Kenichi Ohmae

THE END OF THE NATION STATE

The Rise of Regional Economies

How new engines of prosperity are reshaping global markets

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To my former colleagues at McKinsey,
who have been—and remain—a constant source of
inspiration and intellectual challenge

PREFACE

Ever since I wrote *The Mind of the Strategist,* my professional activities have been largely devoted to helping managers and policymakers alike understand, adapt to, and leverage the primary forces shaping the global economy. Chief among these forces, in my view, are the irreversible effects of technology—in particular, modern information technology—on the structure of business processes and on the values, judgments, and preferences of citizens and consumers in all parts of the world. Indeed, so powerful are these effects that, once the genie of global information flow really gets out of the bottle—and it is certainly out of the bottle now—there can be no turning back. Against this kind of current, no traditional strategy, no familiar line of policy, and no entrenched form of organization can stand untouched or unchanged.

As a group, corporate managers have moved relatively quickly to embrace and accommodate, and even to exploit, this torrent of information. They have understood from the outset that their companies would not—and could not—remain immune to so fundamental a change in their environment. Government leaders, however, the men and women responsible for the affairs of both modern nation states and the assemblies of such states (the United Nations, for example, and the European Union and the parties to the North American Free Trade Act [NAFTA]), have had a very different reaction. Barring such catastrophes as unprecedented natural disaster, nuclear holocaust, or an ill-starred conventional war, they have, by and large, remained convinced that the entities they oversaw *would* remain pretty much unaffected.

Individual nations might, of course, do a little better or a little worse in the global marketplace. The quality of citizens' lives in one might improve a little faster or slower than in another. The industrial mix of value-creating activities might look a little different than it otherwise would have looked. But, surely, the information-led transition to a genuinely borderless economy would not call into question the relevance of nation states as meaningful units of economic activity. Nor would it call into question the ability of governments to "manage," at least in general terms, the evolving shape of that activity. Nor—at the bottom of it all—would it challenge the fundamental integrity or coherence of the nation state itself. To government leaders, that was positively unthinkable. On the maps that mattered, there were—and always would be—borders between countries. The precise line of demarcation might shift with events, but the fact that such lines existed would not. Of this, government leaders were quietly and confidently certain.

But they were wrong. The forces now at work *have* raised troubling questions about the relevance—and effectiveness—of nation states as meaningful aggregates in terms of which to think about, much less manage, economic activity. Once-powerful examples of such nation states *have* come apart at the seams. (At a conference of leading CEOs held in Stuttgart back in 1990, I predicted that the "global logic" unleashed by these forces would lead to the collapse of the Soviet Union. At the time, no one else in the room believed me.) And many of the core values supporting a world order based on discrete, independent nation states—liberal democracy as practiced in the West, for instance, and even the very notion of political sovereignty itself—*have* shown themselves in serious need of redefinition or, perhaps, replacement. Indeed, as the 21st century approaches and as what I call the four "I's"—industry, investment, individuals, and information—flow relatively unimpeded across national borders, the building-block concepts appropriate to a 19th-century, closed-country model of the world no longer hold.

Still, for perfectly understandable reasons, that model and those concepts remain in common, daily use. In some companies—and in most governments—there is a gap of more than a century between the cross-border realities of the external world and the framework of ideas and the principles used to make sense of them. This is not surprising. Old ideas, old explanations die hard. And the more obvious and matter-of-fact they seem, the harder they die. Therefore, my hope for this book is that, together with many of the things I have written in the past, it will provide managers, scholars, and government leaders with the beginnings of a new set of principles for thinking about why some regions prosper economically and others do not, and why traditional policies based on traditional principles simply cannot provide an adequate guide to the borderless world. It is my strong belief that, so long as the old principles continue to shape policy, the century-long gap between intention and result cannot be closed by better execution or implementation. Nothing can close it. The principles themselves have to change.

I would like to thank Alan Kantrow for his intellectual contribution and editorial assistance. Without his help, I would not have been able to crystallize my thinking to this level. Ms. Haruko Maruyama was instrumental in putting the manuscript in order. Bill Matassoni has shaped my aspiration—as he has for more than a decade—to draw a message for global readers from my primary immersion in the experience of companies and industries in Japan and Asia. I owe, as well, a special debt of gratitude to the leaders of Singapore, Malaysia, Hong Kong, and Taiwan, who have done so much to show the rest of us the kind of prosperity that is possible when local geographies are exposed to the global logic of the borderless economy.

My former colleagues at McKinsey & Company, to whom I dedicate this book, have been a constant source of inspiration and intellectual challenge. Without doubt, McKinsey is the most emphatically global organization I know in terms of membership, organization, and value system. I am fortunate to have been, for more than two decades, part of its efforts to help create genuinely global enterprises. We were able to practice what we preached.

As for myself, I have now retired from McKinsey to work with a group of citizens in Japan dedicated to reforming the country and its policies along the lines of the ideas presented in this book and in other writings of mine on the political and social situation in Japan.

Here, too, I hope to practice what I've preached.

For my friends and family, there is, of course, a special debt of gratitude. Without their affection and support, I would never have been able to sustain my enthusiasm for this new challenge. I'm sure they understand that what I am now trying to do is make it possible for them and, one day, their children to enjoy a high quality of life in the kind of country they deserve.

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Introduction

WHERE THE BORDERS FALL IN A BORDERLESS WORLD

With the ending of the frigid Fifty Years' War between Soviet-style communism and the West's liberal democracy, some observers—Francis Fukuyama, in particular—announced that we had reached the "end of history." Nothing could be further from the truth. In fact, now that the bitter ideological confrontation sparked by this century's collision of "isms" has ended, larger numbers of people from more points on the globe than ever before have aggressively come forward to participate *in* history. They have left behind centuries, even millennia, of obscurity in forest and desert and rural isolation to request from the world community—and from the global economy that links it together—a decent life for themselves and a better life for their children. A generation ago, even a decade ago, most of them were as voiceless and invisible as they had always been. This is true no longer: they have entered history with a vengeance, and they have demands—economic demands—to make.

But to whom or to what should they make them? Their first impulse, of course, will likely be to turn to the heads of the governments of nation states. These, after all, are the leaders whose plans and schemes have long shaped the flow of public events. But, in today's more competitive world, nation states no longer possess the seemingly bottomless well of resources from which they used to draw with impunity to fund their ambitions. These days, even they have to look for assistance to the global economy and make the changes at home needed to invite it in. So these new claimants will turn to international bodies like the United Nations. But what is the UN if not a collection of nation states? So they will turn to multilateral agencies like the World Bank, but these too are the creatures of a nation state-defined and -funded universe. So they will turn to explicitly economic groupings like OPEC or G-7 or ASEAN or APEC or NAFTA or the EU (European Union). But once again, all they will find behind each new acronym is a grouping of nation states.

Then, if they are clever, they may interrupt their quest to ask a few simple questions. Are these nation states—notwithstanding the obvious and important role they play in world affairs—really the primary actors in today's global economy? Do they provide the best window on that economy? Do they provide the best port of access to it? In a world where economic borders are progressively disappearing, are their arbitrary, historically accidental boundaries genuinely meaningful in economic terms? And if not, what kinds of boundaries do make sense? In other words, exactly what, at bottom, are the natural business units—the sufficient, correctly-sized and scaled aggregations of people and activities—through which to tap into that economy?

One way to answer these questions is to observe the flows of what I call the 4 "I's" that define it. First, the capital markets in most developed countries are flush with excess cash for investment. Japan, for example, has the equivalent of US $10 trillion stored away. Even where a country itself hovers close to bankruptcy, there is often a huge accumulation of money in pension funds and life insurance programs. The problem is that suitable—and suitably large—investment opportunities are not often available in the same geographies where this money sits. As a result, the capital markets have developed a wide variety of mechanisms to transfer it across national borders.[1] Today, nearly 10 percent of U.S. pension funds is invested in Asia. Ten years ago, that degree of participation in Asian markets would have been unthinkable.

Thus, investment—the first "I"—is no longer geographically constrained. Now, wherever you sit in the world, if the opportunity is attractive, the money will come in. And it will be, for the most part, "private" money. Again, ten years ago, the flow of cross-border funds was primarily from government to government or from multilateral lending agency to government. There was a capital city and an army of public bureaucrats on at least one end of the transaction. That is no longer the case. Because most of the money now moving across borders is private, governments do not have to be involved at either end. All that matters is the quality of the investment opportunity. The money will go where the good opportunities are.[2]

The second "I"—industry—is also far more global in orientation today than it was a decade ago. In the past, with the interests of their home governments clearly in mind, companies would strike deals with host governments to bring in resources and skills in exchange for privileged access to local markets. This, too, has changed. The strategies of modern multinational corporations are no longer shaped and conditioned by reasons of state but, rather, by the desire—and the need—to serve attractive markets wherever they exist and to tap attractive pools of resources wherever they sit. Government-funded subsidies—old-fashioned tax breaks for investing in this or that location—are becoming irrelevant as a decision criterion. The Western firms now moving, say, into parts of China and India are there because that is where their future lies, not because the host government has suddenly dangled a carrot in front of their nose.

As corporations move, of course, they bring with them working capital. Perhaps more important, they transfer technology and managerial know-how. These are not concessions to host governments; they are the essential raw materials these companies need to do their work. But they also bring something else. Pension fund money in the United States, for example, might look for decent China-related opportunities by scouting out the possibilities on the Shanghai stock exchange. The prospects thus identified, however, will be largely unfamiliar. Money managers will do their best to provide adequate research, but everyone will admit that relevant knowledge is limited. But if it is a GE or an IBM or a Unilever or a P&G that is building a presence in China, the markets back home and elsewhere in the developed world will know how to evaluate that. They will be more comfortable with it. And that, in turn, expands the range of capital markets on which these companies can draw for resources to be used in China.

The movement of both investment and industry has been greatly facilitated by the third "I"—information technology—which now makes it possible for a company to operate in various parts of the world without having to build up an entire business system in each of the countries where it has a presence. Engineers at workstations in Osaka can easily control plant operations in newly exciting parts of China like Dalian. Product designers in Oregon can control the activities of a network of factories throughout Asia-Pacific. Thus, the hurdles for cross-border participation and strategic alliance[3] have come way down. Armies of experts do not have to be transferred; armies of workers do not have to be trained. Capability can reside in the network and be made available—virtually anywhere—as needed.

Finally, individual consumers—the fourth "I"—have also become more global in orientation. With better access to information about lifestyles around the globe, they are much less likely to want to buy—and much less conditioned by government injunctions to buy—American or French or Japanese products merely because of their national associations. Consumers increasingly want the best and cheapest products, no matter where they come from. And they have shown their willingness to vote these preferences with their pocketbooks.

Taken together, the mobility of these four I's makes it possible for viable economic units in any part of the world to pull in whatever is needed for development. They need not look for assistance only to pools of resources close to home. Nor need they rely on the formal efforts of governments to attract resources from elsewhere and funnel them to the ultimate users. This makes the traditional "middleman" function of nation states—and of their governments—largely unnecessary. Because the global markets for all the I's work just fine on their own, nation states no longer have to play a market-making role. In fact, given their own troubles, which are considerable, they most often just get in the way. If allowed, global solutions will flow to where they are needed without the intervention of nation states. On current evidence, moreover, they flow better precisely because such intervention is absent.

This fundamentally changes the economic equation. If the unfettered movement of these I's makes the middleman role of nation states obsolete, the qualifications needed to sit at the global table and pull in global solutions begin to correspond not to the artificial political borders of countries, but to the more focused geographical units—Hong Kong, for example, and the adjacent stretch of southern China, or the Kansai region around Osaka, or Catalonia—where real work gets done and real markets flourish. I call these units "region states." They may lie entirely within or across the borders of a nation state. This does not matter. It is the irrelevant result of historical accident. What defines them is not the location of their political borders but the fact that they are the right size and scale to be the true, natural business units in today's global economy.[4] Theirs are the borders—and the connections—that matter in a borderless world.[5]

In the chapters that follow, I will show why traditional nation states have become unnatural, even impossible, business units in a global economy. I will also show why region states are, in fact, so effective as ports of entry to it. And I will explore how these developments change, deeply and forever, the logic that defines how corporations operate and how the governments of nation states understand their proper role in economic affairs.

Chapter One

THE CARTOGRAPHIC ILLUSION

A funny—and, to many observers, a very troubling—thing has happened on the way to former U.S. President Bush's so-called "new world order": the old world has fallen apart. Most visibly, with the ending of the Cold War, the long-familiar pattern of alliances and oppositions among industrialized nations has fractured beyond repair. Less visibly, but arguably far more important, the modern nation state itself—that artifact of the 18th and 19th centuries—has begun to crumble.

For many observers, this erosion of the long-familiar building blocks of the political world has been a source of discomfort at least and, far more likely, of genuine distress. They used to be confident that they could tell with certainty where the boundary lines ran. These are our people; those are not. These are our interests; those are not. These are our industries; those are not. It did not matter that little economic activity remained truly domestic in any sense that an Adam Smith or a David Ricardo would understand. Nor did it matter that the people served or the interests protected represented a small and diminishing fraction of the complex social universe within each set of established political borders.

The point, after all, was that everyone knew—or could talk and act as if he or she knew—where the boundary lines ran. Everyone's dealings could rest, with comfortable assurance, on the certain knowledge, as Robert Reich has put it, of who was "us" and who was "them." The inconvenient fact that most of the guns pointed in anger during the past two decades were pointed by national governments at some segment of the people those governments would define as "us"—well, that really did not matter, either. Boundaries are boundaries.

Politics, runs the time-worn adage, is the art of the possible. Translated, that means it is also the art of ignoring or overlooking discordant facts: guns pointed the wrong way, democratic institutions clogged to the point of paralysis by minority interests defended in the name of the majority—and, perhaps most important, domestic economies in an increasingly borderless world of economic activity. So what if average GNP per capita in China is $317 but, in Shenzhen, whose economy is closely linked with that of Hong Kong, it is $5,695? Boundaries are boundaries, and political dividing lines mean far more than demonstrable communities of economic interest.

No, they don't. Public debate may still be hostage to the outdated vocabulary of political borders, but the daily realities facing most people in the developed and developing worlds—both as citizens and as consumers—speak a vastly different idiom. Theirs is the language of an increasingly borderless economy, a true global marketplace. But the references we have—the maps and guides—to this new terrain are still largely drawn in political terms. Moreover, as the primary features on this landscape—the traditional nation states—begin to come apart at the seams, the overwhelming temptation is to redraw obsolete, U.N.-style maps to reflect the shifting borders of those states. The temptation is understandable, but the result is pure illusion. No more than the work of early cartographers do these new efforts show the boundaries and linkages that matter in the world now emerging. They are the product of illusion, and they are faithful to their roots.

This, too, is understandable. Much of the current awareness of the decay of the modern nation state has been driven by the wrenching experiences of the former Soviet Union and Czechoslovakia, which have formally ceased to exist as single national entities. Perhaps even more frightening, of course, is the noxious brew of ancient hatred, more recent antagonism, and unbridled ambition in what used to be Yugoslavia. These are extremes, to be sure, but they are deeply repre-