images of pretty flowerbeds, marinas, and manicured golf courses became an undefined blur.

A powerful definition of a region-state is that it is a unit for creating a positive virtual cycle. The more people who come in, and the more varied their backgrounds and skills are, the more varied the region becomes over time. If it starts out in manufacturing, other services associated with the manufacturing sector enter the region, too. In time, financial institutions arrive, along with those offering domestic and retail financial services. A positive cycle thus occurs, and the region becomes a totality with a deeper, wider economic and business base. It is amazing how quickly industries and service providers are attracted to prosperous regions and assemble there to support some of the industries that are already spearheading industrial acceleration.

When new industries of a varied background are attracted to a positive area, a whole plethora of affiliated nonbusiness services mushrooms. Schools will inevitably come in to meet the need for education and an educated workforce. Hospitals and clinics will be built to meet the medical and healthcare needs of the region's inhabitants. There are also automobile dealers, not to mention restaurants and supermarkets. In short, once there are people on the ground, they have needs that must be serviced.

This model is repeated in many places. In China, many regions are literally unrecognizable from what they were like 5 or 10 years ago. In 5 or 10 years' time, who can say what the situation will be?

If we look at Dalian, we see a bustling metropolis. Just about everything that is to be found in any city anywhere in the world is to be found there. The different services are available neatly in a geographically sectored environment. People doing business in Dalian don't have to invite civil engineers to perform environmental assessment surveys and the like. They are there already: mechanical engineers, computer scientists, cartoonists—anyone offering a service. It is as complete a city as Paris, London, or Tokyo.

We may ask, "Has Dalian always been a big city?" No. But remember that it is a central plank of the paradigm of the global economy that an area does not have to be prosperous before it can become rich.

Indian Summers

Rapid transformations of this sort have not been confined to China. India is also a land of great contrasts. At nearly every level apart from the geographical and the political, the very notion of unity among such diversity seems artificial. India's many princely states were united under in the British Empire. When the British left in 1947, a federal constitution based on a collection of states was initiated. Most power still remained at the center, though, a phenomenon that was seen as vital for long-term political stability and the continuation of the politicians' control. India's leaders dedicated themselves to alleviating poverty, but they never gave any thought to creating wealth, so the economic models constructed by Ghandi, Nehru, and their successors had the effect of redistributing poverty. In the 1990s, thanks to far-seeing and determined leaders in a handful of states such as Andhra Pradesh and Maharashtra, new areas of prosperity developed, utilizing India's huge and literate population, as well as the reservoir of technical talent that existed in cities such as Bangalore, Hyderabad, and Pune. Once the foundations of prosperity had been laid in these centers, they attracted the usual range of service industries—usual in a Western country, but novel in India. Government regulations were relaxed to allow consumers access to products and services from throughout the world. Much prosperity was known to be available through telecommunications, but the telecom network in India was a long-standing disaster, the source of numerous horror stories. Rather than waiting for an acceptable India-wide fixed-line telecommunications system to be rolled out, satellite connections were established in southern India to bypass the national telecoms service altogether.

The transformation in cities in India such as Hyderabad has been near miraculous. There are now malls lined with shops selling everything from consumer electronics to Western clothing. It is not uncommon to see people walking along the streets speaking into mobile phones, (that is, if they can hear over the cacophonous traffic). Traffic congestion is still endemic in Indian cities, but whereas up to a few years ago the traffic streams were made up of battered, standard-make cars that were fashionable in the 1950s and early 1960s (along with the odd cart pulled by a bullock), India's streets are clogged with a far more up-to-date sample of automobiles (and still a good many cattle).

These region-states in India are now more closely integrated into global business because they are not only developing software and systems, but they also are conducting fixed-line, outsourced business functions on behalf of American and European companies. They have become part of an integrated whole of global corporations.

The experience of places such as Hyderabad is seen as a phenomenon to be emulated by other Indian regions. The most startling of these is West Bengal and Kolkata, for so long the cockpit of militant trade unionism. It is even more surprising that these moves are being spearheaded by a state government dominated by one of India's communist parties.

The same phenomenon of self-sufficiency can be observed on the other side of the Pacific, in California. San Jose today is almost as autonomous and self-supporting as San Francisco. It is not necessary to go to San Francisco to get every service. In the mid-1960s, San Jose was a veritable no man's land, a wilderness. The title of the Dion Warwick song said it all: *Do You Know the Way to San Jose?* Most people did not. Now there is a direct Tokyo–San Jose flight every day, and you may have to ask, "Do you know the way to San Francisco?"

Does Dalian or San Jose worry about intangibles such as "identity"? Does the average resident care where his or her food comes from? Consider Singapore. Notions of nationhood do not perturb it greatly. True, it has all the usual trappings of a nation: a currency, a flag, a national anthem, and so on. It does not worry that no domestic farmers produce its food. It is not troubled by "nightmares" about food security. What is important is that the food Singaporeans consume is inexpensive and also nutritious. It can get this from other food producers in the region. Singapore enjoys the luxury of being both a region-state and a nation-state. It has always been able to set its own agenda.

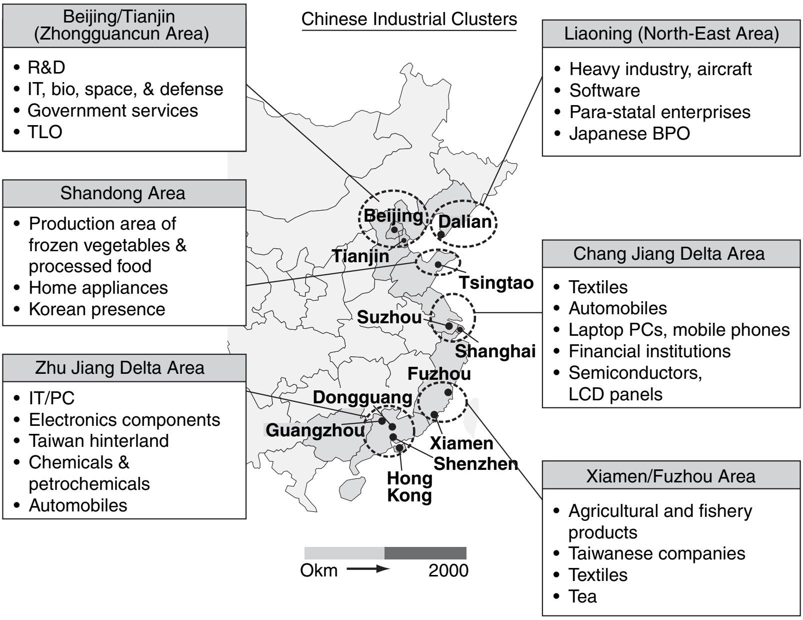
A typical region may defy existing political borders. In the 1990s, Catalonia in northeastern Spain became a successful economic region. A zone of success tends to spread, so neighboring areas in southwest France, such as Languedoc-Roussillon, have also benefited.

We should not think only in terms of geopolitics. Just as a very talented actor can bring crowds to his performances far more readily than any theater, no matter how prestigious, a particularly gifted individual can establish not only his own identity in both a location and a business sector, but this person also can help draw businesses from other unrelated sectors, as if by a power of magnetism. Such a human magnet is Michael Dell. Since its foundation in 1984, Dell Computers has rewritten many of the rulebooks, especially those dealing with logistics. But its impact on its original location, Austin, Texas, has been no less monumental. Not only have a number of software and IT engineering facilities grown up there, but there has been a huge surge in biotechnology startups, to mention just one sector. It is as if Austin has grown from being an IT cluster to its own region-state.

Carried Away in China

The country where the phenomenon of the region-state has taken off most successfully is China (see Exhibit 4.3). In the 1980s, the Chinese government opened up a number of special economic zones aimed at attracting foreign direct investment. One of the most successful was in the Shenzhen area facing Hong Kong. It attracted investment not just from Hong Kong, but from throughout the world. Many local leaders chafed at the amount of central interference from Beijing-based bureaucrats in day-to-day decision making. They sensed that the prosperity they were experiencing was but a taste of what could be achieved by a more active involvement with the world economy and its major actors.

The response of Beijing was predictably cautious: Let's not get carried away, they said. After all, if they allowed greater economic freedom to Guangdong province, might this not turn into calls for greater freedom overall? Might not Shenzhen's calls be echoed by



Source: BBT Research Institute.

Exhibit 4.3 United States of Chunghwa.

other cities, especially those that had been granted special economic zone status? How could the central government, which had a duty to care for all regions of the country equally, allow only a few regions to prosper, while allowing unashamed poverty in areas not too far away such as the Guizhou province?

The People's Republic of China is still a communist state (if only rhetorically), and one of its tenets of government is the euphemistic Democratic Centralism. Bitter debates raged within the secretive ranks of the Communist Party in the 1990s between reformers and conservatives, federalists and centralists.

In the late 1990s, a new vision took shape. At the theoretical level, China remains a communist, centralized state. In practice, provincial leaders are allowed to do pretty much as they like, as long as this is not accompanied by egregious displays of self-enrichment.

The per-capita income of residents in areas such as Dalian, Zhejiang, Beijing, and Shanghai is approaching \$5,000 per year. It may have already surpassed this level in Guangzhou. This has been a massive jump in less than a decade. It is also huge compared to the figures hovering between \$2,000 and \$1,000 (and lower) elsewhere in the country. Many residents of these poorer regions are flocking eastward to share in the prosperity of China's region-states. The Chinese government has recently announced initiatives to reduce income disparities between rural and urban areas.

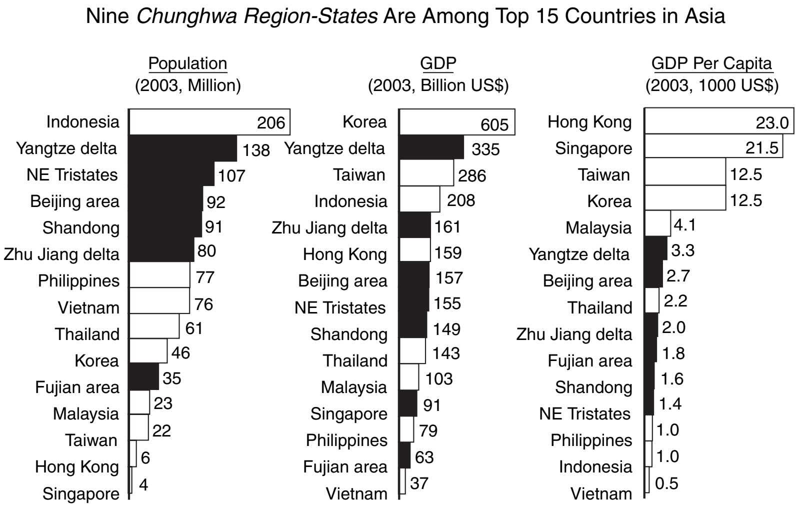
There are estimated to be more than 100 million migrant workers in China today. Many have not permanently settled down in the regions of prosperity. Instead, they send part of their paychecks back to their poor home areas when they get paid. This allows for a circulation of wealth between rich and poor areas. The latter can, therefore, participate vicariously in the success of the former. The money transferred may be used by those in the home region for an investment in machinery, which, in itself, can improve rural productivity and efficiency. It may also go toward education for younger members of the extended family. The migrant workers who ultimately decide to return can bring with them new and valuable skills, especially those who have worked in the service or construction sectors.

There is a worrying downside to the attraction of large population groups in search of wealth. In the Shandong peninsula, one of the prosperous regions of China, there have been clashes between natives and newcomers, especially between ethnic Han Chinese and immigrants from the far west such as the Hui, a Turkic people. Such tensions are an age-old part of any area's rise from poverty to prosperity. We need only note how an influx of Irish migrants into industrialized areas of the north of England led to anti-Irish protests.

Rapid helter-skelter economic growth is also accompanied by negative phenomena such as homelessness and pollution.

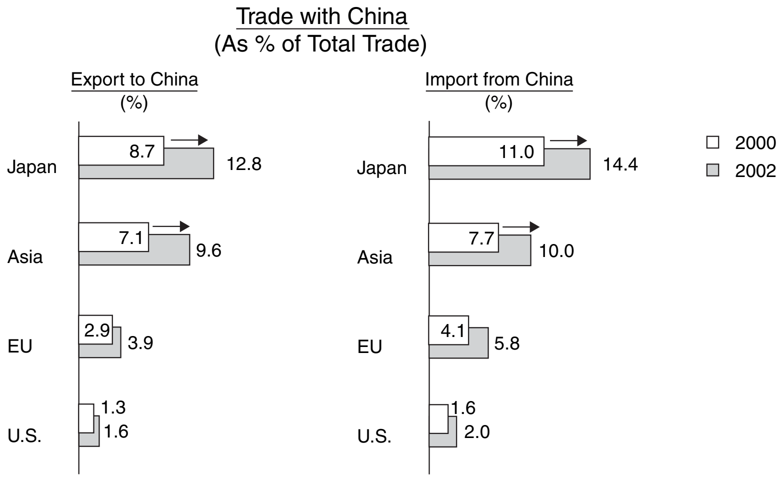
The current boom in demand by the Chinese economy is mostly based around businesses in these successful regions (see Exhibit 4.4). They are not powerhouses of the Chinese economy alone, but of the world economy, and we can see the magnitude of trade with China for each of the key regions of the world (see Exhibit 4.5). The writing is on the wall for nation-states. Just because it is in Chinese characters does not mean that it should be indecipherable to the rest of the world.

If one looks at the Chinese megaregions as region-states, then 9 of the top 15 Asian "countries" are Chinese, or Chunghwa (see Exhibits 4.3 and 4.4). However, if we literally interpret the meaning of "chunghwa," or prosperous centers of the universe, then we have to include Taiwan, Hong Kong, and perhaps Singapore because 70 percent of its population is of Chinese origin. This means that 12 of the top 15 Asian countries, excluding Japan, are Chinese. China was always a political power, but now its economic size is a power felt throughout Asia.



Source: China Statistical Abstract, UN.

Exhibit 4.4 Nine Chunghwa region-states compared with other Asian nations.



Source: International Trade Statistics 2003 (WTO).

Exhibit 4.5 Trade with China.

Not All Regions Are Created Equal

The region state (wherever it is located) is the engine of the global economy. But even though the success of greater economic decentralization is on display for all the world to see along China's eastern coast, there are still entrenched obstacles to other nation-states joining in the prosperity that can come from letting regions do more for themselves.

The constituents of a federal state, even one that is federal in name only, are better placed to become region states. They have a slight infrastructural advantage. One of the powers that is often divested or devolved to a state in a truly federal constitution is that of finance and taxation.

There is also a reservoir of politicians, administrators, and decision makers whose mindset is shaped by the regional rather than the national. In the United States, there is the state government, whose chief executive is an elected governor. The state governor can be a very effective agent in the promotion of his or her state as a place of investment. This can be done directly, ignoring the center at Washington. Ironically, but sensibly, governors frequently become presidents—think of Jimmy Carter in Georgia, Bill Clinton in Arkansas, Ronald Reagan in California, or George Bush in Texas.

The United States has been a truly federal nation for more than two centuries. Although there are continuing tensions between state and federal government, the two spheres of government are acknowledged as being complimentary and central to political culture. The United States emerged onto the historical stage as a federal state—it didn't become one over time. People talk of the American Revolution of 1776, and although this was motivated by the collective desire of the Americans for freedom, it was enacted at many levels by the unique states. Once they had gained freedom, they decided to come together. They were anxious to ensure that they had not swapped one tyranny for another nearer home.

Surprising China

It is all the more surprising (though also welcome) that the People's Republic of China should become such a trailblazer in this regard. Although the People's Republic granted a measure of freedom to certain areas under the title of "autonomous regions," residents of these areas knew that their autonomy did not surpass the semantic. The concept of the whole of the country being held together by a strong hand was one that they inherited from ancient Chinese rulers. It was updated through reading the works of Lenin and Mao.

The surge of the Chinese economy can clearly be traced back to the reforms of 1998, when Zhu Rongji became premier. Troubled by the inefficient parastatal corporations, Zhu declared that they would be left to sink or swim without help or hindrance from Beijing. This effectively transferred responsibility for these enterprises to the regions because failure would cost them dearly. So, without a declaration, Zhu effectively brought central control to an end and decentralized. The cities and provinces then set out to get help from the rest of the world. FDI surged in.

More recently, day-to-day management has been devolved to certain potentially prosperous regions. Most have, at their heart, an urban core of cities, maybe embracing five million inhabitants (often many more).

What has happened in recent years in Guangzhou or Dalian is a novel experiment. The center pays lip service to unity but allows economic autonomy. However, were this economic autonomy to be accompanied by demands for political autonomy, it is doubtful that the center in Beijing would allow this.

Microregions

Are region-states the last word in geographical terms of the global economy? Or is it possible to see, like Bohr and Heisenberg, useful activity at an economic subatomic level?

Clusters of industry have been around for a long time. They are very different to a region-state and take a number of forms, but one of the most long lasting on the human psyche is that of a forest of tall chimneystacks belching black and, no doubt, toxic fumes into the air. In Shenyang and throughout China's Liaoning province, there are lots of "smokestack" industries, operated by old, inefficient, and unprofitable state-owned enterprises, usually in heavy industries such as iron mills, steel works, and precision-machine tooling. In the heyday of Maoism, industrial icons were prominent in the aesthetics of socialist realism. Now they are fast becoming the rust belt of China. These are old-style clusters.

In other regions of China, such as Chungshan in the Guangdong province, approximately 3,000 companies are making lighting fixtures, lamps, and related items. This, too, is a cluster. They breed exclusiveness because companies from other sectors are highly unlikely to try and set up shop there. Traditional clusters are one-dimensional phenomena.

But clusters are not always a negative phenomenon in the global economy. A lot depends on the nature of the business behind the cluster. In the Pearl River Delta area of China, there are 50,000 electronic component suppliers. This cluster is a good industrial hinterland for manufacturers of goods such as plain-paper copiers, tape and disk recorders, desktop computers, televisions, and printers. This cluster is a fertile industrial hinterland that is *not* exclusive or one-dimensional. If anything, it is magnetic, attracting dissimilar industries that need the components in production there. Today, the entire Pearl River Delta is an ideal location, comparable to the Greater Shanghai area, in which all the benefits of Just-in-Time supply chain management can be contracted within a day's drive.

I mentioned earlier that one of the defining elements of a region state is the variety that is created through a positive business cycle. The economy becomes multidimensional. It is not like a region that attracts only textile industries; in turn, other textile industries pile into the region, attracted to it as if to a lodestone. This creates a monodimensional economy.

Europe has seen its industrial clusters. They still exist, but on a much smaller and more specialized scale. They are also much more sophisticated.

There are clusters of clusters in northern Italy, especially in the province of Emilia-Romagna just south of the river Po. The town of Modena has a cluster of producers of fast sports cars. It has the production headquarters of Lamborghini and Maserati, and neighboring Maranello is home to the Ferrari automobile assembly works. Parma has a cluster of famous cheese producers. Nearby Carpi similarly contains a cluster of knitwear manufacturers. Carpi has a high ratio of local enterprises: 1 business for every 12 inhabitants. Every business in Carpi, a town less than 60,000 inhabitants, is related in some way to knitwear. Each has less than 15 employees, but, collectively, it is the Mecca of knitted fabrics, where buyers and designers flock from all over the world to get the newest fashion. Bologna, the provincial capital, has a cluster of packaging industries.

Italy has maybe 1,500 towns specializing in one sector, maybe even the manufacture of one unique product. Each represents a specific cluster, which has probably become the world's foremost production center for that item in terms of innovation. What is true of Carpi for high-quality fashion is also true of Sassuolo in the manufacture of tiles. Italy as a nation economy may be going through a hard time, but these urban regions or townships, with their associated clusters, provide a dynamic element within the region state. Italy may be floundering at the national level, but the province of Emilia-Romagna is not. Places such as Carpi and Modena are microregions because they work with the rest of the world other than with Rome.

These microregions are very competitive, although once again this stands in stark contrast to Italy's noncompetitiveness. Italy's taxation system encourages small companies. It is particularly benevolent to small, almost "mom and pop"–size businesses, with fewer than 15 employees. Everyone wants to stay at this level of fewer than 15 employees. Highly specialized clusters develop, sometimes concentrating on manufacturing or processing a segment of one product, such as metal clasps for belts or bags; luxury shoes; or silk products. This is niche production, and Italian producers achieve global dominance in the supply of these high-end, price-inelastic products.

An amazing aspect of this Italian cluster-centered, microregional niche production is its ability to thrive in the global economy. For one thing, it can survive the challenge from China of low production cost. In cost terms, Italy just does not bother competing with China. The result would be a foregone conclusion. But in the world, there is enough appetite for these deluxe products, where high standards of manufacture and craftsmanship are combined with high prices, to make a desirable product. A Gucci, Versace, or Prada handbag does not sell because of its price or because it is cheaper than any other. It sells because it is a brand with high recognition and brand loyalty. To succeed in a niche market demands the development of a brand. The Italian niche producers serve a market of conspicuous consumers—so much so that famous French brands also use Italian producers for the production of apparel, bags, and shoes.

A brand on its own does not guarantee success. Some brand managers of the past, such as Pierre Cardin, made the mistake of thinking that the whole value of a brand resided in its name. Once a company had that, it could be apathetic and lazy and could afford to take loyalty for granted. There was no need to nurture the brand with further activity and innovation. As a result, the brand was allowed to desiccate and become lifeless. There was also a tendency to "sell" the brand too often and without discrimination. This allowed others to manufacture products using the brand name—a sure way to hasten a brand's death or, worse, its slow yet inexorable decline. There are Pierre Cardin undershirts, handkerchiefs, and trousers all over China. And at that level, a brand is nothing more than a label on a commodity.

Flexibility

One of the successful traits for any prospective region or microregion must be flexibility. This may demand a willingness not to be imprisoned by the paradigms of the past and, if necessary, a reinvention of itself to meet the changing global economy.

Some Italian townships and microregions are armed with an innate survival instinct. They put their success down to specializing in one aspect of manufacture. People in Carpi say that this was necessitated by the annihilation of much of the traditional European textile industry by the Japanese in the 1960s and 1970s. This did not directly affect small manufacturers, such as those in Italy. The mom and pop shops could not move out of their own hometown, let alone Italy, in search of a lower-cost production environment. Some larger French apparel companies, such as Pierre Cardin, switched manufacturing to Japan, Taiwan, and, eventually, China. These firms began a long and rather pathetic trek, migrating from country to country in search of a sustainable low-cost production base. Most perished along the way, usually somewhere in Indonesia or maybe in China. Others stayed in Europe but went to Spain or Portugal, only to meet local competition from the like of Zara (Inditex) and Mango. Most may maintain a presence in the apparel market through managing their brands and by designing. They have also invested heavily in retail operations throughout the world. Most manufacturing, however, has come back to Italy.

The Italians were too small to globalize, so they took the only alternative: specialization. In Carpi, they used to make a very broad spectrum of apparel, but they decided to concentrate instead on one area: knitwear. By specializing, they hoped to maintain a respectable price for their products. This was their wisdom for survival. The threat from Japan in textile manufacturing was a warning signal. Size and good sense allowed small Italian manufacturers to respond correctly. The townships and microregions defended and protected themselves as if they were Renaissance city-states. They have always been good at protecting themselves from external threats and marshalling native pride.

A Japanese city, Tsubame also survived as a high-tech metalwork specialist. It shifted to titanium production—for golf clubs, watches, spectacle frames, and the like—when cutlery production was challenged by lower-cost Asian producers.

The enemy against which the Italian townships have to defend themselves is no longer the forces of either the Pope or the Emperor, the Medicis, or whoever, but the forces of cheap production, such as China and Vietnam. Italy is therefore a tapestry of small townships, each one of which has been able to survive in the global economy by specializing and maintaining the ability to price high, producing items for which there is an inelastic demand. That is how they escape competing with the Chinas of this world.

But they do not seek refuge from harsh economic winds behind their city walls. They may be exclusive, but they are active participants in the global, borderless economy. As I mentioned earlier, many of the constituent parts of high-end French fashion goods are manufactured in Italy: knitwear in Carpi, silk in Como, and shoes in Bellagio, for example. More recently, they have been shifting eastwards to Turkey and Romania.

These niches may be highly specialized, but they do not exist in splendid isolation. In the case of the knitwear Mecca of Carpi, it has links with the broader fashion world in Milan, Paris, and New York, and, through them, with the wider world. By specializing, they have been able to experience globalization, but on their own terms. So, the manufacturer of fabrics in Italy is indirectly linked to the outside world. A fashion designer in New York or Tokyo is able to take advantage of the latest advances in manufacturing fine fabrics in Italy and incorporating them into his or her design portfolio. The fashion industry is but one sector that is built upon what are essentially individual capabilities that have become sanctified by time. They are narrow but deep.

Size and Scale Matter, But Not in a Traditional Way

This is an interesting antidote to the general theory that you have to be able to compete with the larger regions to survive in the global economy and, therefore, attract global capital and finance. The Italian townships seem to have done the exact opposite. They have survived and prospered on their own by using the rest of the world as their customer. They do not have to move because the rest of the world comes to them to buy their products.

This demonstrates another facet of the global economy that enterprises overlook or forget, at their peril. The products may be glamorously presented in cities such as Milan, Paris, London, New York, and Tokyo, but unless the designers and the managers of the global industry have a deep feeling and knowledge of their respective supply chains (in this case, originating in Italy), they cannot stay at the head of their business.

The townships of Emilia-Romagna also offer an alternative strategy. They do things better, through a deepening and narrowing of production and servicing. This may seem like a retreat from the battlefield of competition on a global scale, but it involves only a tactical withdrawal, in search of more favorable battle positions. The theater of competition remains the same.

This approach would not work for companies such as Ivrea for Olivetti, and Torino for Fiat, which are in megacompetition with global players. There is no haven in electronics and automobiles to escape to while still maintaining thousands of workers.

There are not many examples of such successful, Italian-style townships. Many are called, but few are chosen to the banquet of ultimate success. For some, specialization can be a very prudent strategy for some areas. There are other examples in Europe, such as Sheffield and Solingen, both of which specialize in silverware. We might also mention the glassware industry in the Czech Republic (known as Bohemian Glass), as well as Ireland's Waterford Glass, a company that owes much of its continuing success to its possession of an identifiable brand. In these cases, there was a strong historical precedent leading to the specialization. An expertise in metal and craft working had been built up over generations, maybe centuries. A microregion cannot simply wake up one day and decide that it is going to specialize in the production of high-end cufflinks (or anything else) if it has no tradition of involvement with it. The critical test is whether consumers around the world are willing to pay premium price for deluxe items. This, in return, requires that the producing regions need to be intimately linked to high-end customers.

There are other companies that, while starting small, have gained an international respect and following, far greater than the market available domestically. They include the Spanish company I just mentioned, Inditex, along with such brands as Zara, Massimo Dutti, Stradevarius, Pull and Bear, and Oysho. It has more than 3,000 shops around the world with which the company, based in La Coruña in northwest Spain, is linked logistically using Just-In-Time methods.

Regions Are Gaining Their Deserved Recognition

The advent and success of region-states is being recognized throughout the world. Sometimes, the response is rather negative, reflected in attempts by those at the political center to bolster their importance. But these gestures are bound to fail. They are like the medieval English king Canute commanding the sea's waves to flow back.

The importance of regions is increasingly noted by economic statisticians. For example, the Swiss-based Institute of Management Development has begun to include regions as well as nation-states in its lists ranking world competitiveness. The regional units tend to reflect existing regional and provincial boundaries. Among those in which competitiveness is recognized are the states of Maharashtra in India, Sao Paulo in Brazil, and the province of Zhejiang in China, and then Emilia-Romagna in Italy. In countries with huge populations, the centers of prosperity may be even smaller than a province, such as Dalian, which is merely a municipality, though an extensive one. But the inclusion of data according to regions rather than outmoded nation-states is very significant.

It can be problematic in the short term to enhance the power and influence of regions. There are a number of challenges: practical, political, and psychological. But none of these is insurmountable. On the political level, there may be an inertial resistance on the part of national or central government decision makers to devolve effective day-to-day decision-making power to the regions. Smaller countries with populations of 3 million to 10 million, such as Singapore, Denmark, Finland, and Sweden, are able to make organizational and system changes relatively quickly. They do not have the problems that larger countries face, with the center having to coordinate regions with conflicting interests. Nevertheless, friction between the center and the periphery has been evident in the recent past in nations such as Denmark and the Irish Republic.

Devolution of decision making, especially in the area of economic and trade policy, has to happen if regions are to attain their potential. Leaders at the national level are not motivated to or are incapable of taking effective measures to embrace and interface with the global economy. They carry too much excess baggage. They are also answerable to too many economic dinosaurs and shortsighted constituencies.

Once a region seems to be on the way to success, there may be envy at the center and in other less well-endowed or fortunately located areas. This envy may manifest itself in peevish attempts to sabotage a region's success, probably packaged in a benignly packaged policy of national equity or solidarity.

The center may also seek to press the brakes on local autonomy too often, as if reminding the region that it is still the boss and that there are limits within which it can play. Italian governments have tried everything over the last 40 years to fix its perceived problems to no avail. Ironically, micro-regions and high-end branding prosper without governmental intervention or subsidy. Italy is not the exception, but the rule—witness the efforts of the American, French, Japanese, and other governments to "save jobs and manufacturing industry."

If the political structures of the host are inflexible and the region-state as a separate economic entity shows signs of wanting a divorce instead of a separation (or simply more space), military force might be used to bring it back into line. (Witness Northern Ireland.) The detrimental consequences of this type of action on economic development need hardly be elaborated.

Practical Considerations

When an area becomes successful while still remaining part of a nation-state hanging on to nineteenth-century constitutional models, there is persistent tension. This centers on the question, what right has the region to hold on to the wealth it has generated, and how far must it share this with its "parent" state and its less prosperous siblings?

One of the charges that may be laid against region-states by centrists is that they are pursuing selfish, shortsighted, regionalist agendas. Centrists are, to a greater or lesser degree, nationalists. They believe in the righteousness of the nation-state model. This may be the limit of their nationalism. They see those in the regions pushing for greater freedom as mininationalists, competing for and diluting their power.

But the most intelligent leaders in a region know that a region cannot solve its problems by itself. It can do so only by working with the rest of the world. This does not mean that it turns its back on the parent state or the historical center. In some cases, these linkages add to a region's attractiveness in the eyes of outside investors. Some of the appeal of a region such as Hessen can be ascribed to it being a part of the Federal Republic of Germany. But it must be assertive. Its prosperity depends on either an explicit or an implicit renegotiation of its relationship with the center of power.

One of the central beliefs of centrists is that in a nation-state, all resources most flow outward, in a centripetal way, toward the regions from the center. We have seen how forward-looking U.S. governors have done their own successful marketing of their states, avoiding the center altogether. If a region is to prosper, it must be able to do this. It must also be able to attract investment from the rest of the world without going through a central middleman. The sophisticated center should also recognize that if a region draws in capital, corporations, and consumers from the rest of the world, its ability to tax will increase and its obligation to distribute decreases. This creates a win-win situation.

It may not seem a nostalgic idea to call for the re-establishment of regional stock exchanges and money markets. These were a feature of nineteenth-century Europe and America. They helped to finance much of the industrial development of areas such as Northern England and Pennsylvania. In the 1960s and 1970s, there was a move toward amalgamation. So the regional money markets disappeared, replaced by national bourses (with the occasional, often token satellite maintaining a fitful existence). In today's borderless world, finance does not respect borders. Arbitrage and leverage make sure that any residual national feeling in the money markets is dissolved. The national bourses are often meaningless. They may be under the ownership and management of non-nationals. (For example, the Danish and Finnish stock exchanges are owned and operated by the Swedish company, OM.) They can be as much a burden to economic growth as the other nation-state fetishes.

What a Successful Region Has to Do

There are many potentially successful region states in the world today. For many (probably most), that potentiality will remain unrealized. Some regions stubbornly refuse to wrench themselves out of their torpor, no matter how much money could be attracted or how much positive development could take place there.

Even better-placed regions cannot rest on the laurels of future success. In the global economy, there are few dead certainties. They may well enjoy all of the necessary factors for success, but a host of objective factors, from interference by the center to poor marketing strategies, will get in the way.

Choices have to be made. Not being distinctive can be the fastest route to commercial ruin. It is impossible to be a jack-of-all-trades, trying to do too many things and specializing in nothing. A region that seems to be offering all things to all potential investors will soon be exposed as a cheap, talentless auto salesman with nothing worthwhile to offer. A potential investor develops a long list of candidate locations for setting up operations elsewhere in the world. But the real decision makers look at only the short list, typically three to five names. Unless the region remains in the short list, it will not be considered at all. So the real name of the game is to get into the short list. This is the reason a spike of characteristics compared with other regions must be developed and presented. Both Ireland and Singapore have succeeded in labeling themselves as the e-hub of Europe and the de facto ASEAN capital, respectively. Such labels get a region on the short list. Then you have to deliver: Singapore declares that it can off-load a cargo container within 25 minutes of arrival 24x7.

Look at the Irish Republic. Its pursuit of the e-hub vision demonstrated a commitment to telecommunications, but with special emphasis on areas such as back-room services and customer response management. The country has been able to attract call center operations, either standalone facilities or affiliates of large organizations. In just over a decade, it has built up an unrivalled expertise: It has the physical, logistic, and legal infrastructure. It has achieved a very strong position. Those thinking of opening CRM facilities often ask themselves, when discussing location, "Why not Ireland?" rather than "Why Ireland?"

No position in the global economy is completely unassailable. Probably because of its long and bitter history of economic poverty, the Irish Republic does not take its position for granted. It knows that it still has to compete to win and that it must contend with other heirs apparent, such as Holland and, increasingly, Poland and the Czech Republic, for the European CRM crown.

Ireland is interesting because it shows the benefits of concentration on one area. It also shows that benefits from one sector do not preclude other actors. Ireland is in no danger of becoming a hybrid, old style/new style call center cluster. Other high-tech industries have been attracted, and these, in turn, have led to the formation of their own technology and R&D–based clusters. In the summer of 2004, Bell Laboratories announced plans to establish a specialized R&D center in Ireland.

Another vital ingredient for success is, as I've mentioned, flexibility. We have seen how the Italian townships survived by reinventing themselves. We can see that at a higher order in the case of Singapore. Essentially a trading and communications center until the 1950s, it then entered an era of industrialization. However, it had to fight off competition from other manufacturers, and in the 1980s, it switched from its emphasis on manufacturing to the service sector. There was no hope of winning in manufacturing against the much larger and cheaper labor pool of Indonesia, Vietnam, and Thailand within ASEAN countries. It simultaneously promoted itself as a strategic location for multinationals in Southeast Asia who were persuaded to establish regional headquarters there. It trumpeted its logistics and positioned itself as a professional and financial services provider to neighboring countries. In the late 1990s, in the face once again of competition, it has had to change its development goals in the area of biomedical technology and telecommunications technology.

Each change of direction has been difficult, but Singapore has constantly come up with new projects, achieved them, and then moved on to the next. The human costs have often been high. But Singapore has recognized that, without such flexibility, it would be dead in the waters of the South China Sea, both as a nation-state and as a region-state.

Branding Places

Beyond flexibility, regions need marketing. There is an old proverb about the uselessness of hiding a light under a bushel or hood. A successful region-state has to adopt an effective marketing strategy. This can take many forms, always informed by the realization that this is what everyone else is at, too. One of the most important assets in such a marketing campaign is an effective marketing manager. I return to this when we talk in greater detail about leadership. The job description of this marketing manager may have an existing title. In the United States, he or she might be a state governor; in Germany, the premier of a Land; or, in China, a city mayor. Whoever or whatever such leaders are, they must be untiring in their efforts to preach the distinctiveness and the investment friendliness of their region.

They must learn from other successful regions but never slavishly copy them (see Exhibit 4.6). They must be aware of local differences and what assets make their region unique and uniquely attractive. Some of these may hinder the search for inward investment. Others call. But whoever is in charge must not become indifferent to success. Even when hordes of companies set up plants and invest heavily, either directly or indirectly, regional leaders must remember that investment is like seawater: It can flow out as easily as it flows in.

Globally Active and Prosperous Megaregions, Region-States, and Microregions

Breadth of Industrial Spectrum	Functional Specialist	Multiple but Sporadic	Full Range or Controlling
Broad	Shandong	Pearl River Delta Greater Shanghai	Tokyo Metropolitan Area
Sector Specific	Irish CRM Dutch BPO	Singapore Indian BPO (Bangalore/ Hyderabad)	Silicon Valley Greater Boston Medicon Valley
Niche	Italian Towns	Chinese CRM (Dalian)	Austin

Business System Leading to End Users/Customers

Exhibit 4.6 Globally active and prosperous region-states.

The Will to Succeed

Most important, if not vital, is motivation—the will and hunger to succeed. For, unless this is taken collectively to heart and becomes part of the fabric of a region's identity, the desire to participate in the global economy will remain mere rhetoric.

Sometimes, the will to succeed stems from a deep aversion to failure and is the result of an unsettling period of dislocation. Finland is a good example, in which the society was shocked by the disaster of 1992 and 1993. The country was compelled to think about its future. With the collapse of the Soviet Union, they could no longer play the role of playing one power bloc off against another and then take advantage of both sides. There was the realization that their traditional industries based on forestry, timber products, and copper smelting could not afford them a high standard of living or, certainly, the standard of living to which they had become accustomed. They had to move into ICT- and IQ-based industries. The financial catastrophe made them think about how they could live in the future. There was only one conclusion: for the country's population to put their mind and strength and apply their sinews to moving into an ICT environment, not merely superficially, but intrinsically at all levels.

Organizing Regions

The world must start thinking in different scales. It should start to think smaller (in terms of regions), but it should simultaneously think bigger in terms of the global totality and amalgams of effective and progressive regions. Large economic groupings such as the European Union and the countries of ASEAN can play a vital role on the new global stage.

The most successful to date has been the European Union. It was founded as the European Economic Community in Rome in 1956. Its aim was to be, first of all, an economic union that would embrace a Customs union and free trade area.

Its founding document was the Treaty of Rome, amended at the Heads of Government conference at Amsterdam in 1992. There was a commitment from the start that this union would not be a mere talking shop of European politicians exchanging platitudes and indulging in a paper chase of worthless utterances. Free trade was defined as freedom in four vital "factors": freedom of movement of goods, of people, of capital, and of freedom of establishment, so that a citizen of any member state could set up a business in any other member state without discrimination.

These and other core principles were enshrined in the founding treaty. They have been refined and augmented by regulations and directives issued by the Council of Ministers. These form a body of positive law or European Community Law, separate from the laws of the member countries. Most important, a European Court of Justice was established in Luxemburg to adjudicate on European Community Law.

In 1962, this court flexed its muscles for the first time. A Dutch retailer, Van Gend en Loos, was in dispute with the Dutch Customs Administration, and the case was referred to the European Court of Justice. The retail company argued that the actions of the Dutch authorities had violated the Treaty of Rome, and the court found in its favor. In its judgment, the court stated that where there was a conflict between national or municipal law (the laws and regulations of the community's constituent nation-states) and European Community Law, the latter always took precedence. So, Community Law existed not alongside national law, but effectively above it.

The court explained its stance by pointing to the EEC (as it then was) as a unique and unprecedented organization. When its members established it, they consciously ceded a section of their national sovereignty to this new structure, in the interests of the common good of their citizens.

The Dutch (and every other) government could have ignored this judgment, but they didn't. Such judgments are not binding on the parties. Indeed, the judgments are always described as clarifications of European Community Law. After the court pronounces its findings, the case goes back to the national courts for conclusion, with the clarification and judgment made by the European Court. Early on, the European Community demonstrated that it wasn't a paper tiger.

The original Rome Treaty had a very open-ended attitude toward trade restrictions. Apart from fairly visible tariffs, it sought to eradicate less manifest means of distorting the market. These were lumped under the heading of Measures Equivalent to Quantitative Restrictions (MEQRs). In the 1970s, the European Court of Justice identified quite a number of measures by national governments that seemed innocuous on the surface but that it identified as having a deleterious impact on trade. These might include measures designed ostensibly to protect health and welfare. But any measure that made a product or service from another member state less attractive was viewed as a restriction and distortion of trade.

Traditional nation-statists were outraged by much of this. It was a full-frontal attack on national sovereignty and integrity. Worse still, many argued (disingenuously) that it was dictatorial and antidemocratic. The stereotype emerged of a bureaucratic European Commission staffed by jackbooted officials who were intent on homogenizing Europe into a bland and borderless Euroland. These were garnished by absurd "urban myths" about how the EU was planning to ban coasters in bars and enforce standardization of sausages.

But all EU legislation is made by the Council of Ministers (which includes representatives from the national governments). Directives, an important part of the EU legal armory, have to be made into national laws first by national parliaments before they can have any clout. The simple truth is that EU Community Law touches only a portion of the activities of EU citizens, although it is a very important portion.

There are still tensions between those who have a vision of a far more borderless Europe and those who are wary of integration. The nation-state still has its dedicated partisans, as witnessed by the row over voting weights and vetoes in the Council of Ministers at the end of 2003. It may be significant that one of the nation states most adamant in this dispute was Poland. For over four decades, its sense of national identity had been subsumed and effectively browbeaten into acquiescence in such organizations as the Council for Mutual Economic Assistance or COMECON.

The European Community must resist the temptation to transform itself into a new mega state. Its strength must be its looseness, but as it grows in size, it inevitably becomes less coherent and manageable.

One of its continued weaknesses is that its most important constituent part is still the nation-state. It is upon this foundation that voting rights are based and funds are allocated. Although certain principles such as subsidiarity have been developed in an attempt to empower outlying areas, it must remember the vitality of its constituent regions, which are not always the same as the interests of its constituent member states. It would be unfortunate if nation-states such as Ireland, Denmark, Finland, or areas such as Catalonia or Baden Wurtemburg found themselves stifled by external interference and over-rigorous regulation. The EU proclaims its desire to pursue competitiveness. If it is really serious about making Europe more competitive, it should look to those areas within its borders that have achieved and maintained competitiveness. The Irish government, in particular, has opposed any attempt at tax harmonization. Italian townships have also risen above Brussels' bureaucracy—let alone Rome's.

The achievement of a single market in Europe among the Union's members has had significant advantages. It is now much more cost-effective for a company to invest in distribution within Europe. To do this, it needs to set up only one center of distribution or logistics for the entire European Market area. It also needs to set up a single multilingual CRM or call center for the entire EU operational on a 24-hour basis every day of the year. These are a remarkable improvement on the national CRM/SCM models, which had been one of the handicaps of Europe compared with countries such as the United States or Japan.

Perhaps the most important element that has been developed in the EU has been the euro, the common currency central to the community's Economic and Monetary Union. This was first spelled out in 1992 and finally became a reality in January 1999. Two years later, it replaced the national currencies of 12 of the EU's members. This was a further weakening of the dead hand of the nation state.

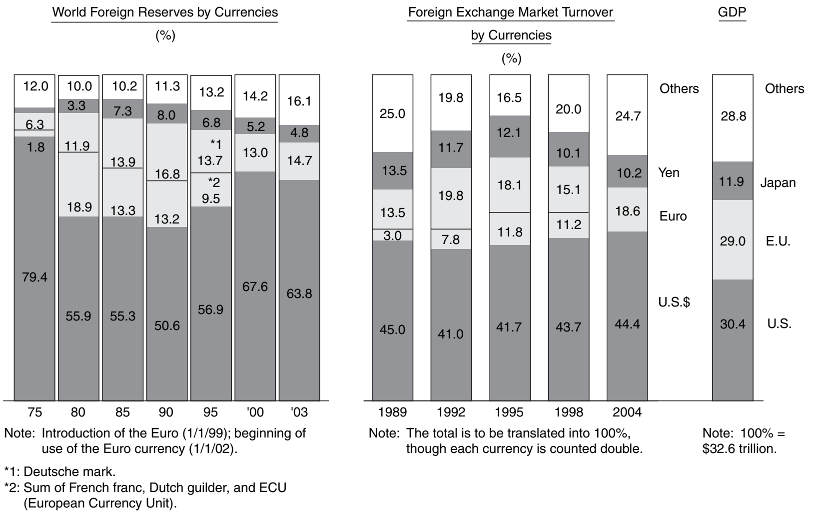
Remember that four of the external symbols of sovereignty were a distinct national currency, a separate central bank, a distinct defense capability, and an effective constitution and legal system. Now, the first two have been absorbed by the European Central Bank (ECB) and Euro respectively, while the third operates under the umbrella of NATO or the Partnership for Peace (PFP) program.

The writing had long been on the wall for European currencies, even those with some international leverage like the French franc and the German mark. How could they effectively compete in a world dominated by the dollar?

But sitting around a table and deciding "a common currency is a good idea" was never enough. There had to be rules and criteria for which currencies could join. The various central banks had to be absorbed into a single European Central Bank with the power to set interest rates.

Unfortunately, it would not have the luxury of dealing yet with one big economy, but with a host of different ones, of different sizes and shapes. This will hopefully change in time. As the various economies are so dependent on each other, there has to be some effective "bad-boy" deterrents to prevent unruly and irresponsible economic behavior by an individual member state. Members are prevented from running budget deficits bigger than 3 percent of GDP. It is regrettable that two of the biggest members of the Eurozone successfully defied this during 2003. Ultimately, the credibility not only of European Monetary Union but also of the wider European Union will depend on how far the Union's economic "Big Boys" are prevented from rewriting the rulebook as they play the game.

The euro has had a bumpy start, but it has now settled down. Some of this was due to sluggish economic performance in the Eurozone area. It may very well come to rival the U.S. dollar as an international reserve and settlement currency. Providers of goods and services to U.S. customers, whether based in Europe or elsewhere, might start to demand settlement of debts not in good old greenbacks, but in euros. This is unlikely in the short term, but it could happen: As Exhibit 4.7 shows, there has been a shift away from European currencies over the last decade for fear of their instability. This is now changing, and many central banks and financial institutions will shift to more balanced portfolios. This represents a major shift from the dollar toward the euro and, possibly, the yen.



Source: World Economic Outlook, September 2004, IMF; Annual Report 2004, IMF; Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2004; International Banking Statistics and Securities Statistics (BIS), JETRO.

Exhibit 4.7 Foreign exchange reserves and turnover by currencies compared with GDP share.

This might lead to a period of furtive feuding, perhaps an economic cold war, with victory for any side uncertain. Sensing the elusiveness of final victory, both sides might decide to come together in a transatlantic currency, the Doro.

Other Unions

So far, the EU is the only group to have gone so far along the road of currency union. But in a world where it often does not pay to be small, other countries are moving in the same direction. The APEC countries have instituted greater trade freedom, particularly bilateral free trade agreements, among members.

Small but important steps are already being taken to achieve this goal. The finance ministers of the ASEAN + three (China, Korea, and Japan) have discussed plans to establish a central agency for monitoring foreign exchange holdings of other member countries' central banks. This not only would lead to greater currency stability, but it also would allow outsiders some important inputs into domestic economic policies. This step, though apparently insignificant, is tremendously important. The notion of watertight sovereignty is one of the great redundant obstacles in the world blocking effective economic growth. We have seen how important the decision of the European Court of Justice in 1962 was: It explained that when the member countries came together, they gave up a part of their sovereignty for the greater good of the whole. A further move toward a common Asian currency is mooted in the form of a common unit for denominating bonds. This unit would be based on a basket of member countries' currencies. These are early steps. As one ASEAN official has noted, "You've got to have countries secure enough in their sovereignty to give up some of it. It took Europe two world wars and centuries of religious conflict to get to that point."[1] But then, as Chairman Mao once said: "A journey of 10,000km starts with a single step."

The APEC nations have recognized the need to adopt a two-speed approach to trade liberalization. The economies of countries such as Laos, Myammar, and Cambodia are still fairly primitive, at less than $1,000 per capita, compared with countries such as Japan, at $35,000. In reality, ASEAN or ASEAN + three is still in the pre–Treaty of Rome phase, trying to line up at the starting line to discuss an Asian Common Market. This built-in fault line might make the ideal of the common market, let alone a common currency, less realizable in the short term.

The African Union, established to replace the Organization of African Unity, is pledged to the creation of a common African currency. The continent of Africa has already had some experience here, as a number of former French colonies were joined in the early 1960s in the African Financial Community (CFA) and still use a common currency, the CFA franc, pegged initially to the French franc. The decision to use a common currency was a response to the lack of financial and technical resources available to the former French colonies that were granted independence in the early 1960s. A combination of natural and man-made calamities have not improved the situation of these countries, most of whose economies are still primitive and based on the production of primary, mainly agricultural, commodities.

The nations of the Caribbean, mainly former British colonies, were too minute to develop independent central banks or currencies, so from the 1960s on, they opted for a currency union based on the use of the Eastern Caribbean Dollar pegged to the U.S. currency.

The possibilities offered by greater freedom of trade at regional level have been realized in theory by many countries. The World Trade Organization has reported no fewer than 150 free trade agreements that are in operation today. But the vast majority of these are bilateral agreements, binding only two nations to differing commitments and levels of trade freedom. Some political leaders favor bilateral agreements over more general multilateral agreements, believing that these give more scope to protect sensitive "national" interests. Apart from the time and energy that must be spent in establishing individual agreements between the 189 nation states in today's world and each other's, broader free trade, especially at regional level, makes sense. In Latin America alone, there are three large trade areas: the Central American Common market, the Andean Pact, and Mercosur. The potential of the latter was severely dented by the financial and economic difficulties that Argentina experienced in the late 1990s. The United States will have to play a key role in supporting the stability of Latin American currencies if the Americas are to move toward a common market and eventually a common currency. Unlike the European Union, the United States will have to offer the dollar as a de facto common currency. This requires a greater fiscal discipline not only on the part of member countries, but also on the United States itself.

Free Trade Area or Fortress?

The challenge is to keep established unions from becoming economic fortresses, offering freedom to member states but also a wall of tariffs and restrictions to those from outside. The EU maintains some very high barriers on imports from beyond its borders. For decades, it pursued the Common Agricultural Policy, a scheme that rewarded waste and inefficiency in the production of agricultural goods in a misguided defense of the member states' rural sector. Not only was this policy based on the costly purchase of food that nobody in the EU wanted, but it also kept prices artificially high. It excluded producers from less developed parts of the world from selling their products and thereby stepping away from perpetual poverty.

The Common Agricultural Policy has been drastically reformed, though not dismantled totally, in the teeth of bitter hostility from Europe's well organized but declining farm lobby. There have always been attempts by the EU or its predecessors to appear less unfriendly to developing nations. There was the Lomé Convention, signed between the European Community (as it then was) and nearly 50

ACP (African, Caribbean, and Pacific) nations. Here the EC removed duties imposed on industrial products entering the community from ACP states. Because the industrial sector in most of these countries was either minimal or non-existent, it was not a move of great generosity.

The Lomé Convention was succeeded in 2000 by the Cotonou Agreement, whereby the EU (as it has become) made a commitment to removing trade barriers on all goods by 2008. This was only a commitment, and certain agricultural goods were to be excluded.

Like many a nation-state, the EU has sought to implement antidumping measures. Most people agree that dumping is an unfair practice. Many also agree that measures taken against it, while at first a virtue, may become a fault. They are, in fact, contingent protection. The devil is in the detail, and within this may lurk attempts to hinder legitimate trade. Certainly, the World Trade Organization has construed some EU antidumping measures as flowing from such an illegitimate desire. Alas, when the currency exchange rate fluctuates so widely, it is difficult to compare the price of the same good in two countries over time.

In a borderless world, where nation-states no longer hold sway, even the concept of dumping will have to be approached fresh. It occurs traditionally where a product or commodity is sold for less in an export market than its price in the domestic market. But it will become increasingly difficult to distinguish so cleanly between markets in the future. When currency exchange rates fluctuate so widely, it is also technically difficult to compare the price of the same good in two countries over time.

Some of the opponents of globalization decry it as an attempt to impose a particular form of commercial activity on the whole world, at the expense of the varied tapestry of cultural differences. Others argue that globalization is the same as Americanization. Globalization is nothing of the sort. It realizes and affirms our interdependence as human beings and societies. It exposes the fallacy of self-sufficiency, whether economic or cultural. It is a process of global optimization and the best mechanism to help less-developed nations to grow without artificial subsidies from the rich but with the legitimate filter of markers.

What I have observed is that globalization is nothing but liberalization of the individual, consumers, corporations, and regions from the legacy of the nation-state in which they belong. Eventually, the information available to each one of them will give them the wisdom of choice. Whether the consumers buy the best and cheapest from anywhere in the world is also their choice and is not the decision of the government. Likewise, corporate activities will eventually shift to the best host regions. Instead of begging from the center, the regions will polish themselves so that the rest of the world comes to help them prosper. Ultimately, it is a competitive world and one that will discipline all members of the global village because wealth will migrate across national borders. Diplomatic and military powers are now subjugated to the branding and marketing strategies of regions as a unit of operation in a borderless world.

Notes

1 "Spotlight: ASEAN Insecurity," *Far Eastern Economic Review*, 15 July 2004, www.feer.com.

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