Note to students- This is a wonderful article that discusses a key question for the world right now. James Fallows lived in Japan for several years. This was written before the development of China was really understood. He is a well known American writer on public affairs. The Atlantic Magazine is one of the nation's best known general interest public affairs magazines. -wdm

http://www.theatlantic.com/politics/ecbig/whatecon.htm

J A N U A R Y 1 9 9 4

What is an Economy For?

We know the answer: to grow so that we can all buy more and keep the world economy spinning. Asians have a different answer: to grow so that a country can produce more--whoever buys the goods--and keep the country's, not the world's, economy spinning

by James Fallows

EVERY country and culture is unique, and the "Asian" economic system naturally is something different in Singapore from what it is in Thailand or Japan. There are comparable variations among European and North American styles of capitalism. In their emphasis on industrial guidance and national policy, France and Germany are more Asian than they are American. In their approach to leisure and the good life, the Europeans are less like the new Asian model than like Americans. Still, four main patterns distinguish the Asian system from the prevailing Western model. Some of them are descended from old clashes between the German and Anglo-American philosophies of economic competition which were outlined here last month. They involve:

The purpose of economic life. In the American-style model the basic reason for having an economy is to raise the consumer's standard of living. In the Asian model it is to increase the collective national strength. Ideally, the goal is to make the nation independent and self-sufficient, so that it does not rely on outsiders for its survival. The American-style goal is materialistic; the Asian-style goal is political, and comes from long experience of being oppressed by people with stronger economies and technologies.

The view of power in setting economic policies. Anglo-American ideology views concentrated power as an evil ("Power corrupts, and absolute power ..."). Therefore it has developed elaborate schemes for dividing and breaking up

power when it becomes concentrated. The Asian-style model views concentrated power as a fact of life. It has developed elaborate systems for ensuring that the power is used for the long-term national good.

The view of surprise and unpredictability. The Anglo-American model views surprise as the key to economic life. We believe that it is precisely because markets are fluid and unpredictable that they work. The Asian-style system deeply mistrusts markets. It sees competition as a useful tool for keeping companies on their toes, but not as a way to resolve any of the big questions of life -- how a society should be run, in what direction its economy should unfold. This is, in Western terms, a military view of economics. Within the American military the Army competes with the Navy for funds, and competition within each branch keeps both the Army and the Navy sharp. But the services don't cast votes or place bids to decide where the nation should fight. Decisions like that are not left to a market.

The view of national borders and an us-versus-them concept of the world. People everywhere are xenophobic and exclusive, but in the Anglo-American model this is thought to be a lamentable, surmountable failing. The Asian-style model assumes that it is a natural and permanent condition. The world consists of us and them, and no one else will look out for us.

Consumers or Employees?

By the tenets of post-Second World War Anglo-American economics, "What is an economy for?" isn't a very difficult question. In fact, it answers itself. Economic development means "more." If people have more choice, more leisure, more wealth, more opportunity to pursue happiness, society as a whole will be a success. In theory, any deal that the market permits will in the long run be good for society as a whole.

The Anglo-American system is long on theories. It is easy to pick up any English-language textbook and find theories proving that whatever gives more to the consumer is best for everyone. The Asian system is not so explicitly theoretical. Yet the fundamental purpose of the Asian model is evident from its performance. Its goal is to develop the productive base of the country -- the industries either within the country or under the control of the country's citizens around the world. When it comes to a choice between the consumer's welfare and the producer's, it's really no choice at all.

In countless ways the most successful of today's Asian societies reveal their bias in favor of the producer. A few illustrations:

Japan and Korea are famous for protecting their rice markets. Even though the small plots, high land prices, and aged rural work force together make the cost of rice several times as high as it is elsewhere in the world, neither country gives its consumers the option of buying from overseas. In the Western world this is usually taken to be a quaint affectation. After all, Japanese and Korean spokesmen usually defend their policy in emotional terms ("our precious heritage"), and even if the markets were thrown wide open, there is a limit to how much foreign rice the Japanese or the Koreans could eat. (Because of crop failures following last year's wet summer, the Japanese government will allow emergency rice imports this year, but says it will close the market when the emergency has passed.)

In fact rice policy reveals a major, consequential pro-producer bias. Especially in Japan, but also in Korea and Taiwan, farm protectionism is the crux of a sweeping anti-consumer social bargain. If there is a single factor limiting consumption in these countries, it is the extremely high price of land; and if there is a single force that keeps the price up, it is the system that sets aside so much land (one quarter of the nonmountainous land in Japan) for the production of very expensive crops. "High land prices have caused the Japanese to act in ways they would not have otherwise," Susan Hanley, of the University of Washington, wrote in 1992. "It is not Japan's Asian cultural heritage that sets it apart ... so much as the result of its artificially high land prices."

The more successful the economy in Asia, the more likely it is to have a rigged, anti-consumer, high-priced retail system. Japan's is the most successful, and its retail economy is the most cartelized and expensive. It's not simply that imported goods are expensive; Japanese-made goods are too. According to a survey at the end of 1991, clothes cost twice as much in Tokyo as in New York, food about three times as much, gasoline about two and a half times as much, and so on.

Anglo-American economic theory can explain why Japanese prices are so high: the retail system is full of cartels and monopolies. A network of laws, contracts, and commercial agreements in Japan discourages discounting and price competition. Until it was relaxed in the early 1990s, Japan's famous dai ten ho, or "big store law," effectively outlawed supermarkets, since it required that small local merchants give their approval (or be bribed into doing so) before a big store could be built. It is hard for familiar economic theory to accept that such an inefficient and anti-consumer system might last for many decades, with the apparent approval even of the victimized population of consumers.

The immediate reason the system lasts is the political power of small merchants, who -- along with farmers and the construction industries -- are big donors to the

powerful Liberal Democratic Party in Japan. The more basic reason it lasts is that it helps producers, and in ways that offset the penalty to consumers. When competition in Europe or America pushes down the price of VCRs, cars, and semiconductor chips, Japanese producers can maintain high prices within Japan. In effect, producers wring monopoly profits out of their own people in order to build a war chest for competition overseas. When the yen doubled in value against the dollar from 1985 to 1988, retail prices in Japan should have fallen significantly -- but they barely budged. Japanese corporations were taxing their own people with artificially high prices so that they could maintain artificially low prices in export markets in Europe and North America. In return for this tax the Japanese got strong organizations and full employment. This may not be an attractive bargain from the Western viewpoint, and no individual Japanese or Korean likes paying higher prices. But as a social bargain it is seen as keeping the nation's producers strong and thereby keeping the social fabric intact.

The closest counterpart in American experience is AT&T before its breakup. Ma Bell penalized consumers in many ways. Rates were higher than they might have been. All equipment had to be "authorized" by AT&T. At the same time, Bell used the money to fund its research labs and all its other operations. This is a version of everyday practice in Japanese business: consumers have fewer choices than they might ideally have, and corporations absorb and redeploy the money they save.

In their own role as consumers even corporations in Japan and Korea reveal the anti-consumer bias of the Asian system. Their workers have for several decades traded artificially low wages for the promise of full employment. The wages are artificially low because through much of the postwar era earnings have lagged behind the increase in corporate productivity. By Western economic logic wages should have been rising much more rapidly. Similarly, Japanese and Korean corporations have traded artificially low profits for their equivalent of full employment, which is an ever-growing market share. In 1991 a business survey listed the thirty most profitable large companies in the world. Twenty-three of them were American, four were British, and none were Japanese.

The parts of Japanese, Korean, and Taiwanese life that encourage consumption are made difficult. The parts that encourage savings, investment, and deferred gratification are made easy and attractive -- the way it was in America during the Second World War. The automobile market in Japan, for instance, is dominated by the shaken racket. The word shaken (pronounced "shah-ken" rather than like the English word "shaken") literally means "car ticket." In effect a shaken is a reinspection certificate that each car in Japan must have in order to remain legally on the road. The shaken policy originated during the infancy of the Japanese auto industry, when domestic cars were such unreliable rattletraps that

bureaucrats thought it would be dangerous to let them on the road without constant safety checks. The public-safety rationale for reinspections obviously no longer applies. Nonetheless, after three years and then every two years thereafter Japanese drivers must take their cars in for a new shaken, and every two years they are saddled with hugely expensive "necessary" repairs. By the time a car is three or five years old, it can cost so many thousands of dollars to meet shaken standards that it makes sense to buy a new car, even though new cars themselves cost much more than the same models outside Japan. It is a way to turn the population into a captive market for producers.

The experience of the past generation has taught most Asian countries one dramatically clear lesson. They can't really go wrong by giving consumers too little, but they can easily go wrong by giving consumers too much. During the collapse of Japan's bubble economy, in 1991 and 1992, government officials said privately that an atmosphere of hardship was useful. Consumerism had been getting out of hand, and the bubble's collapse would have a tonic effect -- without imposing real hardship on Japan or endangering Japan's long-term prospects. (Business-failure rates among Japanese manufacturing and construction firms were actually lower during the "crash" years of the early 1990s than they had been on average during the booming 1980s.)

In Korea the late 1980s were heady, pro-consumer years. The 1988 Seoul Olympics did for the country what the 1964 Tokyo Olympics had done for Japan. Anything seemed possible. In the fashionable parts of Seoul young women wore miniskirts and young men hung out all night. By 1990 the trade surplus was heading for the cellar, and the government had to fight back with a huge "anti-luxury" campaign. With economic growth slipping, the national tax office announced that "extravagance beyond one's reported means" would invite tax scrutiny. In effect this meant that anyone who bought a Mercury Sable, Lincoln Continental, Mercedes, or BMW could expect to be put through the tax wringer -- a more serious threat in Korea than in some other countries, because so much business is off the books. Tariffs and other barriers had already raised the price of these cars to more than twice what they would cost in the United States. That hadn't choked off sales, but the tax threat did; sales of the Sable virtually stopped after the tax men stepped in.

Beyond all these economic calculations is a question of human nature. Anglo-American economic theory boils people down to their roles as consumers. Life experience, even in America, tells us that people have more in mind than getting the cheapest possible price and the highest possible wage. In certain circumstances people like to work hard, and save, and sacrifice themselves. Even though lottery winners typically don't have society's most desirable jobs, many of them decide to keep working even after they have cashed in. For years and years

studies have shown that people who own small businesses behave in a self-exploitative, economically irrational way. They typically work longer hours than normal employees and earn less money than they could if they sold off their assets and invested the proceeds. Decisions like these are oddities in the Anglo-American economic world, where they are explained away with little theories about the "utility" of work. They are central to the Asian model of individual and collective life.

The Emperor's Legacy

In the United States the effort to break up political power and the attempt to prevent the concentration of economic power have been seen as parallel steps toward liberty. The United States has a three-branch government because of fear that any one branch will become too dominant. The great reformers in the American tradition have generally risen to strike down excessive concentrations of power, from Jefferson (in his battle with Hamilton) to Andrew Jackson to Teddy Roosevelt to Ralph Nader to Ronald Reagan, in their varying ways. The people who have argued for centralizing and exercising power have generally had the excuse of wartime: Abraham Lincoln, Woodrow Wilson, Franklin D. Roosevelt, John F. Kennedy, and Lyndon Johnson.

The deepest criticism of Japanese politics, made by the Dutch writer Karel van Wolferen, is that it lacks a definable center of political accountability. In the French or American system a President must finally make big choices, whereas in the Japanese system (as Van Wolferen explains it) the buck never stops anywhere.

The classic illustration of this problem is Japan's apparent paralysis during the first month after Iraq invaded Kuwait. The standard critique outside Japan was that the country was not doing its fair share. This entirely missed the point. Eventually Japan came up with quite a large sum of money, when it could have made the case for not contributing money at all. (The case would have been that it was foolish to go to war over this issue, and that if other countries had emulated Japan, by conserving their use of oil, they could have afforded to take a longer-term view.) Rather, the problem was that Japan seemed incapable of deciding what its position was. The Foreign Ministry announced one policy, the Finance Ministry disavowed it. The Prime Minister at the time, Toshiki Kaifu, was scheduled to go on a trip to the Middle East. Officials in the Foreign Ministry called the trip off. Feuding occurs in any government, but in this government not even the Prime Minister had the authority to resolve it.

Most other Asian societies do have a center of power. Indeed, this center has

often been one dominant figure -- a military strongman, as in Thailand, Indonesia, and often Korea; a statesman-leader, epitomized by Lee Kuan Yew, of Singapore; a sheer tyrant, as in North Korea and Burma; or a political boss, as in Malaysia and often Taiwan.

But whether the center of politics has been weak, as in Japan, or strong, as everywhere else, the political system as a whole has generally been authoritarian in Asia. Compared with any Western societies, and especially the Anglo-American system, Asian states have been less embarrassed and more explicit about the government's role in shaping society. The contrast is obviously sharper with America than with, say, France, which operates a Japanese-style dirigiste system without the social control. The Japanese system also resembles the most successful parts of government-business interaction in the United States, such as nuclear-weapons design and medical research. And it has analogues in many parts of Asia.

Some scholars contend that the heavy hand of government is the living legacy of Confucius. Anglo-American ideology warns against the abuse of power, and therefore tries to restrict Kings, Prime Ministers, and Presidents. The traditional Confucian "mandate of heaven" approach assumes that there will be an Emperor, asking only whether he exercises power well or poorly. Other scholars argue that such theories are merely cultural window-dressing, used by ruling groups to rationalize their hold on power.

Either way, the history of powerful governments in East Asia has made most governments both more competent and more legitimate when they work with businesses. They are more competent because the great prestige of the civil service continues to attract the best-educated people in the country. For a variety of historical and social-status reasons, jobs in the government bureaucracy are still among the most desirable ones in Korea, Japan, Taiwan, and other Confucian-influenced East Asian societies. Ambitious young graduates compete for positions in the Japanese Ministry of Finance or with the Korean Economic Planning Board the way ambitious young Americans compete for jobs at what we drolly call "investment" banks. (In 1990 Wasserstein Perella & Company, the mergers-and-acquisition house that was spun off from First Boston, received more than 30,000 applications for eight positions for college graduates.)

Today's Asian bureaucrats always complain that the thrill is gone, that they're not paid enough, that the long hours are driving out the real talent, and so on. For instance, early in 1992 the Yomiuri Shimbun, Japan's largest paper, said that the bureaucrats were groaning because they were about to be switched to a mandatory work week of five (rather than six) days, as part of Japan's efforts not to work so hard. Their grievance was that it would just mean more overtime

during the regular week. Still, by international standards the Asian governments attract very skillful people into their ministries, and the ministers have both personal and institutional legitimacy.

A Fundamental Mistrust of the Market

THE dynamic view of economics is connected to the main spirit of American culture. People's lives should change! The future should be full of surprise!

This is not the spirit of most Asian societies, least of all Japan. The more familiar you become with Japanese customs, the more you are impressed with the virtue of doing the expected thing. (Letters to friends in Japanese, for instance, are always supposed to begin with comments about the weather.) The ideal Japanese life is one from which uncertainty has been removed as early as possible -- by getting into the right school, by joining the right corporation. In 1989 pollsters asked citizens in seven countries to react to the statement "It is boring to live like other people." In America 69 percent of respondents agreed with the statement. In Japan only 25 percent did.

In a much broader sense, the Asian systems mistrust the uncertainty the market brings. The Asian and Anglo-American models both trust the market to decide which products will succeed or fail, which companies will beat which others. The Anglo-American model trusts political and economic markets with larger decisions as well: what is a good society, what is the right course for economic growth. The Asian model shrinks in horror from this possibility -- as American parents would shrink from the idea that "the market," in the form of music videos, TV shows, and shopping malls, should teach their children what is right and wrong.

"The peoples of China, North Korea, South Korea, Japan, and other Confucian cultures deeply believe that the state ought to provide not only material wherewithal for its peoples but moral guidance," the Korean scholar Jung-en Woo wrote in 1991. "By and large, Westerners have no way to understand this point except to assert that the Asian countries suffer from a series of absences: no individual rights, no civil society, no Enlightenment, and thus a weak or absent liberalism." The individual may sometimes feel these lacks, but what is more important is that the system roll on.

According to most Western political theory -- displayed in America at its extreme -- the state has no legitimate power to say what makes a good life or a healthy economy. Everyone makes such choices for every day; the choice for the society emerges naturally from these decisions. If everyone wants to avoid taxes,

taxes stay low. If people want to buy computers -- or guns, or X-rated videos -- that industry flourishes. The genius of this system is that it can use people's hungers and jealousies as a tool. It perfectly melds political and economic theories: political liberalism and economic laissez-faire, each of which says to leave the individual alone. (wdm note- no, this is philosophical liberalism)

The flaw is that the system suffers from "market failures," as economists and political scientists call them. Most people would be better off if the society invested more in schools or roads, but no one wants to vote for higher taxes. Everyone feels worse off when there are very wide social divisions, but no individual can make choices that narrow them.

In reality, the largest questions of right and wrong have been settled outside the market system -- through religion, or family prejudice, or patriotism, or ethnic loyalty. But it is hard for the American-style system to argue that anything profitable is wrong if a willing seller and a willing buyer can agree on a price. No government in Asia believes such things. Many individuals do, people being the same everywhere. But governments, with the possible exception of Hong Kong's, think that they, not individuals, should make the big decisions of right and wrong.

Time and again the visitor to Japan hears the phrases "confusion in the market" and "excessive competition." These are shorthand for the dangers of letting market forces get out of control. Each time these phrases come up, they raise intriguing translation problems. You can almost hear the interpreters saying the phrase as if it had quotation marks around it in English -- "confusion in the market." There are no comparable terms in English, because the very concepts do not exist. What the Japanese and Koreans call "excessive" competition is what Western economics texts call "perfect" competition.

A deeper idea is the fundamental distinction between the market as a means and the market as an end in itself. Every healthy society knows that market incentives are necessary -- real price competition, failure for products that don't make the grade, reward for innovation and enterprise. But only in the Western model is nothing besides the market necessary.

In the early stages of their economic development, especially after the Second World War, Asian governments found it easy to set targets and plans. Above all else they had to catch up to the Western lead. Even now Asian systems reveal their faith that the goals should be chosen, rather than left to the market to decide. For example:

The Korean government has for decades divided up the work of national

development among Korea's major companies. One group of companies must run the shipyards; another must collaborate with the Americans on semiconductor projects. In Taiwan the government requires companies to set aside a certain share of their sales revenue for research-and-development expenses. "Such measures would probably strike those South Koreans [and Taiwanese] who have absorbed the political ideals of the Anglo-Saxon model as flagrant violations of liberty," the economist Alice Amsden wrote in 1991.

> Yet this is a very Anglo-Saxon view of democracy, not a universal one. It could just as well be argued that to leave in private hands investment decisions that have the potential to make a major impact on the welfare of society is itself inherently undemocratic.

The Anglo-American system tries to permit as many deals to be made as possible. In general, anything that's profitable should be legal, unless there's a compelling argument against it. The only loyalties that are not supposed to be for sale are within a family and to the country. More generally, friendship is supposed to operate outside the market system. But in Asia, and especially in Japan, business relationships are also supposed to operate outside the market, with loyalty to one's employer being more important than whether the relationship is immediately profitable or not. A Japanese scholar named Michio Morishima pointed out, in Why Has Japan "Succeeded"?, that

> the "loyalty" market is opened only once in a lifetime to each individual, when he graduates from school or college. It is in this market that those who are able to provide loyalty meet those who are looking for it, their "lords."

During the Japanese stock market's long slide from 1989 to 1992, Japanese analysts contended that computer-program trading, introduced into the Tokyo stock market by American firms, was driving the market to daily lows. This strengthened the general feeling that the way to save the market was to restrict its flexibility -- to make it more regulated again rather than to perfect its market forces. A Japanese report at the time said, "Deregulation of brokers' commissions in the US caused securities industry profits to fall and forced many firms into high-risk areas, such as aggressive mergers and acquisitions, a report by the Securities Industry Council charged." That is, letting too many decisions be made by the market created instability for all.

In the summer of 1991, when scandals were being revealed practically every day in the Japanese securities industry, a strange scandal was also unfolding in the earth-moving industry. Many of the competitors of the large Komatsu

Corporation had been paying spies to provide secrets about Komatsu's master plan. The Nihon Keizai Shimbun reported, with a worried tone, that after the revelations "many [initially] thought confusion would reign in the construction industry." But, the paper said with relief, "it has been as calm as a lake in the morning -- nary a ripple."

> One of the reasons for this camaraderie is the fact that the Japan Construction Equipment Manufacturers Association, the "club" of the construction machinery industry, has just been organized. Until the "club" was organized, the industry was one huge price war. And, if the war went on, no one would make a profit and all would lose. Sensing that they were cutting each other's throats, the industry finally got together. So Komatsu didn't want to ruin all that effort.

Once the industry had formed its cartel, everyone felt secure again.

In 1955 the American novelist Richard Wright, the author of Black Boy and Native Son, went to Bandung, in newly independent Indonesia, for the historic conference of the nonaligned countries. This was the first real postcolonial muscle-flexing by Asian and African countries, led by the likes of Jawaharlal Nehru, Gamal Abdel Nasser, and Sukarno. As a black American, Wright had gone expecting to feel fellowship with those who had been controlled by white colonialists. His book about the conference, The Color Curtain, reflected his increasing puzzlement over, and estrangement from, the nonaligned policies. Although he did not put it this way, mistrust of the market was one of the traits that struck him most.

> Still another and, to the Western mind, somewhat baffling trait emerged from these Asian responses. There seemed to be in their consciousness a kind of instinct (I can't find a better word!) toward hierarchy, toward social collectivities of an organic nature. In contrast to the Western feeling that education was an instrument to enable the individual to become free, to stand alone, the Asian felt that education was to bind men together.

The point for the moment is that one economic system assumes that it does not have to make the largest decisions about national purpose except when the system is being attacked from outside, in time of war. The other assumes that the state always has a role in guiding the nation. It is the clash between these visions, rather than the rightness or wrongness of either of them, that creates current problems.

Borders and Borderlessness

IN Western economics it's hard to come up with a theoretical reason for concentrating on national economic well-being. In the Asian model this is not a problem at all; it's taken for granted.

In daily life there is no shortage of nationalistic spirit in Western countries in general or the United States in particular. The flag waves constantly in American TV commercials. Crowds chant "USA" at international sporting events. But the principles that guide economic policy in the Anglo-American approach avoid the concept of national interest except in strictly military terms.

Most Anglo-American concepts in fact treat national economic interests as if they didn't really exist. Companies move their plants overseas, because that is what business logic says they should do. When it comes to politics, we're able to explain -- but just barely -- why one person should be inconvenienced for the good of all. I pay taxes because I'm part of a political community, even though in any given year I may pay more into the government than I directly get out. In the Anglo-American model there really isn't an economic community that justifies anyone's paying higher prices than he absolutely has to, or preferring to deal with someone from the same country rather than buying from overseas.

This outlook seems advanced and tolerant from the Western, liberal perspective. The world should be "borderless." In the summer of 1990 Roger Porter, who was then President Bush's chief domestic-policy adviser, gave a speech about America's outlook on world trade. Some people, he said, clung to the "old notion of nations, companies, and markets rigidly defined by national borders." But in this modern age, he concluded, such a notion was "outdated and dangerous." Porter was making a partisan argument in behalf of the Bush economic program, but his assumption that consciousness of nationality was "outdated and dangerous" reflected an educated Western view that has nothing to do with party.

In the United States discussions of corporate nationality have stuck mainly to the realm of theory. According to American assumptions, it is only natural for businesses to operate in rootless, global fashion. Therefore most Americans assume that denationalization has already occurred. American discussion on this point has been heavily influenced by the writings of Robert Reich, who was a lecturer at Harvard's John F. Kennedy School of Government before he became Secretary of Labor in the Clinton Administration. Since the mid-1970s Reich has been proposing solutions to America's long-term economic problems, and his ideas about industrial policy (some of which were published in The Atlantic Monthly) have attracted a broad following. During the Bush years Reich wrote

several influential articles in the Harvard Business Review and a subsequent book called The Work of Nations, which argued that corporations had grown past the point where they could sensibly be considered American or German or Japanese. With headquarters in one country, research centers in another, factories in yet other countries, and customers all around the world, Reich said, big diversified corporations could be loyal only to their own economic interests. Though Chrysler had its headquarters in Detroit and Matsushita was based in Osaka, neither would necessarily care about the government or labor force of its home country. Each would go wherever the money, the market, and the skilled work force drew it. In an age of global corporations, Reich concluded, a nation's well-being rises or falls with the skills of its workers. Therefore he vigorously advocated plans for improving American education and retraining American workers.

In practical terms, Reich said in a 1990 article titled "Who Is Us?," published in the Harvard Business Review, this blurring of corporate nationality meant that the U.S. government should not try to help American-owned companies solely because they were American-owned. The government owed its loyalty to citizens and workers within its borders, and companies from Europe, Japan, Mexico, or anywhere else might have more to offer the American work force. When the U.S. government gave contracts to Boeing, provided bailouts to Chrysler, or negotiated on behalf of Motorola or Zenith, by Reich's analysis it might not have been helping American workers in any direct way. There was no telling where the companies would build the products that federal money was subsidizing. If Toyota was building plants in America and Chrysler was moving plants to Mexico, then Toyota should be considered at least as "American" as Chrysler.

As a theoretical matter, this proposition is sensible and appealing. Daily life abounds with cases that seem to confirm the point. American plants move to Mexico; Japanese and German plants open up in the United States. A large number of American commentators have embraced the "Who Is Us?" assumption, usually crediting Reich for having precisely defined the shift to a world in which corporations no longer have citizenship. Yet many of the specific illustrations on which this changed perspective is based turn out to be misleading. For instance:

In the summer of 1989 Reich published an article in The New Republic that provided a perfect illustration of the way a preference for home-based companies could backfire. U.S. trade negotiators, he said, had been hammering at the Japanese government to open the country's market to cellular phones made by Motorola. The irony, he said, was that in helping Motorola the government was doing little or nothing for American workers, because the phones Motorola wanted to sell were actually designed and made in Kuala Lumpur.

As a recent resident of Kuala Lumpur, I was surprised when I read this assertion, since I had known Motorola officials there and had never heard them say that they made cellular phones. As it turns out, they didn't. Motorola officials wrote immediately to The New Republic pointing out that the phones were made in the United States. James P. Caile, the director of marketing for Motorola's Cellular Subscriber Group, said in his letter that the telephones in question were designed and made in Arlington Heights, Illinois.

Half a year later Reich published his seminal article, "Who Is Us?" Once again he used Motorola as a main illustration of the difference between the welfare of American companies and the welfare of American workers. Motorola, he said this time, "designs and makes many of its cellular telephones in Kuala Lumpur, while most of the Americans who make cellular telephone equipment in the United States for export to Japan happen to work for Japanese-owned companies."

After this article appeared, Richard W. Heimlich, Motorola's director of international strategy, wrote to the Harvard Business Review, pointing out once more that the phones were made in America, not Malaysia. Heimlich's letter also questioned Reich's claim that some "Japanese-owned companies" were building cellular phones in America and exporting them to Japan. Heimlich's letter was published in the Harvard Business Review; Reich replied in the magazine about cellular telephones thus: "One of those [Motorola's] Southeast Asian plants, by the way, does make parts for cellular telephones, according to industry sources."

Heimlich also wrote directly to Reich, offering to discuss the issue further. Reich sent back an angry personal letter (which Motorola officials gave me when I asked for their side of the story), saying that he resented having his intellectual and academic integrity challenged. This letter referred Heimlich to a book by Edward Graham and Paul Krugman, which Reich said would substantiate his claims.

The book is called Foreign Direct Investment in the United States. I found when I looked at it that it says nothing at all about Motorola in Kuala Lumpur, and in a broader sense its argument is the opposite of Reich's. Its perspective is clearly internationalist, and one of its intentions is to rebut irrational American fears about the effects of foreign investment. Nevertheless the data Krugman and Graham examined show that corporate nationality does matter, and that it matters most for Japanese-owned firms.

At least in the United States, foreign-owned companies behave differently from American-owned firms in many ways. The biggest difference is that foreign-owned firms are far more likely to import their components from

suppliers in the home country than to buy them locally. This difference is most pronounced for Japanese-owned firms. In December of 1991 Edward Graham published a comparison of Japanese-owned and American-owned manufacturing firms operating in the United States. He found that the Japanese-owned firms were less likely to produce goods for export from the United States, less likely to invest R&D funds in America -- and four times as likely to import components, instead of manufacturing or buying them in the United States.

In the Winter, 1991, issue of The American Prospect, Reich once again used Motorola to illustrate the borderless nature of the new, integrated world, and Heimlich once again protested in a letter to the editor. Later that year Reich published The Work of Nations. It included a full-scale presentation of the borderless argument, including "one example" that summed up the folly of the U.S. government's working in behalf of U.S.-based corporations -- the same example.

The power of the Motorola-in-Malaysia story depends on the assumption that it is one of many possible illustrations of a widespread trend. If there really were a large number of examples to choose from, it's hard to explain why an author would have stuck with such a troublesome case. After I made numerous calls to the Labor Department to ask Reich why he seemed so attached to this one story, he replied through a press representative at the department that he had "seen no evidence to change his mind" about the Motorola case.

Last year, after he became Labor Secretary, Reich presented another perfect example of the "coming irrelevance of corporate nationality." The example came in a memorandum he sent to President Bill Clinton on March 23, concerning trade and "competitiveness" strategies. "Our efforts should focus on opening foreign markets to American exports, rather than merely to U.S. products," he said, sensibly. American exports would employ workers in America; mere "U.S. products," for instance Coca-Cola sold overseas, might do little for America's work force. Then came the example:

> Japan's agreement to purchase 20 per cent of its semiconductors from non-Japanese firms, for example, does not necessarily promote high-wage production in the United States. Close to 75 per cent of the chips which Japan purchased last year from U.S. firms were fabricated in Japan.

If true, this illustration would be even more powerful than the Motorola story in showing that corporations had transcended nationality. It would also mean that the semiconductor agreement had completely backfired, "forcing" Japanese purchasers, Brer Rabbit-like, into buying more output from factories based in Japan. But this account of the agreement's effects also turns out to be inaccurate.

According to figures collected by the U.S. Trade Representative's office, the percentage of such American-brand chips that were made in Japan was 30, not "close to 75." The semiconductor agreement had in fact achieved its stated purpose: most of the American chips sold in Japan were indeed designed and made in the United States.

In the same memorandum Reich gave another illustration of the borderless paradox. The U.S. government at that time was evaluating how to get involved in the emerging technologies of high-definition television. The main decisions lay with the Federal Communications Commission, which was to decide which transmission system, among several competing proposals, should be the standard for HDTV broadcasts within the United States. At the time Reich wrote his memo, three business consortia were vying to have their standards selected. One was led by the electronics makers Thomson, based in France, and Philips, based in Holland. The other two were all-American, in that the main partners in them were all U.S.-based institutions: an alliance between Zenith and AT&T, and a group led by the Massachusetts Institute of Technology and the Chicago firm General Instruments. (A fourth group, led by Japanese firms, dropped out of the competition when it became clear that its analog transmission system would lose in competition against the digital systems proposed by each of the other teams.)

In his memorandum to the President, Reich said that the government should look beyond strictly technical issues to see "which standard is likely to generate the greatest amount of high-wage production in the United States." He added,

> (Interestingly, the only consortium which has pledged to develop and manufacture its high-definition televisions in the United States is the Dutch-French group [Phillips-Thompson-Sarnoff] [sic]; the AT&T-Zenith group will not do so, because Zenith is moving all its television production to Mexico.)

Like the Motorola and semiconductor examples, this one seemed to show the folly of helping American corporations. But as with the other examples, the real facts of this case undercut the "Who Is Us?" argument.

The French-Dutch consortium did indeed plan to do the final assembly of its TV sets in America. Zenith planned to do its final assembly in Mexico. But this stage of the process boils down to "screwdriver jobs": final assembly is the bolting together of sophisticated, high-value components made somewhere else. Most of the value of an HDTV, which in turn means most of the sophisticated, high-wage jobs, would come from designing and producing those components. The most important and valuable components would be the many diverse semiconductors that would

control the conversion and display of incoming digital signals. The high-resolution, large-scale picture tubes would be the next most valuable components. Where these specialized products were made, rather than where the sets were put together, would determine where the highest-value jobs from HDTV would end up.

If Thomson-Philips eventually leads the HDTV industry, the advanced semiconductors for its sets will almost certainly come from Thomson's factories in France. If the AT&T-Zenith group does, the semiconductors will come from AT&T in the United States. In a letter to Reich, Zenith's chairman, Jerry K. Pearlman, had emphasized that since the "American" consortium would make its advanced components in the United States, it would produce more highly skilled jobs for Americans than the European consortium would.

Pearlman is hardly an impartial observer, but his account of HDTV supply patterns conforms to most other accounts in the industry. It is "interesting," as Reich had said in his memorandum to the President, to speculate that the foreign-based consortium would create more high-value jobs within the United States, but this is probably not the reality. Most other evidence, both anecdotal and analytic, confirms the antique-seeming idea that corporations do their most valuable work in the country where they are based.

Them Against Us

ANGLO-AMERICAN theory instructs Westerners that economics is a "positive-sum game," from which all can emerge as winners. Asian history instructs many Koreans, Chinese, Japanese, and others that economic competition is a form of war. To be strong is much better than to be weak; to give orders is better than to take them. By this logic the way to be strong, to give orders, to have independence and control -- to win -- is to keep in mind the difference between us and them. This perspective comes naturally to Koreans when thinking about Japan, or to Canadians when thinking about the United States, or to Chinese or Japanese when thinking about what the Europeans did to their nations. It does not come naturally to Americans.

But, again, it comes naturally in the Asian system. There are more examples from Japan than from the other countries, because Japan got there first; Korea, for instance, would love to be just as nationalistic, but under the current balance of power in Asian economies it doesn't have a chance.

Here are a few ways in which Asian economies are more nationalistic than ours.

Intra-industry trade. Theory seems to call for international trade to become more specialized by region as time goes on. Wine and cheese will come from France, magazine editors from England, cars from Japan, wool from New Zealand, and vodka from the Russian potato lands. Each country will develop its own national skill.

In fact just the opposite occurs. Since the end of the Second World War the fastest-growing type of international trade has been "intra-industry" trade. German car companies like Mercedes, Audi, and BMW make cars that are attractive to customers in France, Japan, and America -- but some people in Germany want non-German cars like Ferraris, Toyotas, Volvos, and Fords. Germany also has a very active auto-parts industry. It sells to other auto makers around the world, and its own auto makers buy parts from non-German makers, notably in the United States.

The result is that Germany actively sells automobiles and auto parts to the rest of the world -- and actively buys the same things. This pattern, of sales and purchases within an industry, is intra-industry trade. It is measured on a scale that runs from zero to 100. An intra-industry trade rate of zero means that trade in a certain industry all runs one way: a country only sells or only buys a certain product. (For instance, Saudi Arabia's trade rate for oil sales would be zero.) A rate of 100 means that a country sells exactly as much of a certain product as it buys.

Countries that have very low intra-industry trade rates are typically Third World countries or others with unbalanced economies. The classic banana republic would sell only raw materials and would import nearly all the machinery it used. The intra-industry trade rate in most developed countries is high and steadily rising. Depending on the industry, countries in Western Europe have recently had intra-industry trade rates in the low 60s through the low 80s. The U.S. rates are slightly lower than the European ones, which is not surprising, since the U.S. economy is bigger and less influenced by foreign trade.

Japan does not fit this pattern. First, its overall rate has been unusually low. Edward Lincoln, of the Brookings Institution, in his 1990 book Japan's Unequal Trade, calculated that Japan's overall rate was 25, which was one third the overall rate for France and far below that of any other industrial power. This means in practice that the Japanese economy buys only the goods it simply cannot make: fuel, food, raw materials, and certain advanced products (notably airplanes) in which its industries cannot yet compete.

Second, Japan's rate has rarely risen. For the rest of the developed world

intra-industry trade has been the main engine of trade growth during the postwar years. Countries started with different rates, but all the rates went up. Japan's stayed low through most of the postwar era and, according to Edward Lincoln, rose only modestly in the late 1980s, when Japanese manufacturers moved some of their plants overseas. It is not necessary to say that Japan's low rate is wise, unwise, or some mixture: its effect is to divide the world into "us" and "them" production zones, and to keep as many industries as possible in the hands of "us."

Management. The board members of U.S. companies are still mainly American white men, but there are exceptions. For instance, in May of 1992 The Wall Street Journal provided a long list of executives of major American corporations who were born outside the United States. The computer industry is full of people who started in other countries. The magazine world is full of the English.

Most Asian countries have a far more nationality-conscious policy. It would be inconceivable for a non-Korean to run one of the major Korean enterprises. Although it is difficult to find reliable figures for the number of non-Japanese who serve on the boards of directors of major Japanese companies (Japan's big-business federation, the Keidanren, says it has "no information" on this subject), the number, as best I can determine, is in the single digits. Japanese firms doing business around the world had a much higher proportion of Japanese managers than American firms had of Americans, or European firms had of their own nationalities. At the end of 1991 the Nihon Keizai Shimbun surveyed Japanese-owned companies in America. It concluded, "Only about 5 percent of executives are American and delegation of authority to local companies just isn't happening."

Incoming investment. During the late 1980s Americans debated about the higher levels of foreign investment coming into their country, and whether it was racist to be concerned about investment from Japan rather than, say, from Holland. One answer to this question is that there was more of it from Japan. During the late 1980s Japanese investors overtook the Dutch to hold the second largest amount of U.S. assets. (The leading holders were the British.) In terms of new investments the Japanese were far ahead of everyone else in the late 1980s.

The real reason for the complaint about Japanese investment was that European investment did not seem profoundly foreign. European-owned companies in America were mainly run by Americans. Japanese-owned companies were to a much larger extent run by Japanese. During the 1988 campaign Michael Dukakis made a famous gaffe by denouncing foreign ownership at an auto-parts factory that turned out to be owned by Italian interests. The fact that on his visit he didn't notice that it was foreign-owned pointed up the underlying message: he would never have made that error with Mitsubishi.

Moreover, the British and Dutch economies were wide open for American investment. Japan's economy was not. Indeed, the share of Japan's economy that is owned by foreigners is the nation's most distinctive economic trait -- because it is so tiny. Systems for measuring foreign ownership vary, but approximately 10 percent of the U.S. economy is now foreign-owned. For most European nations the foreign-owned share is higher, since the countries are smaller and their economies are more integrated. Yet for Japan the foreign-owned share is about one percent, and is virtually zero in certain crucial industries. The foreign-owned share of North American and European economies has been steadily rising. The foreign-owned share of Japan's economy has fallen for several years -- despite the collapse of prices on the Japanese stock market in the early 1990s, which should theoretically have attracted bargain hunters from overseas.

For the first few decades after the Second World War, Japanese laws flatly prohibited foreigners from buying Japanese companies. The handful of foreign companies that are well established in Japan -- Coca-Cola, IBM -- are the exceptions that prove the rule. For various reasons they were able to grandfather themselves into the system. Their success is usually cited as proof that anyone who tries hard enough can find a way into the Japanese system. But most other companies were forbidden to do the same thing thirty or forty years ago, when it would have been cheap -- and they can't afford to do it now.

Dennis Encarnation, of the Harvard Business School, has pointed out that when Japanese enterprises invest in plants in Europe or North America, they almost always buy a controlling interest -- 100 percent if possible, 51 percent at least. When foreigners have bought shares of Japanese firms, they have almost always ended up as minority owners, and often receive no seats on the board of directors.

Technology. There is a final point to emphasize about a nationality-conscious business policy: it goes with an aversion to relying on foreigners. This desire for autarky is completely understandable in historical and psychological terms, although it is considered irrational in the realm of economics.

When Japan suddenly became industrialized, in the opening decades of this century, it lost the ability to feed its own people from its own soil. When its leaders and generals considered making war on America, in the 1930s, what drove them was the fear that they would run out of oil. One nightmare they faced was that their shipping would be cut off and they could be starved out. Today is a very different time -- supplier cartels can be broken, as with OPEC; people who have money, as Japan does, can find food to buy. Yet much the same mentality runs through many Japanese -- and other Asian -- approaches to technology. In

ways that no economic theory can fully explain, the goal of national policy is to bring control of the technology into Japanese (or Korean, or Chinese) hands -- even if this is irrational, even if it violates the spirit of the borderless world.

Japanese corporations do practice a form of conventional economic competition, but all within their own borders. This is known as the "one-set" philosophy: each big company makes a set of products that includes one of each kind. Each beer maker produces a draft beer, a "dry" beer, a lager, and so on; each electronics company tries to produce a full range of radios, TVs, and fax machines. Successful Japanese students are expected to get top marks in every subject. Economists say that specializing in everything is in principle not possible. But in practice the urge to be on top in every field, rather than concentrating on some and leaving the rest to competitors, is a stronger impulse in Japanese society than in most others.

Americans may complain about the decline of their steel and semiconductor industries -- that is, areas where the United States once enjoyed a lead and has had to watch factories shut their doors. But few Americans really think it is a problem if we have to buy our entire supply of CD players from overseas. The United States has no government project under way to create a domestic fax-machine industry, and when government guidance is proposed -- for semiconductors, HDTVs, and superconductors -- it is always controversial. The Japanese assumption is very different. In 1988, after an agricultural-trade conference in Montreal, a Japanese negotiator spoke to a Canadian colleague. "You know what really makes Japan unusual?" he said. "We are the only major industrial power that is not also a food exporter. If we could improve the productivity of our rice farming by fifteen percent a year, in eight years we would be competitive with California." Not even Japan's least competitive industry, agriculture, should be conceded to foreign competition.

The Japanese emphasis on the country's "unique" capacity for high-quality manufacturing provides an argument for national self-sufficiency. In 1985 the most disastrous crash in Japanese air history occurred outside Tokyo. A Boeing 747 owned by Japan Air Lines took off from Tokyo's Haneda Airport, bound for Osaka. Shortly afterward it crashed into a mountainside, killing 520 passengers. Officials from Japan Air Lines visited the bereaved families to express the company's contrition. On investigation it proved that the principal cause of the crash was a faulty repair job carried out by Boeing engineers, which had left one of the plane's pressure bulkheads in a weakened state.

Many lessons might be drawn from the catastrophe. The high death toll was in part an indictment of bureaucratic infighting within Japan's Self-Defense Force, which squabbled for hours over which branch would do what in going to aid the

victims. Autopsies showed that many people had survived the crash but died later of exposure or injuries; they could have been saved with a faster response. Nonetheless the crash was taken in Japan as a symbol of the across-the-board shoddiness of American equipment; over the next few years I heard it mentioned in that context dozens of times.

I moved to Japan half a year after the JAL crash, and less than a month after the space shuttle Challenger blew up shortly after being launched. Several times during the next year I heard quite similar responses from Japanese: if we had done it, it wouldn't have happened. A Canadian friend was at the Japanese space center that day and recalls the air of schadenfreude. The unspoken mood was, what can you expect? This gloating was unwarranted on the part of Japanese quality-control experts, since their country's own H-2 rocket, usually described in the press as the first "pure" Japanese aerospace project, kept blowing up on the launch pad in the late 1980s and early 1990s.

But the general perception of shoddy American production perfectly reinforces the Japanese view of the JAL crash and the Challenger explosion. Early in 1992, when the speaker of the Japanese House complained about American work habits, a Wall Street Journal story quoted a Japanese pollster, Takayoshi Miyagawa, as saying that the comment "represents a general perception of Japanese people on the quality of American labor." The result of the JAL crash and similar U.S.-made catastrophes, he said, is that "the Japanese people think we should make by ourselves whatever concerns human life."

Sometimes the strategy of saving lives by restricting imports backfires. In 1988 Japan's Ministry of Health and Welfare coordinated a drive by the country's three largest vaccine-making companies to produce an alternative to an American vaccine that had not been approved for sale in Japan. The American vaccine, produced by the Merck Corporation, had the trademarked name of MMR and was used to protect children against measles, mumps, and rubella (German measles) with one inoculation. Merck's vaccine was extremely safe; after it had been used on more than 100 million children, no cases of serious side effects had been confirmed. Japanese doctors at the time administered three separate shots for the three diseases. To promote the growth of Japan's pharmaceutical industry, and to avoid using Merck's product, the Japanese government asked each of the three companies to produce its best vaccine for one of the diseases covered by MMR. These the government combined into a new vaccine, which it also called MMR. When the vaccine was ready, in early 1989, the Ministry of Health and Welfare began a mandatory nationwide inoculation program for children. "Rather than use foreign products, we wanted Japanese products because they are of better quality," an official of Japan's Association of Biologicals Manufacturers told Leslie Helm, who reported the story in the Los

Angeles Times.

In fact Japan's MMR was of much worse quality than the foreign alternatives. Based on the safety record of Merck's MMR and similar foreign vaccines, the Ministry of Health and Welfare had expected that its vaccine would produce side effects in no more than one case per 100,000 inoculations -- but the incidence of side effects was at least 100 times as great as predicted. The most serious side effects were meningitis and encephalitis, which killed some children and left others paralyzed or brain-damaged. By the end of 1989 the government had made the Japanese MMR vaccine optional rather than mandatory, but it left the vaccine on the market while the remaining stocks were used up and did not approve the safer Merck product for sale in Japan. (Japanese doctors have now returned to giving separate immunizations for the three diseases.)

The preferences of such a system cannot be explained by a desire to save lives -- or to protect consumers. By modern Western standards such preferences seem illogical and self-defeating at best, brutally misguided at worst. Yet they are in keeping with the belief, widespread outside the English-speaking world, that inconvenience to consumers is less damaging in the long run than weakness of a nation's productive base. The fastest-growing modern economies, in East Asia, reflect this view. Like it or not, we live in the world that Asian success stories have shaped. We need to figure out how to compete in it.

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