THE RISE
OF THE REGION STATE

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The Nation State Is Dysfunctional

THE NATION STATE has become an unnatural, even dysfunctional, unit for organizing human activity and managing economic endeavor in a borderless world. It represents no genuine, shared community of economic interests; it defines no meaningful flows of economic activity. In fact, it overlooks the true linkages and synergies that exist among often disparate populations by combining important measures of human activity at the wrong level of analysis.

For example, to think of Italy as a single economic entity ignores the reality of an industrial north and a rural south, each vastly different in its ability to contribute and in its need to receive. Treating Italy as a single economic unit forces one—as a private sector manager or a public sector official—to operate on the basis of false, implausible and nonexistent averages. Italy is a country with great disparities in industry and income across regions.

On the global economic map the lines that now matter are those defining what may be called “region states.” The boundaries of the region state are not imposed by political fiat. They are drawn by the deft but invisible hand of the global market for goods and services. They follow, rather than precede, real flows of human activity, creating nothing new but ratifying existing patterns manifest in countless individual decisions. They represent no threat to the political borders of any nation, and they have no call on any taxpayer’s money to finance military forces to defend such borders.

Region states are natural economic zones. They may or may not fall within the geographic limits of a particular

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nation—whether they do is an accident of history. Sometimes these distinct economic units are formed by parts of states, such as those in northern Italy, Wales, Catalonia, Alsace-Lorraine or Baden-Württemberg. At other times they may be formed by economic patterns that overlap existing national boundaries, such as those between San Diego and Tijuana, Hong Kong and southern China, or the "growth triangle" of Singapore and its neighboring Indonesian islands. In today’s borderless world these are natural economic zones and what matters is that each possesses, in one or another combination, the key ingredients for successful participation in the global economy.

Look, for example, at what is happening in Southeast Asia. The Hong Kong economy has gradually extended its influence throughout the Pearl River Delta. The radiating effect of these linkages has made Hong Kong, where GNP per capita is $12,000, the driving force of economic life in Shenzhen, boosting the per capita GNP of that city’s residents to $5,695, as compared to $317 for China as a whole. These links extend to Zhuhai, Amoy and Guangzhou as well. By the year 2000 this cross-border region state will have raised the living standard of more than 11 million people over the $5,000 level. Meanwhile, Guangdong province, with a population of more than 65 million and its capital at Hong Kong, will emerge as a newly industrialized economy in its own right, even though China’s per capita GNP may still hover at about $1,000. Unlike in Eastern Europe, where nations try to convert entire socialist economies over to the market, the Asian model is first to convert limited economic zones—the region states—into free enterprise havens. So far the results have been reassuring.

These developments and others like them are coming just in time for Asia. As Europe perfects its single market and as the United States, Canada and Mexico begin to explore the benefits of the North American Free Trade Agreement (NAFTA), the combined economies of Asia and Japan lag behind those of the other parts of the globe’s economic triad by about $2 trillion—roughly the aggregate size of some 20 additional region states. In other words, for Asia to keep pace existing regions must continue to grow at current rates throughout the next decade, giving birth to 20 additional Singapores.

Many of these new region states are already beginning to emerge. China has expanded to 14 other areas—many of them inland—the special economic zones that have worked so
well for Shenzhen and Shanghai. One such project at Yunnan will become a cross-border economic zone encompassing parts of Laos and Vietnam. In Vietnam itself Ho Chi Minh City (Saigon) has launched a similar "sepzone" to attract foreign capital. Inspired in part by Singapore's "growth triangle," the governments of Indonesia, Malaysia and Thailand in 1992 unveiled a larger triangle across the Strait of Malacca to link Medan, Penang and Phuket. These developments are not, of course, limited to the developing economies in Asia. In economic terms the United States has never been a single nation. It is a collection of region states: northern and southern California, the "power corridor" along the East Coast between Boston and Washington, the Northeast, the Midwest, the Sun Belt, and so on.

What Makes a Region State

THE PRIMARY linkages of region states tend to be with the global economy and not with their host nations. Region states make such effective points of entry into the global economy because the very characteristics that define them are shaped by the demands of that economy. Region states tend to have between five million and 20 million people. The range is broad, but the extremes are clear: not half a million, not 50 or 100 million. A region state must be small enough for its citizens to share certain economic and consumer interests but of adequate size to justify the infrastructure—communication and transportation links and quality professional services—necessary to participate economically on a global scale. It must, for example, have at least one international airport and, more than likely, one good harbor with international-class freight-handling facilities. A region state must also be large enough to provide an attractive market for the brand development of leading consumer products. In other words, region states are not defined by their economies of scale in production (which, after all, can be leveraged from a base of any size through exports to the rest of the world) but rather by their having reached efficient economies of scale in their consumption, infrastructure and professional services.

For example, as the reach of television networks expands, advertising becomes more efficient. Although trying to introduce a consumer brand throughout all of Japan or Indonesia may still prove prohibitively expensive, establishing it firmly in
the Osaka or Jakarta region is far more affordable—and far more likely to generate handsome returns. Much the same is true with sales and service networks, customer satisfaction programs, market surveys and management information systems: efficient scale is at the regional, not national, level. This fact matters because, on balance, modern marketing techniques and technologies shape the economies of region states.

Where true economies of service exist, religious, ethnic and racial distinctions are not important—or, at least, only as important as human nature requires. Singapore is 70 percent ethnic Chinese, but its 30 percent minority is not much of a problem because commercial prosperity creates sufficient affluence for all. Nor are ethnic differences a source of concern for potential investors looking for consumers.

Indonesia—an archipelago with 500 or so different tribal groups, 18,000 islands and 170 million people—would logically seem to defy effective organization within a single mode of political government. Yet Jakarta has traditionally attempted to impose just such a central control by applying fictional averages to the entire nation. They do not work. If, however, economies of service allowed two or three Singapore-sized region states to be created within Indonesia, they could be managed. And they would ameliorate, rather than exacerbate, the country’s internal social divisions. This holds as well for India and Brazil.

The New Multinational Corporation

WHEN VIEWING the globe through the lens of the region state, senior corporate managers think differently about the geographical expansion of their businesses. In the past the primary aspiration of multinational corporations was to create, in effect, clones of the parent organization in each of the dozens of countries in which they operated. The goal of this system was to stick yet another pin in the global map to mark an increasing number of subsidiaries around the world.

More recently, however, when Nestlé and Procter & Gamble wanted to expand their business in Japan from an already strong position, they did not view the effort as just another pin-sticking exercise. Nor did they treat the country as a single coherent market to be gained at once, or try as most Western companies do to establish a foothold first in the
Tokyo area, Japan’s most tumultuous and overcrowded market. Instead, they wisely focused on the Kansai region around Osaka and Kobe, whose 22 million residents are nearly as affluent as those in Tokyo but where competition is far less intense. Once they had on-the-ground experience on how best to reach the Japanese consumer, they branched out into other regions of the country.

Much of the difficulty Western companies face in trying to enter Japan stems directly from trying to shoulder their way in through Tokyo. This instinct often proves difficult and costly. Even if it works, it may also prove a trap; it is hard to “see” Japan once one is bottled up in the particular dynamics of the Tokyo marketplace. Moreover, entering the country through a different regional doorway has great economic appeal. Measured by aggregate GDP, the Kansai region is the seventh-largest economy in the world, just behind the United Kingdom.

Given the variations among local markets and the value of learning through real-world experimentation, an incremental region-based approach to market entry makes excellent sense. And not just in Japan. Building an effective presence across a landmass the size of China is of course a daunting prospect. Serving the people in and around Nagoya City, however, is not.

If one wants a presence in Thailand, why start by building a network over the entire extended landmass? Instead focus, at least initially, on the region around Bangkok, which represents the lion's share of the total potential market. The same strategy applies to the United States. To introduce a new top-of-the-line car into the U.S. market, why replicate up front an exhaustive coast-to-coast dealership network? Of the country's 3,000 statistical metropolitan areas, 80 percent of luxury car buyers can be reached by establishing a presence in only 125 of these.

The Challenges for Government

Traditional issues of foreign policy, security and defense remain the province of nation states. So, too, are macroeconomic and monetary policies—the taxation and public investment needed to provide the necessary infrastructure and incentives for region-based activities. The government will also remain responsible for the broad require-
ments of educating and training citizens so that they can participate fully in the global economy.

Governments are likely to resist giving up the power to intervene in the economic realm or to relinquish their impulses for protectionism. The illusion of control is soothing. Yet hard evidence proves the contrary. No manipulation of exchange rates by central bankers or political appointees has ever “corrected” the trade imbalances between the United States and Japan. Nor has any trade talk between the two governments. Whatever cosmetic actions these negotiations may have prompted, they rescued no industry and revived no economic sector. Textiles, semiconductors, autos, consumer electronics—the competitive situation in these industries did not develop according to the whims of policymakers but only in response to the deeper logic of the competitive marketplace. If U.S. market share has dwindled, it is not because government policy failed but because individual consumers decided to buy elsewhere. If U.S. capacity has migrated to Mexico or Asia, it is only because individual managers made decisions about cost and efficiency.

The implications of region states are not welcome news to established seats of political power, be they politicians or lobbyists. Nation states by definition require a domestic political focus, while region states are ensconced in the global economy. Region states that sit within the frontiers of a particular nation share its political goals and aspirations. However, region states welcome foreign investment and ownership—whatever allows them to employ people productively or to improve the quality of life. They want their people to have access to the best and cheapest products. And they want whatever surplus accrues from these activities to ratchet up the local quality of life still further and not to support distant regions or to prop up distressed industries elsewhere in the name of national interest or sovereignty.

When a region prospers, that prosperity spills over into the adjacent regions within the same political confederation. Industry in the area immediately in and around Bangkok has prompted investors to explore options elsewhere in Thailand. Much the same is true of Kuala Lumpur in Malaysia, Jakarta in Indonesia, or Singapore, which is rapidly becoming the unofficial capital of the Association of Southeast Asian Nations. São Paulo, too, could well emerge as a genuine region state, someday entering the ranks of the Organization
of Economic Cooperation and Development. Yet if Brazil's central government does not allow the São Paulo region state finally to enter the global economy, the country as a whole may soon fall off the roster of the newly industrialized economies.

Unlike those at the political center, the leaders of region states—interested chief executive officers, heads of local unions, politicians at city and state levels—often welcome and encourage foreign capital investment. They do not go abroad to attract new plants and factories only to appear back home on television vowing to protect local companies at any cost. These leaders tend to possess an international outlook that can help defuse many of the usual kinds of social tensions arising over issues of “foreign” versus “domestic” inputs to production.

In the United States, for example, the Japanese have already established about 120 “transplant” auto factories throughout the Mississippi Valley. More are on the way. As their share of the U.S. auto industry's production grows, people in that region who look to these plants for their livelihoods and for the tax revenues needed to support local communities will stop caring whether the plants belong to U.S.- or Japanese-based companies. All they will care about are the regional economic benefits of having them there. In effect, as members of the Mississippi Valley region state, they will have leveraged the contribution of these plants to help their region become an active participant in the global economy.

Region states need not be the enemies of central governments. Handled gently, region states can provide the opportunity for eventual prosperity for all areas within a nation's traditional political control. When political and industrial leaders accept and act on these realities, they help build prosperity. When they do not—falling back under the spell of the nationalist economic illusion—they may actually destroy it.

Consider the fate of Silicon Valley, that great early engine of much of America's microelectronics industry. In the beginning it was an extremely open and entrepreneurial environment. Of late, however, it has become notably protectionist—creating industry associations, establishing a polished lobbying presence in Washington and turning to “competitiveness” studies as a way to get more federal funding for research and development. It has also begun to discourage, and even to bar, foreign investment, let alone foreign
takeovers. The result is that Boise and Denver now prosper in electronics; Japan is developing a Silicon Island on Kyushu; Taiwan is trying to create a Silicon Island of its own; and Korea is nurturing a Silicon Peninsula. This is the worst of all possible worlds: no new money in California and a host of newly energized and well-funded competitors.

Elsewhere in California, not far from Silicon Valley, the story is quite different. When Hollywood recognized that it faced a severe capital shortage, it did not throw up protectionist barriers against foreign money. Instead, it invited Rupert Murdoch into 20th Century Fox, C. Itoh and Toshiba into Time-Warner, Sony into Columbia, and Matsushita into MCA. The result: a $10 billion infusion of new capital and, equally important, $10 billion less for Japan or anyone else to set up a new Hollywood of their own.

Political leaders, however reluctantly, must adjust to the reality of economic regional entities if they are to nurture real economic flows. Resistant governments will be left to reign over traditional political territories as all meaningful participation in the global economy migrates beyond their well-preserved frontiers.

Canada, as an example, is wrongly focusing on Quebec and national language tensions as its core economic and even political issue. It does so to the point of still wrestling with the teaching of French and English in British Columbia, when that province’s economic future is tied to Asia. Furthermore, as NAFTA takes shape the “vertical” relationships between Canadian and U.S. regions—Vancouver and Seattle (the Pacific Northwest region state); Toronto, Detroit and Cleveland (the Great Lakes region state)—will become increasingly important. How Canadian leaders deal with these new entities will be critical to the continuance of Canada as a political nation.

In developing economies, history suggests that when GNP per capita reaches about $5,000, discretionary income crosses an invisible threshold. Above that level people begin wondering whether they have reasonable access to the best and cheapest
available products and whether they have an adequate quality of life. More troubling for those in political control, citizens also begin to consider whether their government is doing as well by them as it might.

Such a performance review is likely to be unpleasant. When governments control information—and in large measure because they do—it is all too easy for them to believe that they “own” their people. Governments begin restricting access to certain kinds of goods or services or pricing them far higher than pure economic logic would dictate. If market-driven levels of consumption conflict with a government’s pet policy or general desire for control, the obvious response is to restrict consumption. So what if the people would choose otherwise if given the opportunity? Not only does the government withhold that opportunity but it also does not even let the people know that it is being withheld.

Regimes that exercise strong central control either fall on hard times or begin to decompose. In a borderless world the deck is stacked against them. The irony, of course, is that in the name of safeguarding the integrity and identity of the center, they often prove unwilling or unable to give up the illusion of power in order to seek a better quality of life for their people. There is at the center an understandable fear of letting go and losing control. As a result, the center often ends up protecting weak and unproductive industries and then passing along the high costs to its people—precisely the opposite of what a government should do.

The Goal is to Raise Living Standards

The CLINTON administration faces a stark choice as it organizes itself to address the country’s economic issues. It can develop policy within the framework of the badly dated assumption that success in the global economy means pitting one nation’s industries against another’s. Or it can define policy with the awareness that the economic dynamics of a borderless world do not flow from such contrived head-to-head confrontations, but rather from the participation of specific regions in a global nexus of information, skill, trade and investment.

If the goal is to raise living standards by promoting regional participation in the borderless economy, then the less Washington constrains these regions, the better off they will
be. By contrast, the more Washington intervenes, the more citizens will pay for automobiles, steel, semiconductors, white wine, textiles or consumer electronics—all in the name of “protecting” America. Aggregating economic policy at the national level—or worse, at the continent-wide level as in Europe—inevitably results in special interest groups and vote-conscious governments putting their own interests first.

The less Washington interacts with specific regions, however, the less it perceives itself as “representing” them. It does not feel right. When learning to ski, one of the toughest and most counterintuitive principles to accept is that one gains better control by leaning down toward the valley, not back against the hill. Letting go is difficult. For governments region-based participation in the borderless economy is fine, except where it threatens current jobs, industries or interests. In Japan, a nation with plenty of farmers, food is far more expensive than in Hong Kong or Singapore, where there are no farmers. That is because Hong Kong and Singapore are open to what Australia and China can produce far more cheaply than they could themselves. They have opened themselves to the global economy, thrown their weight forward, as it were, and their people have reaped the benefits.

For the Clinton administration, the irony is that Washington today finds itself in the same relation to those region states that lie entirely or partially within its borders as was London with its North American colonies centuries ago. Neither central power could genuinely understand the shape or magnitude of the new flows of information, people and economic activity in the regions nominally under its control. Nor could it understand how counterproductive it would be to try to arrest or distort these flows in the service of nation-defined interests. Now as then, only relaxed central control can allow the flexibility needed to maintain the links to regions gripped by an inexorable drive for prosperity.
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