METROPOLITAN ECONOMIC STRATEGY

ECONOMIC DEVELOPMENT IN A FLAT WORLD: GLOBAL TRADE, TECHNOLOGY, INVESTMENT, INCOMES, EMPLOYMENT, EDUCATION, AND ENTREPRENEURSHIP IN THE 21ST CENTURY

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The more I worked on this book, the more I found myself asking people I met around the world where they were when they first discovered that the world was flat. In the space of two weeks, I got two revealing answers, one from Mexico, one from Egypt. I was in Mexico City in the spring of 2004, and I put the question on the table during lunch with a few Mexican journalist colleagues. One of them said he realized that he was living in a new world when he started seeing reports appearing in the Mexican media and on the Internet that some statuettes of Mexico's patron saint, the Virgin of Guadalupe, were being imported into Mexico from China, via ports in California. When you are Mexico and your claim to fame is that you are a low-wage manufacturing country, and some of your people are importing statuettes of your own patron saint from China, because China can make them and ship them all the way across the Pacific more cheaply than you can produce them, you are living in a flat world.

You've also got a problem. Over at the Central Bank of Mexico, I asked its governor, Guillermo Ortiz, whether he was aware of this issue. He rolled his eyes and told me that for some time now he could feel the competitive playing field being leveled — and that Mexico was losing some of its natural geographic advantages with the US market — by just staring at the numbers on his computer screen. "We started looking at the numbers in 2001 — it was the first year in two decades that [Mexico's] exports to the US declined," said Ortiz. "That was a real shock. We started reducing our gains in market share and then started losing them. We said that there is a real change here … And it was about China."

China is such a powerhouse of low-cost manufacturing that even though the NAFTA accord has given Mexico a leg up with the United States, and even though Mexico is right next door to us, China in 2003 replaced Mexico as the number two exporter to the United States. (Canada remains number one.) Though Mexico still has a strong position in big-ticket exports that are costly to ship, such as cars, auto parts, and refrigerators, China is coming on strong and has already displaced Mexico in areas such as computer parts, electrical components, toys, textiles, sporting goods, and tennis shoes. But what's even worse for Mexico is that China is displacing some Mexican companies in Mexico, where Chinese-made clothing and toys are now showing up on store shelves everywhere. No wonder a Mexican journalist told me about the day he interviewed a Chinese central bank official, who told him something about China's relationship with America that really rattled him: "First we were afraid of the wolf, then we wanted to dance with the wolf, and now we want to be the wolf."

A few days after returning from Mexico, I had breakfast in Washington with a friend from Egypt, Lamees El-Hadidy, a longtime business reporter in Cairo. Naturally I asked her where she was when she discovered the world was flat. She answered that it was just a few weeks earlier, during the Muslim holy month of Ramadan. She had done a story for CNBC Arabiya Television about the colorful lanterns called *fawanis*, each with a burning candle inside, that Egyptian schoolchildren traditionally carried around during Ramadan, a tradition dating back centuries to the Fatimid period in Egypt. Kids swing the lanterns and sing songs, and people give them candy or gifts, as in America on Halloween. For centuries, small, low-wage workshops in Cairo's older neighborhoods have manufactured these lanterns — until the last few years.

That was when plastic Chinese-made Ramadan lanterns, each with a battery-powered light instead of a candle, began flooding the market, crippling the traditional Egyptian workshops. Said Lamees, "They are invading our tradition — in an innovative way — and we are doing nothing about it … These lanterns come out of our tradition, our soul, but [the Chinese versions] are more creative and advanced than the Egyptian ones." Lamees said that when she asked Egyptians, "Do you know where these are made?" they would all answer no. Then they would turn the lamps over and see that they came from China.

Many mothers, like Lamees, though, appreciated the fact that the Chinese versions are safer than the traditional Egyptian ones, which are made with sharp metal edges and glass, and usually still use candles. The Chinese versions are made of plastic and feature flashing lights and have an embedded microchip that plays traditional Egyptian Ramadan tunes and even the theme song to the popular Ramadan TV cartoon series *Bakkar*. As *Business Monthly*, published by the American Chamber of Commerce in Egypt, reported in its December 2001 issue, Chinese importers "are pitted not only against each other, but also against the several-hundred-year-old Egyptian industry. But the Chinese models are destined to prevail, according to [a] famous importer, Taha Zayat. 'Imports have definitely cut down on sales of traditional fawanis,' he said. 'Of all fawanis on the market, I don't think that more than 5 percent are now made in Egypt.' People with ties to the Egyptian [fawanis] industry believe China has a clear advantage over Egypt. With its superior technology, they said, China can make mass quantities, which helps to keep prices relatively low. Egypt's traditional [fawanis] industry, by contrast, is characterized by a series of workshops specialized in different stages of the production process. Glassmakers, painters, welders and metal craftsmen all have their role to play. 'There will always be fawanis in Ramadan, but in the future I think Egyptian-made ones could become extinct,' Zayat said. 'There is no way they can ever compete with things made in China.' "

Think how crazy that statement is: Egypt has masses of low-wage workers, like China. It sits right next to Europe, on the Suez Canal. It could be and should be the Taiwan of the eastern Mediterranean, but instead it is throwing in the towel to atheistic China on the manufacture of one of Muslim Egypt's most cherished cultural artifacts. Ibrahim El Esway, one of the main importers from China of fawanis, gave *The Business Monthly* a tour of his warehouse in the Egyptian town of Muski: He had imported 16 different models of Ramadan lanterns from China in 2004. "Amid the crowds at Muski, [El Esway] gestured to one of his employees, who promptly opened a dust-covered box and pulled out a plastic fawanis shaped like the head of Simba, from *The Lion King*. 'This is the first model we imported back in 1994,' he said. He switched it on. As the blue-colored lion's head lit up, the song 'It's a Small World' rang out."

Introspection

This article focuses on what sort of policies developing countries need to undertake in order to create the right environment for their companies and entrepreneurs to thrive in a flat world, although many of the things I am about to say apply to many developed countries as well.

When developing countries start thinking about the challenge of flatism, the first thing they need to do is engage in some brutally honest introspection. A country, its people and leaders alike, has to be honest with itself and look clearly at exactly where it stands in relation to other countries and in relation to the 10 flatteners. It has to ask itself, "To what extent is my country advancing or being left behind by the flattening of the world, and to what extent is it adapting to and taking advantage of all the new platforms for collaboration and competition?" As that Chinese banking official boasted to my Mexican colleague, China is the wolf. Of all the 10 flatteners, the entry of China into the world market is the most important for developing countries, and for many developed countries. China can do high-quality low-cost manufacturing better than any other country, and increasingly, it also can do high-quality higher-cost manufacturing. With China and the other nine flatteners coming on so strong, no country today can afford to be anything less than brutally honest with itself.

To that end, I believe that what the world needs today is a club that would be modeled after Alcoholics Anonymous (AA). It would be called Developing Countries Anonymous (DCA). And just as at the first AA meeting you attend you have to stand up and say, "My name is Thomas Friedman and I'm an alcoholic," so at Developing Countries Anonymous, countries would have to stand up at their first meeting and say, "My name is Syria and I'm underdeveloped." Or "My name is Argentina and I'm underachieving. I have not lived up to my potential."

Every country needs "the ability to make your own introspection," since "no country develops without going through an X-ray of where you are and where your limits are," said Luis de la Calle, one of Mexico's chief NAFTA negotiators. Countries that fall off the development wagon are a bit like drunks; to get back on they have to learn to see themselves as they really are. Development is a voluntary process. You need a positive decision to make the right steps, but it starts with introspection.

I Can Get It for You Wholesale

During the late 1970s, but particularly after the fall of the Berlin Wall, a lot of countries started to pursue development in a new way through a process that I call reform wholesale. The era of Globalization 2.0, when the world shrank from a size medium to a size small, was the era of reform wholesale, an era of broad macroeconomic reform. These wholesale reforms were initiated by a small handful of leaders in countries like China, Russia, Mexico, Brazil, and India. These small groups of reformers often relied on the leverage of authoritarian political systems to unleash the state-smothered market forces in their societies. They pushed their countries into more export-oriented, free-market strategies — based on privatization of state companies, deregulation of financial markets, currency adjustments, foreign direct investment, shrinking subsidies, lowering of protectionist tariff barriers, and introduction of more flexible labor laws — from the top down without ever really asking the people. Ernesto Zedillo, who served as president of Mexico from 1994 to 2000 and was finance minister before that, once remarked to me that all the decisions to open the Mexican economy were taken by three people. How many people do you suppose Deng Xiaoping consulted before he declared, "To get rich is glorious," and opened the Chinese economy, or when he dismissed those who questioned China's move from communism to free markets by saying that what mattered was jobs and incomes, not ideology? Deng tossed over decades of Communist ideology with one sentence: "Black cat, white cat, all that matters is that it catches mice." In 1991, when India's finance minister, Manmohan Singh, took the first tentative steps to open India's economy to more foreign trade, investment, and competition, it was a result not of some considered national debate and dialogue, but of the fact that India's economy at that moment was so sclerotic, so unappealing to foreign investors, that it had almost run out of foreign currency. When Mikhail Gorbachev started dabbling with perestroika, it was with his back up against the Kremlin wall and with few allies in the Soviet leadership. The same was true of Margaret Thatcher when she took on the striking coal miners' union in 1984 and forced reform wholesale onto the sagging British economy.

What all these leaders confronted was the irrefutable fact that more open and competitive markets are the only sustainable vehicle for growing a nation out of poverty, because they are the only guarantee that new ideas, technologies, and best practices are easily flowing into your country and that private enterprises, and even government, have the competitive incentive and flexibility to adopt those new ideas and turn them into jobs and products. This is why the nonglobalizing countries, those that refused to do any reform wholesale — North Korea, for instance — actually saw their per capita GDP growth shrink in the 1990s, while countries that moved from a more socialist model to a globalizing model saw their per capita GDP grow in the 1990s. As David Dollar and Art Kray conclude in their book *Trade, Growth, and Poverty*, economic growth and trade remain the best antipoverty program in the world.

The World Bank reported that in 1990 there were roughly 375 million people in China living in extreme poverty, on less than US$1 per day. By 2001, there were 212 million Chinese living in extreme poverty, and by 2015, if current trends hold, there will be only 16 million living on less than US$1 a day. In South Asia — primarily India, Pakistan, and Bangladesh — the numbers go from 462 million in 1990 living on less than US$l a day down to 431 million by 2001 and down to 216 million in 2015. In sub-Saharan Africa, by contrast, where globalization has been slow to take hold, there were 227 million people living on less than US$1 a day in 1990, 313 million in 2001, and an expected 340 million by 2015.

The problem for any globalizing country lies in thinking you can stop with reform wholesale. In the 1990s, some countries thought that if you got your 10 commandments of reform wholesale right — thou shall privatize state-owned industries, thou shall deregulate utilities, thou shall lower tariffs and encourage export industries, etc. — you had a successful development strategy. But as the world started to get smaller and flatter — enabling China to compete everywhere with everyone on a broad range of manufactured products, enabling India to export its brainpower everywhere, enabling corporations to outsource any task anywhere, and enabling individuals to compete globally as never before — reform wholesale was no longer sufficient to keep countries on a sustainable growth path.

A deeper process of reform was required — a process I would call reform retail.

I Can Only Get It for You Retail

What if regions of the world were like the neighborhoods of a city? What would the world look like? I'd describe it like this: Western Europe would be an assisted-living facility, with an aging population lavishly attended to by Turkish nurses. The United States would be a gated community, with a metal detector at the front gate and a lot of people sitting in their front yards complaining about how lazy everyone else was, even though out back there was a small opening in the fence for Mexican labor and other energetic immigrants who helped to make the gated community function. Latin America would be the fun part of town, the club district, where the workday doesn't begin until 10 pm and everyone sleeps until midmorning. It's definitely the place to hang out, but in between the clubs, you don't see a lot of new businesses opening up, except on the street where the Chileans live. The landlords in this neighborhood almost never reinvest their profits here, but keep them in a bank across town. The Arab street would be a dark alley where outsiders fear to tread, except for a few side streets called Dubai, Jordan, Bahrain, Qatar, and Morocco. The only new businesses are gas stations, whose owners, like the elites in the Latin neighborhood, rarely reinvest their funds in the neighborhood. Many people on the Arab street have their curtains closed, their shutters drawn, and signs on their front lawn that say, "No Trespassing. Beware of Dog." India, China, and East Asia would be "the other side of the tracks." Their neighborhood is a big teeming market, made up of small shops and one-room factories, interspersed with Stanley Kaplan SAT prep schools and engineering colleges. Nobody ever sleeps in this neighborhood, everyone lives in extended families, and everyone is working and saving to get to "the right side of the tracks." On the Chinese streets, there's no rule of law, but the roads are all well paved; there are no potholes, and the streetlights all work. On the Indian streets, by contrast, no one ever repairs the streetlights, the roads are full of ruts, but the police are sticklers for the rules. You need a license to open a lemonade stand on the Indian streets. Luckily, the local cops can be bribed, and the successful entrepreneurs all have their own generators to run their factories and the latest cell phones to get around the fact that the local telephone poles are all down. Africa, sadly, is that part of town where the businesses are boarded up, life expectancy is declining, and the only new buildings are health-care clinics.

The point here is that every region of the world has its strengths and weaknesses, and all are in need of reform retail to some degree. What is reform retail? In the simplest terms, it is more than just opening your country to foreign trade and investment and making a few macroeconomic policy changes from the top. That is reform wholesale. Reform retail presumes you have already done reform wholesale. It involves looking at four key aspects of your society — infrastructure, regulatory institutions, education, and culture (the general way your country and leaders relate to the world) — and upgrading each one to remove as many friction points as possible. The idea of reform retail is to enable the greatest number of your people to have the best legal and institutional framework within which to innovate, start companies, and become attractive partners for those who want to collaborate with them from elsewhere in the world.

Many of the key elements of reform retail were best defined by the research done by the World Bank's International Finance Corporation (IFC) and its economic analysis team led by its chief economist, Michael Klein. What do we learn from their work? To begin with, you don't grow your country out of poverty by guaranteeing everyone a job. Egypt guarantees all college graduates a job each year, and it has been mired in poverty with a slow-growing economy for 50 years.

"If it were just a matter of the number of jobs, solutions would be easy," note Klein and Bita Hadjimichael in their World Bank Study, *The Private Sector in Development*." For example, state-owned enterprises could absorb all those in need of employment. The real issue is not just employment, but increasingly productive employment that allows living standards to rise." State-owned enterprises and state-subsidized private firms usually have not delivered sustainable productivity growth, and neither have a lot of other approaches that people assume are elixirs of growth, they add. Just attracting more foreign investment into a country also doesn't automatically do it. And even massive investments in education won't guarantee it.

"Productivity growth and, hence, the way out of poverty, is not simply a matter of throwing resources at the problem," say Klein and Hadjimichael. "More important, it is a matter of using resources well." In other words, countries grow out of poverty not only when they manage their fiscal and monetary policies responsibly from above, ie, reform wholesale. They grow out of poverty when they also create an environment below that makes it very easy for their people to start businesses, raise capital, and become entrepreneurs, and when they subject their people to at least some competition from beyond — because companies and countries with competitors always innovate more and faster.

The IFC drove home this point with a comprehensive study of more than 130 countries, called *Doing Business in 2004*. The IFC asked five basic questions about doing business in each of these countries, questions about how easy or difficult it is to 1) start a business in terms of local rules, regulations, and license fees, 2) hire and fire workers, 3) enforce a contract, 4) get credit, and 5) close a business that goes bankrupt or is failing. To translate it into my own lexicon, those countries that make all these things relatively simple and friction-free have undertaken reform retail, and those that have not are stalled in reform wholesale and are not likely to thrive in a flat world. The IFC's criteria were inspired by the brilliant and innovative work of Hernando de Soto, who has demonstrated in Peru and other developing nations that if you change the regulatory and business environment for the poor, and give them the tools to collaborate, they will do the rest.

Doing Business in 2004 tries to explain each of its points with a few colorful examples: "Teuku, an entrepreneur in Jakarta, wants to open a textile factory. He has customers lined up, imported machinery, and a promising business plan. Teuku's first encounter with the government is when registering his business. He gets the standard forms from the Ministry of Justice, and completes and notarizes them. Teuku proves that he is a local resident and does not have a criminal record. He obtains a tax number, applies for a business license, and deposits the minimum capital (three times national income per capita) in the bank. He then publishes the articles of association in the official gazette, pays a stamp fee, registers at the Ministry of Justice, and waits 90 days before filing for social security. One hundred sixty-eight days after he commences the process, Teuku can legally start operations. In the meantime, his customers have contracted with another business.

"In Panama, another entrepreneur, Ina, registers her construction company in only 19 days. Business is booming and Ina wants to hire someone for a two-year appointment. But the employment law only allows fixed-term appointments for specific tasks, and even then requires a maximum term of one year. At the same time, one of her current workers often leaves early, with no excuse, and makes costly mistakes. To replace him, Ina needs to notify and get approval from the union, and pay five months' severance pay. Ina rejects the more qualified applicant she would like to hire and keeps the underperforming worker on staff.

"Ali, a trader in the United Arab Emirates, can hire and fire with ease. But one of his customers refuses to pay for equipment delivered three months earlier. It takes 27 procedures and more than 550 days to resolve the payment dispute in court. Almost all procedures must be made in writing, and require extensive legal justification and the use of lawyers. After this experience, Ali decides to deal only with customers he knows well.

"Timnit, a young entrepreneur in Ethiopia, wants to expand her successful consulting business by taking a loan. But she has no proof of good credit history because there are no credit information registries.

Although her business has substantial assets in accounts receivable, laws restrict her hank from using these as collateral. The bank knows it cannot recover the debt if Timnit defaults, because courts are inefficient and laws give creditors few powers. Credit is denied. The business stays small.

"Having registered, hired workers, enforced contracts, and obtained credit, Avik, a businessman in India, cannot make a profit and goes out of business. Faced with a 10-year-long process of going through bankruptcy, Avik absconds, leaving his workers, the bank, and the tax agency with nothing."

If you want to know why two decades of macroeconomic reform wholesale at the top have not slowed the spread of poverty and produced enough new jobs in key countries of Latin America, Africa, the Arab worId, and the former Soviet Empire, it is because there has been too little reform retail. According to the IFC report, if you want to create productive jobs (the kind that lead to rising standards of living), and if you want to stimulate the growth of new businesses (the kind that innovate, compete, and create wealth), you need a regulatory environment that makes it easy to start a business, easy to adjust a business to changing market circumstances and opportunities, and easy to close a business that goes bankrupt, so that the capital can be freed up for more productive uses.

"It takes two days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of Congo," the IFC study found. "There are no monetary costs to start a new business in Denmark, but it costs more than five times income per capita in Cambodia and over 13 times in Sierra Leone. Hong Kong, Singapore, Thailand, and more than three dozen other economies require no minimum capital from start-ups. In contrast, in Syria the capital requirement is equivalent to 56 times income per capita … Businesses in the Czech Republic and Denmark can hire workers on part-time or fixed-term contracts for any job, without specifying maximum duration of the contract. In contrast, employment laws in El Salvador allow fixed-term contracts only for specific jobs, and set their duration to be at most one year … A simple commercial contract is enforced in seven days in Tunisia and 39 days in the Netherlands, but takes almost 1,500 days in Guatemala. The cost of enforcement is less than 1 percent of the disputed amount in Austria, Canada, and the United Kingdom, but more than 100 percent in Burkina Faso, the Dominican Republic, Indonesia, … and the Philippines. Credit bureaus contain credit histories on almost every adult in New Zealand, Norway, and the United States. But the credit registries in Cameroon, Ghana, Pakistan, Nigeria, and Serbia and Montenegro have credit histories for less than 1 percent of adults. In the United Kingdom, laws on collateral and bankruptcy give creditors strong powers to recover their money if a debtor defaults. In Colombia, the Republic of Congo, Mexico, Oman, and Tunisia, a creditor has no such rights. It takes less than six months to go through bankruptcy proceedings in Ireland and Japan, but more than 10 years in Brazil and India. It costs less than 1 percent of the value of the estate to resolve insolvency in Finland, the Netherlands, Norway, and Singapore — and nearly half the estate value in Chad, Panama, Macedonia, Venezuela, Serbia and Montenegro, and Sierra Leone."

As the IFC report notes, excessive regulation also tends to hurt most the very people it is supposed to protect. The rich and the well connected just buy or hustle their way around onerous regulations. In countries that have very regulated labor markets where it is difficult to hire and fire people, women, especially, have a hard time finding employment.

"Good regulation does not mean zero regulation," concludes the IFC study. "The optimal level of regulation is not none, but may be less than what is currently found in most countries, and especially poor ones." It offers what I call a five-step checklist for reform retail. One, simplify and deregulate wherever possible in competitive markets, because competition for consumers and workers can be the best source of pressure for best practices, and overregulation just opens the door for corrupt bureaucrats to demand bribes. "There is no reason for Angola to have one of the most rigid employment laws if Portugal, whose laws Angola adapted, has already revised them twice to make the labor market more flexible," says the IFC study. Two, focus on enhancing property rights. Under de Soto's initiative, the Peruvian government in the last decade has issued property titles to 1.2 million urban squatter households. "Secure property rights have enabled parents to leave their homes and find jobs instead of staying in to protect the property," says the IFC study. "The main beneficiaries are their children, who can now go to school."

Three, expand the use of the Internet for regulation fulfillment. It makes it faster, more transparent, and far less open to bribery. Four, reduce court involvement in business matters. And last but certainly not least, advises the IFC study, "Make reform a continuous process … Countries that consistently perform well across the *Doing Business* indicators do so because of continuous reform."

In addition to the IFC's criteria, reform retail obviously has to include expanding the opportunities for your population to get an education at all levels and investing in the logistical infrastructure — roads, ports, telecommunications, and airports — without which no reform retail can take off and collaboration with others is impossible. Many countries today still have telecommunications systems dominated by state monopolies that make it either too expensive or too slow to get high-speed Internet access and wireless access, and to make cheap long-distance and overseas phone calls. Without reform retail in your telecom sector, reform retail in the other five areas, while necessary, will not be sufficient. What is striking about the IFC's criteria is that a lot of people think they are relevant only for Peru and Argentina, but in fact some of the countries that score worst are places like Germany and Italy. (Indeed, the German government protested some of the findings.)

"When you and I were born," said Luis de la Calle, "our competition [was] our next-door neighbors. Today our competition is a Japanese or a Frenchman or a Chinese. You know where you rank very quickly in a flat world … You are now competing with everyone else." The best talent in a flat world will earn more, he added, "and if you don't measure up, someone will replace you — and it will not be the guy across the street."

If you don't agree, just ask some of the major players. Craig Barrett, the chairman of Intel, said to me, "With very few exceptions, when you would think about where to site a manufacturing plant, you would think about the cost of labor, transportation, and availability of utilities — that sort of stuff. The discussion has been expanded today, and so it is no longer where you put your plant but now where do you put your engineering resources, your research and development — where are the most efficient intellectual and other resources relative to cost? You now have the freedom to make that choice … Today we can be anywhere. Anywhere could be part of my supply chain now — Brazil, Vietnam, the Czech Republic, Ukraine. Many of us are limiting our scope today to a couple of countries for a very simple reason: Some can combine the availability of talent and a market — that is, India, Russia, and China." But for every country Intel considers going into, added Barrett, he asks himself the same question: "What inherent strength does [the] country bring to the party? India, Russia — crummy infrastructure, good educational level, you have a bunch of smart folks. China has a little bit of everything, China has good infrastructure, better than Russia or India. So if you go to Egypt, what unique capability [does that country have to offer]? Exceedingly low labor rates, but what is [the] infrastructure and education base? The Philippines or Malaysia have good literacy rates — you get to employ college grads in your manufacturing line. They did not have infrastructure, but they had a pool of educated people. You have got to have something to build on. When we go to India and are asked about opening plants, we say, 'You don't have infrastructure. Your electricity goes off four times a day.' "

Added John Chambers, the CEO of Cisco Systems, which uses a global supply chain to build the routers that run the Internet and is constantly being wooed to invest in one country or another, "The jobs are going to go where the best-educated workforce is with the most competitive infrastructure and environment for creativity and supportive government. It is inevitable. And by definition those people will have the best standard of living. This may or may not be the countries who led the Industrial Revolution."

But while the stakes in reform retail today are higher than ever, and countries know it, one need only look around the world to notice that not every country can pull it off. Unlike reform wholesale, which could be done by a handful of people using administrative orders or just authoritarian dictates, reform retail requires a much wider base of public and parliamentary buy-in if it is going to overcome vested economic and political interests.

In Mexico, "we did the first stages of structural reform from the top down," said Guillermo Ortiz. "The next stage is much more difficult. You have to work from the bottom up. You have to create the wider consensus to push the reforms in a democratic context." And once that happens, noted Moises Naim, a former Economy Minister of Venezuela and now editor of *Foreign Policy* magazine, you have a much larger number of actors participating, making the internal logic and technical consistency of the reform policies much more vulnerable to the impact of political compromises, contradictions, and institutional failures. "Bypassing or ignoring the entrenched and defensive public bureaucracy — a luxury frequently enjoyed by the government teams that launch initial reform measures — is more difficult in this stage," Naim said.

So why does one country get over this reform retail hump, with leaders able to mobilize the bureaucracy and the public behind these more painful, more exacting micro-reforms, and another country get tripped up?

Culture Matters: Glocalization

One answer is culture.

To reduce a country's economic performance to culture alone is ridiculous, but to analyze a country's economic performance without reference to culture is equally ridiculous, although that is what many economists and political scientists want to do. This subject is highly controversial and is viewed as politically incorrect to introduce. So it is often the elephant in the room that no one wants to speak about. But I am going to speak about it here, for a very simple reason: As the world goes flat, and more and more of the tools of collaboration get distributed and commoditized, the gap between cultures that have the will, the way, and the focus to quickly adopt these new tools and apply them and those that do not will matter more. The differences between the two will become amplified.

One of the most important books on this subject is *The Wealth and Poverty of Nations* by the economist David Landes. He argues that although climate, natural resources, and geography all play roles in explaining why some countries are able to make the leap to industrialization and others are not, the key factor is actually a country's cultural endowments, particularly the degree to which it has internalized the values of hard work, thrift, honesty, patience, and tenacity, as well as the degree to which it is open to change, new technology, and equality for women. One can agree or disagree with the balance Landes strikes between these cultural mores and other factors shaping economic performance. But I find refreshing his insistence on elevating the cultural question, and his refusal to buy into arguments that the continued stagnation of some countries is simply about Western colonialism, geography, or historical legacy.

In my own travels, two aspects of culture have struck me as particularly relevant in the flat world. One is how outward your culture is: To what degree is it open to foreign influences and ideas? How well does it "glocalize"? The other, more intangible, is how inward your culture is. By that I mean, to what degree is there a sense of national solidarity and a focus on development, to what degree is there trust within the society for strangers to collaborate together, and to what degree are the elites in the country concerned with the masses and ready to invest at home, or are they indifferent to their own poor and more interested in investing abroad?

The more you have a culture that naturally glocalizes — that is, the more your culture easily absorbs foreign ideas and best practices and melds those with its own traditions — the greater advantage you will have in a flat world. The natural ability to glocalize has been one of the strengths of Indian culture, American culture, Japanese culture, and, lately, Chinese culture. The Indians, for instance, take the view that the Moguls come, the Moguls go, the British come, the British go, we take the best and leave the rest — but we still eat curry, our women still wear saris, and we still live in tightly bound extended family units. That's glocalizing at its best.

"Cultures that are open and willing to change have a huge advantage in this world," said Jerry Rao, the MphasiS CEO who heads the Indian high-tech trade association. "My great-grandmother was illiterate.

My grandmother went to grade two. My mother did not go to college. My sister has a master's degree in economics, and my daughter is at the University of Chicago. We have done all this in living memory, but we have been willing to change … You have to have a strong culture, but also the openness to adapt and adopt from others. The cultural exclusivists have a real disadvantage. Think about it, think about the time when the emperor in China threw out the British ambassador. Who did it hurt? It hurt the Chinese. Exclusivity is a dangerous thing. "

Openness is critical, added Rao, "because you start tending to respect people for their talent and abilities. When you are chatting with another developer in another part of the world, you don't know what his or her color is. You are dealing with people on the basis of talent — not race or ethnicity — and that changes, subtly, over time your whole view of human beings, if you are in this talent-based and performance-based world rather than the background-based world."

This helps explain why so many Muslim countries have been struggling as the world goes flat. For complicated cultural and historical reasons, many of them do not glocalize well, although there are plenty of exceptions — namely, Turkey, Lebanon, Bahrain, Dubai, Indonesia, and Malaysia. All of these latter countries, though, tend to be the more secular Muslim nations. In a world where the single greatest advantage a culture can have is the ability to foster adaptability and adoptability, the Muslim world today is dominated by a religious clergy that literally bans *ijtihad*, reinterpretation of the principles of Islam in light of current circumstances.

Think about the whole mind-set of bin Ladenism. It is to "purge" Saudi Arabia of all foreigners and foreign influences. That is exactly the opposite of glocalizing and collaborating. Tribal culture and thinking still dominate in many Arab countries, and the tribal mind-set is also anathema to collaboration. What is the motto of the tribalist? "Me and my brother against my cousin; me, my brother, and my cousin against the outsider." And what is the motto of the globalists, those who build collaborative supply chains? "Me and my brother and my cousin, three friends from childhood, four people in Australia, two in Beijing, six in Bangalore, three from Germany, and four people we've met only over the Internet all make up a single global supply chain." In the flat world, the division of labor is steadily becoming more and more complex, with a lot more people interacting with a lot of other people they don't know and may never meet. If you want to have a modem complex division of labor, you have to be able to put more trust in strangers.

In the Arab-Muslim world, argues David Landes, certain cultural attitudes have in many ways become a barrier to development, particularly the tendency to still treat women as a source of danger or pollution to be cut off from the public space and denied entry into economic activities. When a culture believes that, it loses a large portion of potential productivity of the society. A system that privileges the men from birth on, Landes also argues, simply because they are male, and gives them power over their sisters and other female members of society, is bad for the men. It builds in them a sense of entitlement that discourages what it takes to improve, to advance, and to achieve. This sort of discrimination, he notes, is not something limited to the Arab Middle East, of course. Indeed, strains of it are found in different degrees all around the world, even in so-called advanced industrial societies.

The Arab-Muslim world's resistance to glocalization is something that some liberal Arab commentators are now focusing on. Consider a May 5, 2004, article in the Saudi English-language daily *Arab News* by liberal Saudi journalist Raid Qusti, titled "How Long Before the First Step?"

"Terrorist incidents in Saudi Arabia are more or less becoming everyday news. Every time I hope and pray that it ends, it only seems to get worse," Qusti wrote. "One explanation to why all of this is happening was brought up by the editor in chief of *Al-Riyadh* newspaper, Turki Al-Sudairi, on a program about determining the roots of the terrorist acts. He said that the people carrying out these attacks shared the ideology of the Juhaiman movement that seized the Grand Mosque in the 1970s. They had an ideology of accusing others of being infidels and giving themselves a free hand to kill them, be it Westerners — who, according to them, ought to be kicked out of the Arabian Peninsula — or the Muslim believer who does not follow their path. They disappeared in the 1980s and 1990s from the public eye and have again emerged with their destructive ideology. The question Al-Sudairi forgot to bring up was:

What are we Saudis going to do about it? If we as a nation decline to look at the root causes, as we have for the past two decades, it will only be a matter of time before another group of people with the same ideology spring up. Have we helped create these monsters? Our education system, which does not stress tolerance of other faiths — let alone tolerance of followers of other Islamic schools of thought — is one thing that needs to be reevaluated from top to bottom. Saudi culture itself and the fact that the majority of us do not accept other lifestyles and impose our own on other people is another. And the fact that from fourth to 12th grade we do not teach our children that there are other civilizations in the world and that we are part of the global community and only stress the Islamic empires over and over is also worth re-evaluating."

It is simply too easily forgotten that when it comes to economic activities, one of the greatest virtues a country or community can have is a culture of tolerance. When tolerance is the norm, everyone flourishes — because tolerance breeds trust, and trust is the foundation of innovation and entrepreneurship. Increase the level of trust in any group, company, or society, and only good things happen. "China began its astounding commercial and industrial takeoff only when Mao Zedong's odiously intolerant form of communism was scrapped in favor of what might be called totalitarian laissez-faire," wrote British historian Paul Johnson in a June 21, 2004, essay in *Forbes*. "India is another example. It is the nature of the Hindu religion to be tolerant and, in its own curious way, permissive … When left to themselves, Indians (like the Chinese) always prosper as a community. Take the case of Uganda's Indian population, which was expelled by the horrific dictator Idi Amin and received into the tolerant society of Britain. There are now more millionaires in this group than in any other recent immigrant community in Britain. They are a striking example of how far hard work, strong family bonds and devotion to education can carry a people who have been stripped of all their worldly assets." Islam, down through the years, has thrived when it fostered a culture of tolerance, as in Moorish Spain. But in its modern form, in too many cases Islam has been captured and interpreted by spiritual leaders who do not embrace a culture of tolerance, change, or innovation, and that, Johnson noted, surely has contributed to lagging economic growth in many Muslim lands.

Here we come again to the coefficient of flatness. Countries without natural resources are much more likely, through human evolution, to develop the habits of openness to new ideas, because it is the only way they can survive and advance.

The good news, though, is that not only does culture matter, but culture can change. Cultures are not wired into our human DNA. They are a product of the context — geography, education level, leadership, and historical experience — of any society. As those change, so too can culture. Japan and Germany went from highly militarized societies to highly pacifist and staunchly democratic societies in the last 50 years. Bahrain was one of the first Arab countries to discover oil. It was the first Arab country to run out of oil. And it was the first Arab country in the Arab Gulf to hold an election for parliament where women could run and vote. China during the Cultural Revolution seemed like a nation in the grip of a culture of ideological madness. China today is a synonym for pragmatism. Muslim Spain was one of the most tolerant societies in the history of the world. Muslim Saudi Arabia today is one of the most intolerant. Muslim Spain was a trading and merchant culture where people had to live by their wits and therefore learned to live well with others; Saudi Arabia today can get by just selling oil. Yet right next to Saudi Arabia sits Dubai, an Arab city-state that has used its petrodollars to build *the* trading, tourist, service, and computing center of the Arab Gulf. Dubai is one of the most tolerant, cosmopolitan places in the world, with, it often seems, more sushi bars and golf courses than mosques — and tourists don't even need a visa. So yes, culture matters, but culture is nested in contexts, not genes, and as those contexts, and local leaders, change and adapt, so too can culture.

The Intangible Things

You can tell a lot by just comparing skylines. Like many Indian Americans, Dinakar Singh, the hedge fund manager, regularly goes back to India to visit family. In the winter of 2004, he went back to New Delhi for a visit. When I saw him a few months later, he told me about the moment when he realized why

India's economy, as a whole, still had not taken off as much as it should have — outside of the high-tech sector.

"I was on the sixth floor of a hotel in New Delhi," he recalled, "and when I looked out the window I could see for miles. How come? Because you do not have assured power in Delhi for elevators, so there are not many tall buildings." No sensible investor would want to build a tall building in a city where the power could go out at any moment and you might have to walk up 20 flights of stairs. The result is more urban sprawl and an inefficient use of space. I told Singh that his story reminded me of a trip I had just taken to Dalian, China. I had been to Dalian in 1998, and when I went back in 2004, I did not recognize the city. There were so many new buildings, including modern glass-and-steel towers, that I began to question whether I had actually visited there in 1998. Then I added another recollection. I went to school in Cairo in the summer of 1974. The three most prominent buildings in the city then were the Nile Hilton, the Cairo Tower, and the Egyptian TV building. Thirty years later, in 2004, they are still the most prominent buildings there; the Cairo skyline has barely changed. Whenever I go back to Cairo, I know exactly where I am. I visited Mexico City shortly before Dalian, where I had not visited in five years. I found it much cleaner than I had remembered, thanks to a citywide campaign by the mayor. There were also a few new buildings up, but not as many as I expected after a decade of NAFTA. Inside the buildings, though, I found my Mexican friends a little depressed. They told me that Mexico had lost its groove — it just wasn't growing like it had been, and people's self-confidence was waning.

So in Delhi, you can see forever. In Cairo, the skyline seems forever the same. In China, if you miss visiting a city for a year, it's like you haven't been there in forever. And in Mexico City, just when Mexicans thought they had turned the corner forever, they ran smack into China, coming the other way and running much faster.

What explains these differences? We know the basic formula for economic success — reform wholesale, followed by reform retail, plus good governance, education, infrastructure, and the ability to glocalize. What we don't know, though, and what I would bottle and sell if I did, is the answer to the question of why one country gets its act together to do all these things in a sustained manner and why another one doesn't. Why does one country's skyline change overnight and another's doesn't change over half a century? The only answer I have been able to find is something that cannot be defined: I call it *the intangible things*. These are primarily two qualities: a society's ability and willingness to pull together and sacrifice for the sake of economic development and the presence in a society of leaders with the vision to see what needs to be done in terms of development and the willingness to use power to push for change rather than to enrich themselves and preserve the status quo. Some countries (such as Korea and Taiwan) seem to be able to focus their energies on the priority of economic development, and others (such Egypt and Syria) get distracted by ideology or local feuds. Some countries have leaders who use their time in office to try to drive modernization rather than personally enrich themselves. And some countries simply have venal elites, who use their time in office to line their pockets and then invest those riches in Swiss real estate. Why India had leaders who built institutes of technology and Pakistan had leaders who did not is a product of history, geography, and culture that I can only summarize as one of those intangible things. But even though these intangibles are not easily measured, they really do matter.

The best way I know to illustrate this is by comparing Mexico and China. Mexico, on paper, seemed perfectly positioned to thrive in a flat world. It was right next door to the biggest, most powerful economy in the world. It signed a free-trade agreement with the United States and Canada in the 1990s and was poised to be a springboard to Latin America for both these huge economies. And it had a valuable natural resource in oil, which accounted for more than a third of government income. China, by contrast, was thousands of miles away, burdened by overpopulation, with few natural resources, with its best labor crowded onto a coastal plain, and with a burdensome debt legacy from 50 years of Communist rule. Ten years ago, if you took the names off these two countries and just gave someone their profiles, he surely would have bet on Mexico. And yet China has replaced Mexico as the second-largest exporter of goods into the United States. And there is a general sense, even among Mexicans, that even though China is thousands of miles away from America, it is growing closer to America economically, while Mexico, right on America's border, is becoming thousands of miles away.

I am by no means writing Mexico off. Mexico, in the fullness of time, may turn out to be the slow-but-sure tortoise to China's hare. China still has a huge political transition to get through, which could derail it at any moment. Moreover, Mexico has many entrepreneurs who are as Chinese as the most entrepreneurial Chinese. Mexico would not have exported US $138 billion worth of goods to the United States in 2003 if that were not the case. And you have many rural Chinese who are no more advanced or productive than rural Mexicans. But on balance, when you add it all up, the fact is that China has become the hare and Mexico has not, even though Mexico seemed to start with so many more natural advantages when the world went flat. Why?

This is a question Mexicans themselves are asking. When you go to Mexico City these days, Mexicans will tell you that they are hearing that "giant sucking sound" in stereo. "We are caught between India and China," Jorge Castaneda, Mexico's former foreign minister, told me in 2004. "It is very difficult for us to compete with the Chinese, except with high-value-added industries. Where we should be competing, the services area, we are hit by the Indians with their back offices and call centers."

No doubt China is benefiting to some degree from the fact that it still has an authoritarian system that can steamroll vested interests and archaic practices. Beijing's leadership can order many reforms from the top down, whether it is a new road or accession to the World Trade Organization. But China today also has better intangibles — an ability to summon and focus local energies on reform retail. China may be an authoritarian state, but it nevertheless has strong state institutions and a bureaucracy that manages to promote a lot of people on merit to key decision-making positions, and it has a certain public-spiritedness. The Mandarin tradition of promoting bureaucrats who see their role as promoting and protecting the interests of the state is still alive and well in China. "China has a tradition of meritocracy — a tradition that is also carried on in Korea and Japan," said Francis Fukuyama, author of the classic *The End of History and the Last Man*. "All of them also have a basic sense of 'stateness' where [public servants] are expected to look to the long-term interests of the state" and are rewarded by the system for doing so.

Mexico, by contrast, moved during the 1990s from a basically one-party authoritarian state to a multiparty democracy. So just when Mexico needs to summon all its will and energy for reform retail on the micro level, it has to go through the much slower, albeit more legitimate, democratic process of constituency building. In other words, any Mexican president who wants to make changes has to aggregate so many more interest groups — like herding cats — to implement a reform than his autocratic predecessors, who could have done it by fiat. A lot of these interest groups, whether unions or oligarchs, have powerful vested interests in the status quo and the power to strangle reforms. And Mexico's state system, like that of so many of its Latin American neighbors, has a long history of simply being an instrument of patronage for the ruling party or local interests, not the national interest.

Another of these intangible things is how much your culture prizes education. India and China both have a long tradition of parents telling their children that the greatest thing they can be in life is an engineer or a doctor. But building the schools to make that happen in Mexico simply has not been done. India and China each have more than 50,000 students studying in the United States today. They come from about 12 time zones away. Mexico, which is smaller but right next door, has only about 10,000. Mexico is also right next door to the world's biggest economy, which speaks English. But Mexico has not launched any crash program in English education or invested in scholarships to send large numbers of Mexican students to the United States to study. There is a "disconnect," said President Zedillo, among Mexico's political establishment, the challenges of globalization, and the degree to which anyone is educating and harnessing the Mexican public to this task. You would have to look a long time for a graduate science or math program at an American university that is dominated by Mexican students the way most are dominated by Chinese and Indian students.

The government of President Vicente Fox had set out five areas for reform retail to make the Mexican economy more productive and flexible: labor market reform to make it easier to hire and fire workers, judicial reform to make Mexico's courts less corrupt and capricious, electoral and constitutional reform to rationalize politics, tax collection reform to increase the country's dismal tax harvest, and energy reform to open the energy and electricity markets to foreign investors so that Mexico, a major oil producer, gets out of the crazy bind of importing some natural gas and gasoline from America. But almost all of these initiatives got stalled in the Mexican parliament.

It would be easy to conclude from just looking at Mexico and China that democracy may be a hindrance to reform retail. I think it is premature to conclude that. I think the real issue is leadership. There are democracies that are blessed with leaders who are able to make the sale and get their people focused on reform retail — Margaret Thatcher in England comes to mind — and there are democracies that drift for a long time without biting the bullet — modern Germany, for example. There are autocracies that really get focused — modern China — and there are others that just drift aimlessly, unwilling really to summon their people because the leaders are so illegitimate they are afraid of inflicting any pain — Zimbabwe.

Mexico and Latin America generally have "fantastic potential," says President Zedillo. "Latin America was ahead of everyone 30 years ago, but for 25 years we have been basically stagnant and the others are moving closer and well ahead. Our political systems are not capable of processing and adopting and executing those [reform retail] ideas. We are still discussing prehistory. Things that are taken for granted everywhere we are still discussing as if we are living in the 1960s. To this day you cannot speak openly about a market economy in Latin America." China is moving every month, added Zedillo, "and we are taking years and years to decide on elementary reforms whose needs should be strikingly urgent for any human being. We are not competitive because we don't have infrastructure; you need people to pay taxes. How many new highways have been built connecting Mexico with the US since NAFTA? [Virtually none.] Many people who would benefit from government expenditure don't pay taxes. The only way for government to serve is get people to pay higher taxes, [but] then the populism comes up and kills it."

A Mexican newspaper recently ran a story about how the Converse shoe company was making tennis shoes in China using Mexican glue. "The whole article was about why are we giving them our glue," said Zedillo, "when the right attitude would be how much more glue can we sell them? We still need to break some mental barriers."

It is not that Mexico has failed to modernize its export industries. It is losing ground to China primarily because China has changed even faster and more broadly, particularly in educating knowledge workers. As business consultant Daniel H. Rosen pointed out in an essay in *The International Economy* journal (Spring 2003), Mexico and China both saw their share of global exports grow in many of the same areas during the booming 1990s — from auto parts to electronics to toys and sporting goods — but China's share was growing faster. This was not just because of what China was doing right but because of what Mexico was doing wrong, which was not steadily honing its competitiveness with microreforms. What Mexico succeeded in doing was creating islands of competitiveness, like Monterrey, where it got things right and could take advantage of proximity to the United States, but the Mexican government never had a strategy for melting those islands into the rest of the country. This helps explain why from 1996 to 2002, Mexico's ranking in the Global Competitiveness Report actually fell while China's rose. And this was not just about cheap wages, said Rosen. It was about China's advantages in education, privatization, infrastructure, quality control, mid-level management, and the introduction of new technology.

"So China is eating Mexico's lunch," concluded Rosen, "but more due to the Mexican inability to capitalize on successes and induce broader reform than to China's lower wage workers per se." In other words, it's reform retail, stupid. According to the *Doing Business in 2005* report, it takes an average of 58 days to start a business in Mexico, compared with eight in Singapore and nine in Turkey. It takes 74 days to register a property in Mexico, but only 12 in the United States. Mexico's corporate income tax rate of 34 percent is twice as high as China's.

The *McKinsey Quarterly* report "Beyond Cheap Labor" noted that since 2000, as China joined the WTO and started to take advantage of the flattening of the world, Mexico lost 270,000 assembly jobs, and hundreds of factories closed. But the main advice the report had for Mexico and other middle-income countries feeling squeezed by China was this: "Rather than fixating on jobs lost to China, these countries should remember a fact of economic life: no place can remain the world's low-cost producer forever —

even China will lose that title one day. Instead of trying to defend low-wage assembly jobs, Mexico and other middle-income countries should focus on creating jobs that add higher value. Only if more productive companies with higher-value-added activities replace less productive ones can middle income economies continue down the development path."

In short, the only way for Mexico to thrive is with a strategy of reform retail that will enable it to beat China to the top, not the bottom, because China is not focused on beating Mexico as much as it is on beating America. But winning that kind of race to the top takes intangible focus and will.

You cannot maintain rising standards of living in a flattening world when you are up against competitors who are getting not only their fundamentals right but also their intangibles. China does not just want to get rich. It wants to get powerful. China doesn't just want to learn how to make GM cars. It wants to be GM and put GM out of business. Anyone who doubts that should spend time with young Chinese.

Said Luis Rubio, president of Mexico's Center of Research for Development, "The more self-confidence you have, the more it diminishes your mythologies and complexes. One of the great things about Mexico in the early 1990s was that Mexicans saw that they could do it, they could make it." A lot of that self-confidence, though, has been lost in Mexico in recent years, because the government stopped reforming. "A lack of self-confidence leads a country to keep chewing on the past," added Rubio. "A lack of self-confidence [in Mexico] means that everyone in the country thinks the US is going to take Mexico to the cleaners." That is why NAFTA was so important for Mexico's sell-confidence. "What NAFTA accomplished was to get Mexicans to think forward and outward instead of inward and backward. [But] NAFTA was seen [by its architects] as an end more than a beginning. It was seen as the conclusion of a process of political and economic reforms." Unfortunately, he added, "Mexico did not have a strategy for going forward."

Will Rogers said it a long time ago: "Even if you're on the right track, you'll get run over if you just sit there." The flatter the world gets, the faster that will happen. Mexico got itself on the right track with reform wholesale, but then, for a lot of tangible and intangible reasons, it just sat there and reform retail stalled. The more Mexico just sits there, the more it is going to get run over. And it won't be alone.

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