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Three Billion New Capitalists: The Great Shift of Wealth and Power to the East

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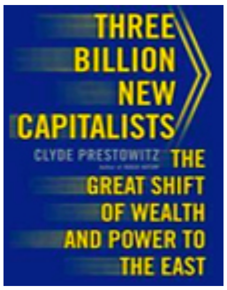

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Introduction

JOANNE MYERS: Good morning. I am Joanne Myers, director of Merrill House Programs. On behalf of the Carnegie Council, I would like to welcome our members, guests, and C-SPAN Book TV to our Books for Breakfast program. Today we are delighted to have back with us Clyde Prestowitz, author of *Three Billion New Capitalists: The Great Shift of Wealth and Power to the East.* At the end of the program, his book will be available for you to purchase.

In perusing the newspapers of recent weeks, one cannot help but read about the uncertainty of the U.S. economy and the decline of U.S. technological leadership. At the same time that our economic role is receding, we are witnessing the reemergence of very strong market economies in China, India, and other parts of Asia. Logic tells us that the time has come for the United States to rethink its strategic economic options, before our economic superiority and competitive edge totally slip away. Yet, for our policymakers in Washington, this approach seems elusive.

In Three Billion New Capitalists, distinguished author, businessman, and policymaker Clyde Prestowitz gives us his diagnosis for why our country is sliding towards economic decline under globalization. In looking at the world's economic future, he suggests that unsustainable U.S. trade deficits, the buildup of massive dollar reserves in Japan and China, the entrance of billions of individuals into the workforce in India and China, combined with the relocation of technological innovation from America to the East and the ease of outsourcing, will shortly bring about the end of the American era of economic leadership. Our speaker believes that these powerful trends will soon be followed by increasing geopolitical strength in Asia as well.

If you were to examine Mr. Prestowitz's passport, you would note that he has spent a great deal of time traveling in Asia. He has led several U.S. trade and investment negotiations with Japan and China, served as consular to the Secretary of Commerce in the Reagan Administration, and acted as vice chairman of the President's Committee on Trade and Investment in the Pacific. He is a founding member of the Asian Pacific Council and continues to sit on its board.

He is also the author of the acclaimed *Trading Places,* and *Rogue Nation,* which was discussed here at the Carnegie Council not so long ago. With firsthand experience and not only a clear grasp of the economic challenges that lie ahead but a recognition of what needs to be done to address them, our speaker will share with us just how fragile our current economic position really is.

Please join me in welcoming the current President of the Economic Strategy Institute in Washington and author of *Three Billion Capitalists,* Clyde Prestowitz.

Remarks

CLYDE PRESTOWITZ: Joanne, thank you very much. It really is a pleasure to be back here. I love this group. I spoke here two years ago when I published *Rogue Nation.* I think it was actually my kickoff speech. It was great fun. I enjoyed it. I am really pleased that so many of you decided to come back and try me again.

We meet this morning, of course, in the shadow of the French *non* to the European constitution. I was at a dinner party last night where the implications of the French vote were greatly discussed. I was asked my view of what the significance of the vote was. I said I thought it had a lot of different implications and significances, but if I were to ask myself what is kind of underlying this anxiety that clearly is bothering the French, I would say that it has to do with concern about globalization.

I was in France about three weeks ago and did my normal cabdriver survey and gleaned from that that there was great concern in Paris about the Polish, Hungarian and Turkish workers coming in and taking French jobs. That is, ultimately, a concern about globalization and confirmed what I have been sensing for quite some time.

Globalization has been embraced by the United States — in fact, so much so that in most of the world they don't call it "globalization"; they call it "Americanization." In the 1990s, President Clinton articulated that globalization is the strategy of America. The idea was that through globalization, economic development around the world would take place rapidly; and as developing countries became richer, they would become more democratic; and as they became more democratic, they would be less likely to go to war with each other, because we have this conviction that democracies don't go to war with each other.

So the notion was that through globalization, the world would get rich, it would become democratic, and it would be peaceful — and it wouldn't cost anything, because it would all be done through open markets and free trade. It was and is a beautiful dream, but I suggest that it is a dream that is in trouble.

I guess I first had an epiphany of some of the trouble on a ski lift about two years ago. My oldest son lives in Truckee, California, near Lake Tahoe. He is a software developer and a big-time skier. Actually, I guess I should say it the other way around: he is a big-time skier and a software developer.

Anyhow, we were on the lift, and he said to me, "Dad, how would you like to co-invest with me?"

"In what?"

"Well," he said, "There's this snow removal company here in Tahoe that I'm interested in."

"What in the name of creation is snow removal? Shovels or what?"

He said, "No. It's a ski resort, and it snows a lot between October and May, and the hotels and the condos and the restaurants have to be plowed. This company has the plows and the contracts to do the plowing."

"Do they make any money?"

"Oh, yeah, the guy makes enough money in six months that he takes the other six months off."

"Sounds pretty good. Send me the numbers. Maybe I'll put in a few bucks. But wait a minute. I don't get it. You're a software guy. Remember when you went to college, you asked me what to study, and I told you computer science. That's the future. You can write your own ticket. And you did it — the one time in your life that you took my advice. You did it. Maybe I'll put a few bucks in, but you're a software guy. Why are we talking snow removal?"

In a tone of exasperation, he says to me, "Dad, don't you get it? They can't move the snow to India."

That got my attention. I was on my way to China. I hadn't been to India for a very long time. I thought, "What the heck, I will just keep on going."

So I went to China, which, as you all know, is always an epiphany. If you haven't been to China for two weeks, it has changed pretty much completely since the last time you were there.

On this particular trip, I happened to stop to see my old friend Richard Chang, who is now the head of Shanghai Semiconductor, Inc. Richard is from Taiwan — an interesting story. He is actually from the Mainland; got to Taiwan in 1947-1948, grew up in Taiwan; went to NYU, got his Ph.D. in electrical engineering at NYU; went to work for Texas Instruments for a number of years; wound up back in Taiwan, in one of the early semiconductor foundry operations; and then raised money and has now put a new semiconductor foundry in Shanghai.

So the lesson of this last trip was that the Chinese not only make textiles and cheap toys; they also make semiconductors and very advanced technology. But China was something of a known quantity. Then I went on to India.

I have to say I was blown away. I am on Intel's advisory board. Intel arranged a number of meetings for me in India, one of which was their own operation. Intel has 2,000 Ph.D. electrical engineers in Bangalore designing absolutely the latest chips. In fact, the Intel team in Bangalore is teamed with a group at Oregon, so when Oregon sleeps Bangalore works, and when Bangalore sleeps Oregon works. Both teams are right at the cutting edge.

Even more interestingly, I visited the Apollo Hospital in Hyderabad, and I discovered a whole new export industry that I had never thought of existing. It is called "medical tourism." It works like this: Maybe you need a new heart — you are in line, but you haven't been able to get a heart yet — or you need a new hip or something like that. There is an 800 number here in New York City for the Apollo Hospital. You call them up, book your trip. Airfare, heart, side trip to the Taj Mahal, private nursing care — all for about 15 percent of what it would cost you here — surgery done by board-certified U.S. surgeons, trained in U.S. medical schools. This is a billion-dollar industry in India today.

I went from there to Delhi and had this really funny, wonderful experience. You have all heard of these call centers. I went to a call center on the outskirts of Delhi. I got there about 1:00 in the morning, which is when these the peak of the day for these places because of the time difference with the East Coast of the United States. I was in a section of the call center known as the AOL Retention Center. What that means is that if you are an AOL customer and you are really fed up and you dial the 800 number to cancel, this is where your call goes. The job of the people in the retention center is to convince you to stay with AOL.

So I was talking to some of these young people — they are all young people in the AOL Retention Center — in particular to this Indian gal named Nishat, who explained to me that she was taking a year off from college to earn some money and to have some fun, because, she said, "This is really a fun job." These are all young kids, and the atmosphere is kind of a college dorm. They have motivational signs on the wall: "Win!" "Sell up!" "We add value!"

Anyhow, while I was talking to her, a call came in from Bob in Camden, New Jersey. I used to live in Camden, New Jersey. I thought, "I'm going to listen to Bob. Maybe I know Bob." So I pick up on the other line, and Nishat answers. She has a screen name. Her screen name is Megan.

Bob is really upset, believe me he is really upset, he does not want one more second of AOL.

Nishat/Megan says soothingly, "Bob, my name is Megan. I know you're really upset, and I want to help you as much as I can. Just tell me a little bit about what you do with your computer. Do you use Instant Messaging? Did you know you could do that? Have you ever tried that? I could offer you this."

She gets him talking, and he's calming down, and he's beginning to get into it. She's reeling him in. He's just about at the boat, and he hesitates. With perfect timing and perfect intonation, she says, "Bob, trust me. Believe me, it will be okay. You can call me if it doesn't work." Bob jumps right in the boat and signs up for another year of AOL.

I said, "Megan, that's really good. What's your hit rate?" She said, "Oh, about 80 percent."

She's AOL's secret weapon, right? I am thinking, "Wow, this is incredible. I am ten time zones from Bob. I might as well be in his living room." So I found that all very impressive.

But what really grabbed my attention, actually, was the trip home. I flew back out of Bombay. I came back through Charles de Gaulle Airport in Paris. While stopping over, I picked up a bunch of newspapers, one of which was *The Guardian* of London. I kid you not, the front page lead story of *The Guardian* was about the British National Health Service — it is in the red — trying to cut costs. They have a new scheme, which is that they are going to fly their blood samples to India and have the analysis done in Indian labs and the results emailed back to London.

So I fly home. I get into Washington. It is tax time. I go see my tax accountant, a small local firm in Bethesda, Maryland. I am talking taxes and just making small talk. My accountant says, "Have you taken any trips recently?"

"Yeah, I'm just back from India."

"India," he says, "we just moved our whole back office to Bangalore." He says, "Your taxes are going to be done in Bangalore."

Then about a week after that, I was here in New York. I went to see Steve Roach, the chief economist at Morgan Stanley. I happened to notice a lot of empty offices. I said, "Steve, what's the matter? Is business bad?" "No, no, no. We moved half of our staff to Bombay."

So what we are seeing is a revolution, in two ways. One way is that we have, in the last ten, twelve years, seen 3 billion people — China, India, and the former Soviet countries — come into what we have been calling the global economy. Of course, it hasn't been a global economy, because half of the world's population has not been in it. But we have been calling it a "global economy." It is like the World Series — we only play it in America, but we call it "the World Series."

We have been calling it a "global economy." We have been calling it "globalization." Everybody else calls it "Americanization." But now it is getting really global, because we have brought these 3 billion people into the system. This has never happened before. We have never had this huge a shift in the number of people who have suddenly entered into the global capitalist market economy.

Moreover, when developing countries have come into the system in the past — Korea, Japan, Taiwan, places like that — they have been relatively small with regard to the rest of the global economy, and we have become accustomed to thinking of developing countries as countries that are poor and that have cheap labor, and the labor is cheap because the labor is unskilled. So we are accustomed to thinking of these countries as countries that concentrate on doing unskilled, labor-intensive tasks.

Typically, textiles and apparel are the first industries that they go into in the chain of development. We have developed a whole paradigm in which we think of developing countries undertaking labor-intensive manufacturing, while developed countries move to higher-value-added manufacturing, move to high technology, move to innovation and R&D, and to services and sophisticated design, and up the scale of value-added.

What is interesting about these 3 billion people is that, while, on average, they are poor and while most of them are unskilled, there are such a large number of them — and a small percentage of 3 billion is still a lot of people.

So within these 3 billion people there is a very large population — 300 million, as large as the United States, ; larger than any European country, larger than Japan — that is highly skilled, that can do anything that can be done in Japan or Europe or the West, for fifteen cents on the dollar. So you have a unique combination of high skill and low cost, which has really never been seen in the global economy before. So that is kind of the first revolution.

But the second part makes it even better. That is, this group of people is arriving in the global economy at just the moment when a second revolution is removing the basis of most of the assumptions of international trade theory and of globalization as we have known it.

Adam Smith and David Ricardo, the iconic founders of market economics and capitalism and free trade, of course, developed their thinking in the eighteenth and nineteenth centuries. At the time, things like economies of scale were pretty much unknown and were not included in much of the analysis. Even more significantly, it was assumed at the time, and has continued to pretty much be assumed in international trade theory, that technology and capital and labor don't move easily from one country to the next, that they are more or less immobile; that products move, but that capital and labor and technology are kind of indigenous.

With the Internet, it is two seconds, anywhere in the world. From here to Bangalore, from here to Cape Town, it is two seconds — the speed of light. So anything that you can do digitally or electronically — software, call centers, — time and distance are basically gone. Even if you work in atoms, even if you still are old-fashioned and you make things and ship things, FedEx can deliver anywhere in the world in, maximum, thirty-six hours. So, effectively, even in atoms, time and distance have been negated.

It means that Bob really is right next-door if you are in Delhi. For example, I just bought a new IBM laptop computer. I traced the root of my computer. It is an interesting journey. The computer has a Pentium chip, which began as a cylinder of silicon in Korea that FedEx carried to Albuquerque, New Mexico, where it was turned into a wafer. That wafer then went back to Albuquerque Airport, to San Francisco, to Narita, to Penang, Malaysia, where it was cut, assembled, and tested. It then went to Zhuhai, China, where it met up with the flat panel that was coming in from Japan and the hard drive that came in from Singapore and the memory chips that came in from Taiwan. It was all assembled by a company called Flextronics, which, probably, none of you have ever heard tell of, which is the actual assembler and manufacturer not only of my IBM ThinkPad, but of your HP printers and lots of other things that have other people's labels on them &,mdash; Dell computers and so forth.

Then it flew from Zhuhai to Shanghai, got on FedEx Flight 24 from Shanghai to Memphis, seventeen-and-a-half hours, sorted out, on another plane, and at my house at 11:30 in the morning. It took four days for me to get my computer. All those materials went through that loop in those four days. That is how the system of globalization works today.

So what that means is that my son, my software-developer son, wasn't so crazy. He is in competition with the software developers in India. Call-center people here in New York are in competition with call-center people in India. It is a whole new world of international competition that we haven't ever seen before. Part of the issue here in responding to it is that our policymakers and our economists have not absorbed this into their thinking. They are still operating on the basis of Adam Smith and David Ricardo's assumptions, which essentially no longer really hold together.

So this is one part of the story and one part of how globalization is changing dramatically — it is no longer Americanization; it truly is globalization — and how it is changing the nature of the game dramatically. It is also changing the nature of the game dramatically at a moment when the whole global economy is distorted and under enormous stress. Let me explain what I mean.

If you look at the structure of the global economy, my friend Tom Friedman talks about the earth being flat. I agree with what he says in terms of the flattening by dint of the Internet and FedEx and so forth. But it is really tilted. It may be flat, but it is kind of tilted. It is tilted because, in this whole system, there is one consumer. The United States. We are the world's all-time champion superpower, hyper-power consumer. We consume $700 billion more than we produce. We are such great consumers that, when we go to war, our president tells us, "Go buy more." It is not, "Buy war bonds," not, "Save," but, "Buy more, and by the way, here's a tax cut to help you buy more." We really consume.

Think of yourself as an individual who makes $100,000 a year and spends $150,000. You are going to borrow the $50,000 somewhere. Maybe you take a home equity loan or borrow it some other way, but you have to borrow. That is what we do as a country. We spend $700 billion a year more than we produce, so we have to borrow that $700 billion. We do, and we get it from all of our friends abroad. But importantly, we get a big chunk of it from the Central Bank of China and from the Central Bank of Japan, who buy our treasuries. That feels good, too, because interest rates stay low, mortgage rates stay low, and people can get good rates on their home equity loans, so that they can go buy more. As housing prices move up, they can get bigger loans and buy more. So everybody feels really good here in the United States.

The rest of the world are sellers — the Japanese, the Chinese, the EU. The rest of the world saves, invests, produces, exports to us, and they lend us money — kind of vendor financing — so that we can continue to buy their goods.

If everybody in this game could or would guarantee to keep doing exactly what they are doing, this would be perfect. We would get to have a party indefinitely in the United States, live way above our means forever. What could be better than that? The rest of the world likes this, too, because it facilitates their development, their growth. It tends to sweep technology and sweep know-how away from the West, away from the U.S., into Asia and helps them catch up. It serves their strategic purposes.

You may wonder, why are they lending us all this money? Why is the Bank of China accumulating these huge dollar holdings — $800 billion in the bank of China, almost $1 trillion in the Bank of Japan? Why are they holding all this stuff? Sometimes they ask themselves the question, too, which is part of the problem.

But one of the reasons is because it serves not just an economic purpose, it serves a geopolitical purpose. If any of you remember the Asian financial crisis of 1997-98, you remember that some of the Asian countries were in debt, they were essentially bankrupt, and what happened? The IMF [International Monetary Fund] came in and gave them a program. In their eyes, the IMF is a front for the U.S. Treasury, and they are not so crazy. They saw and they felt — and they still feel — that their destiny was pretty much dictated by the U.S. Treasury. "That," they say, "is not going to happen again. No, siree, Bob! We're going to have dollars, come hell or high water. The IMF is not going to tell us what to do, or the U.S. Treasury." That's one thing.

The second thing is this: think about China in particular. This is just a scenario, but there is this little issue of Taiwan. The Taiwanese keep talking about declaring independence. The mainland Chinese keep talking about going to war if the Taiwanese declare independence. We keep saying that we are going to defend Taiwan to the last American. Imagine that this gets out of hand and there is a declaration of independence, and the landing boats start to be unloaded across from the Straits of Taiwan by the Chinese, and the Taiwanese call up Washington and ask for the Seventh Fleet. It is not hard to imagine that the head of the Central Bank of China might call the Secretary of the Treasury and say something like, "John, do you know how many dollars we have?" I am not saying it would happen, but you have to understand the geopolitical elements of this interdependence that is kind of growing up willy-nilly.

But the real danger here is not that one. First, I want to make clear is that I have lived my whole life and spent my whole career as a globalist. I have lived half my life outside the United States. I have spent my whole career in international business, international government, international negotiations. I believe in internationalism. I believe that globalization is, one, inevitable, and two, can be the answer to a lot of the world's problems.

But there are different ways to approach globalization. The difficulty is that the way that we are approaching globalization right now is a way in which there are really two games being played. All these countries are members of the World Trade Organization. Many of them are members of the OECD [Organisation for Economic Co-operation and Development] and the International Monetary Fund. So the presumption, and the way this is presented to the press and to the public, is that we are all playing the same game.

But the truth is that, in the world of economics, it is a bipolar world. Part of the world is playing what I would call "dirty free trade." That would include us, the Canadians, the Mexicans, the EU, the Chileans, the Aussies. When I say "dirty free trade," what I mean is that they are not pure. We protect the sugar industry. We put tariffs on steel every once in a while. We are far from pure in our approach to free trade. But on balance, we believe in markets. The objective of our policies is essentially consumer welfare. The system is pretty transparent. We have a rule of law. We believe in competition. So it is consumer-oriented dirty free trade.

There is a whole different set of countries, particularly in Asia, who are playing mercantilism. It is interesting to see how that works out.

Recently, as you all know, IBM sold its PC division to China's Lenovo. After the sale, IBM's CEO, Sam Palmisano, gave an interview to *The New York Times,* in which he explained that before initiating negotiations with Lenovo, he had gone to China and he had met not with the head of Lenovo, but with the top leaders of China, Jiang Zemin, and Hu Jintao, and talked to them about their plans for China's development; if IBM sold its division to a Chinese company, whether that would fit kind of with their thinking about the future of China. They said, "Yes, that's exactly what we want."

So having gotten the green light, he then did the deal with Lenovo and then gave this interview to *The New York Times,* in which he said that IBM wants to be part of China's strategy. Interesting — part of China's strategy.

I am not criticizing Sam Palmisano. If I were he, I would be wanting to be part of China's strategy, too. It is big; it is going to be bigger. IBM needs to be there. But it raises an interesting question in my mind: Does anybody want to be part of America's strategy? The answer is no. Why not? Because we don't have a strategy. That is the point. A number of countries have strategic economics. They do have a strategy. China happens to be one of them. It is not the only one. Singapore, Malaysia, Japan — they all have strategies. These countries that have strategies operate in the following way:

They all have very high savings rates. These savings rates are high not because of Confucian principles, but because there is compulsion; there are strong incentives to save. In Singapore, they just take 40 percent of your check and put it in the Provident Fund before you get your check, and that is your savings.

They all have relatively low consumption rates. It doesn't mean they are not good consumers. If you see them, as individuals, shopping, they shop like crazy. You know that, if you see a bunch of Japanese shoppers. But if you look at their GDP, consumption is not a high percentage of GDP, because, again, there are all kinds of incentives in the system to make it hard to spend that much money. So consumption is low; savings is high.

They all have export-led growth strategies. They all are focusing explicitly on achieving growth by promoting exports. To do that, they manage the dollar. They either peg their currency or they intervene massively in exchange markets to keep the dollar artificially high against their currencies, in order to facilitate these exports.

The objective here is to accumulate surpluses and to accumulate big dollar reserves, for the purposes that I explained earlier. This is the strategy.

So you have one set of countries that is playing strategic economics and another set of countries that is kind of playing dirty free trade.

Think about the significance of the dollar being the world's money. It is so nice if you are American. You have a unique privilege. If you buy oil, as an American, all you have to do is print green pictures of presidents. You print those and give them to the oil producers, and they give you oil. Or you give them to the Japanese auto producers, and they give you autos — whatever. You just carry around these green pictures of presidents and hand them out to everybody and get whatever you want. It is great.

If you are French or Japanese or German or whatever, you have to build a Mercedes or a Lexus or produce some Camembert or something, and sell it to the Americans to get dollars. Then you take those dollars and buy your oil.

So we are relieved of any real pressure to be fiscally responsible. We can, as Dick Cheney said, say deficits don't matter, because we can just print these things. The interesting thing is that it also means the other guys don't have to be fiscally responsible either, because they manage our dollar. By managing our dollar — I said we don't save anything — they save too much. There is such a thing as too much savings. They save too much. But they can manage that, because they manage our dollar, for a while — actually, for a long time.

The only difficulty is that with the continuation of this structure, you have this enormous trade deficit in the United States, all the other countries lending us more and more money to keep this kind of Ponzi-scheme system going; it is ultimately not sustainable. The players cannot and will not promise to keep doing it, because they can't promise to keep doing it. The United States is now soaking up 80 percent of global savings. Obviously, when you hit 100 percent, the music stops.

Paul Volcker has said that there is a 75 percent chance of a major global financial crisis within the next five years. Warren Buffett is betting $21 billion — the $21 billion he has put into foreign currencies &mash; he is betting that against the dollar. George Soros is making a big bet against the dollar. All of them recognize that ultimately the system doesn't compute. There is a crisis or a huge adjustment somewhere in our future.

The effect of these 3 billion newcomers — their objective is to get rich, and the way they are thinking of getting rich is to sell more to us — the effect is only to accelerate and exacerbate this movement.

We want these people to succeed, after all. I don't want China not to succeed. The most dangerous thing in the world would be a failed China or a failed India. Believe me, these countries have enormous challenges, such as pollution and energy and water shortages. I want them to succeed. I want them to get rich.

The question is, how can we help them get rich and stay rich ourselves? The answer we have been giving ourselves is technology — we have to be smarter, we have to innovate, we have to do the next new thing. The difficulty is that we keep saying that we are going to do the next new thing, but just last month, the government agency that invented the Internet — think about that for a minute. If I say a government agency invented the Internet, a lot of American audiences are dumbfounded, because they assume that it must have been some Silicon Valley entrepreneur. But it was the Defense Advanced Research Projects Agency that invented the Internet. That agency just had its budget chopped.

Imagine: Who here could live without email? What body here could live for a day without email? The

Internet has become part of us in the last ten years. That was the next new thing ten years ago. But DARPA just had its budget chopped. So we are not doing the things necessary to provide for that future.

The structure that I just mentioned is one which facilitates the movement of this technology out of the United States and out of the West. I mentioned IBM and the sale of the PC division. You may think the PC division is high-tech, but it is pretty commodity high-tech.

But Intel's CEO, Paul Otellini, recently told a presidential advisory panel that in the future Intel's plants, Intel's semiconductor factories, may well be built outside the United States. That should have been seen as a nuclear detonation. Intel is not General Motors. Intel is not the textile industry. Intel is one of the two or three top technology companies in the world. It dominates this industry. It is a huge developer of the next new things.

Otellini further told this presidential panel that if he were to make a decision based solely on market considerations — in other words, the cost of production, the quality of production, the distribution of the product — there are great advantages to keeping the factories in the United States. And that is logical, because according to all the international economic theories, that is what we should be good at; that is what we should be producing. So that makes sense.

Yet he is telling this panel that those plants may not stay in the United States. Why the heck not? Because Singapore, Israel, Ireland, China — you name it &mash; are crawling all over Intel, and they are saying, "How would you like a tax holiday for fifty years? How about a capital grant? How about free land? How about free labor training? How about free anything? What will it take to get your factory?" Those are not market forces.

But the really interesting thing to me is not so much that all these other countries are offering these enticements to get the factories. The really interesting thing is that there has been no telephone call from the White House or the Secretary of Commerce or even a low-ranking official in the Commerce Department. Nobody in the Commerce Department even knows that Intel might be planning a new plant. This is not something that is on anybody's radar screen. So because nobody in the United States is paying attention to this stuff, it is very likely that this will begin to slip. Mark my words — and I have a gentleman here, whom I am going to introduce in a couple of minutes, who can tell you from personal experience the significance of the movement of these plants and these factories.

But the reason that these countries offer such fancy enticements is because they don't see it as a factory; they see these things as a university. They see them as a magnet to attract other investment by suppliers and financiers and so forth. They see these things as an investment in their long-term infrastructure. That is why they are willing to kind of give the plants away.

The fallacy here is that we tend to think of development and innovation in terms of the linear progression. You begin with a couple of scientists in a lab, and they invent something, and then you go to applied technology, and then you go to development, and then you go to commercialization and, finally, to production. That is not the way it works. Very frequently, the first idea comes from the factory floor, and then they take it back to the lab. It is an iterative process. If you don't have the chain, if you are not linked, if you are out of the business, forget it. It becomes prohibitive, once you are out of the business, to get back in the business.

It is so frustrating to me because, if you thought of the international globalization game as a bridge match and you asked yourself, whose hand would I want to play — the Japanese hand or the Chinese hand or the American hand — believe me, I would take the American hand, even with all the problems I just mentioned. We have more aces and more trumps than anybody else. We still have the best graduate schools. We still have the best science and technology. We have the best system for innovation. We have stable institutions, rule of law, transparency. We have lots and lots of aces and trumps.

But we are playing them like a bunch of klutzes. We need to get a strategy. We need to start playing like we are serious about playing bridge. I don't want to leave you hopeless. I just want to leave you motivated to get America thinking about getting real and responding to and trying to get the structure of globalization right. I could go on for a long time. I have lots of policy prescriptions and so forth. But the best way for you to learn about them is to read the book.

Before we get to questions, I said I wanted to introduce somebody. Richard Elkus is the developer of the first videocassette recorder. He announced this product in 1970. It was on the cover of *Life* magazine, and was a breakthrough accomplishment. Yet you know that there are no videocassette recorders made in the United States today. Many of you have digital cameras. The core of the digital camera is a charge-coupled device. Those charge-coupled devices all came out of the videocassette recorder. They are all made in Japan.

The story of the videocassette recorder and how it went from being a Dick Elkus invention to a Japanese monopoly, and to digital cameras and flat-panel displays, is in the book. It is a fascinating story. But it is also the story of what happens to you when you get out of these linkages, when you say, "Oh, we'll put our factory over here," like RCA, "and we'll just put our name on the product." Who has ever heard of RCA anymore? Some old guys here, but my kids wouldn't know what RCA was. That is a story that Dick Elkus can tell you in spades. So as we answer these questions, I might turn some of them over to Dick as well.

Questions and Answers

QUESTION: At the Council we have had Tom Friedman. We had xenophobic Lou Dobbs. Now once again we are hearing that, somehow or other, American strategy is not a strategy, that capitalism doesn't have some inherent direction, and that we are challenged by regulated economies and by the normal growth and globalization of the world.

We are in changing times. It turns out that IBM's computer system was basically sort of irrelevant. We now have Dell, and Dell can produce it just as fast. IBM recognized that. IBM, as a huge monolithic company, may, because of its size, not be the IBM that we all learned to think was our major firm.

Relative to China, we may have a housing bubble in China. China needs our money as much as we need their goods. It is a symbiotic relationship that our government is very, very aware of. I just raise the question of whether or not there is sort of this alarmist view of changes in the world.

Every day I am astonished, in the capitalistic world, by the new remarkable companies. Flextronics was an IPO company at one time. It may not be American. Every day there is new science, new technology — whether or not we agree with the defense policy, the defense industry of our country is so technologically adroit, so phenomenally ahead of the rest of the world, that to say that America is not technologically aware or strategic, I feel, is somehow or other a distortion.

I just question this overall alarmist view that Americans are dealing with, that all of our industries are moving apart. We are in a world. We are dealing in the world as best we can. We are not giving up our strategy.

CLYDE PRESTOWITZ: You said we are not giving up our strategy. A lot of people are saying, what is our strategy? How would you describe our strategy?

QUESTIONER: It is a capitalistic natural growth of new changes, new companies, the demise of companies, the ingenuity of capitalism.

CLYDE PRESTOWITZ: Creative destruction.

QUESTIONER: I don't want to make rhetorical triteness out of a system that is very hard to place in the rest of the world. These regulated economies — we see what's happened in Europe. We see how slow the economies are in Europe. We see how they respond to the changing world. There's enormous growth. We had Hugh Pope here a few weeks ago, who spoke about the Turkic people. Remarkably, this clan of nomads out somewhere in the world that most people don't know are becoming quite affluent. They are actually investing. They are building hotels. They have managed to adjust to a changing world. I think there is some alarmism here because it sounds good — we are giving our industries away; we are giving IBM away. I don't see our country going down the drain so fast.

CLYDE PRESTOWITZ: Let me respond quickly. You are interpreting my comments about IBM as if I'm concerned that somehow the PC division went to Lenovo. I thought I emphasized that I don't see it as particularly significant, number one. Number two, I thought I emphasized that I want China to succeed. So I think you may be inferring something I didn't mean to imply.

What I tried to get at there, the point of that story, is that Palmisano felt a need to somehow deal with the Chinese government in a way that he doesn't deal with the U.S. government. He went and consulted them before he made this sale. He didn't consult the U.S. government before he made the sale. I am not saying that we necessarily want him to. But what I am saying is that in a world in which he feels the need to consult the Chinese government and not the U.S. government, the ultimate structure of that kind of an economy is likely to be much more along the lines of Chinese thinking than along the lines of free-market, open-market capitalism, which, you say, is our strategy, and which kind of is our strategy.

My point here is not to say that China is bad or evil or that we ought to be afraid of China. It's much more to say that we need to understand the game China is playing and then play our own game so that we maintain our position. In the absence of an American consideration, in the absence of an American strategy, de facto, the decisions get made in Beijing. Not surprisingly, Beijing may not always make decisions that you think are best for us.

But more broadly, to respond to your point, I think that in the debate between free trade and mercantilism, it has typically been the argument of the free-trade community in the West that mercantilism only hurts the mercantilists, that if the Europeans want to subsidize the Airbus or if the Chinese want to give away free factories, they're only hurting themselves. These are subsidies which are a misallocation of their own resources. They are hurting themselves. It's too bad they're doing that, but don't worry about it because it doesn't hurt you.

I think there is now enough evidence, both empirical and theoretical, to demonstrate that it may be that the Europeans are misallocating their resources when they subsidize the Airbus, it may be they're hurting themselves, but for sure they're hurting Boeing and they're hurting the U.S. economy as well. The argument I would make is that, since that is the case, then you need to be aware of that and either decide you want to accept the pain or take some action, such as negotiating with them. Remember, all these countries are in the World Trade Organization. They're all basically committed not to do that kind of thing. So we should be able to negotiate and to use the international tools to create a much more even game.

QUESTION: Could you discuss a little bit how you see the tilting being righted at some point?

CLYDE PRESTOWITZ: I told you you have to read the book.

QUESTIONER: As a part of that, do you see any currency on the horizon, in the foreseeable future, being able to replace the dollar?

CLYDE PRESTOWITZ: There is a big fix and a little fix. The big fix is at the macro level. Because of this kind of symbiosis that the previous questioner mentioned, although the United States is, in my view, over-consuming, if we were suddenly to reduce that consumption — if we suddenly all got a savings book and the rest of the world did not get a consumption book — the whole thing goes kersplat. So there has to be a deal here where we somehow credibly decide to consume less, which means, basically, reducing our federal budget deficit, and the rest of the world credibly takes steps to stimulate their economies and consume more, which probably means opening up their consumer credit. That has to be a deal among the major players, and it has to be accompanied by a currency arrangement of some kind.

The dollar is going to have to devalue dramatically. I'm talking about a dollar that might be 150 or 160 euros — 1.6 dollars to a euro. I'm talking about a yen that might be 75 yen to a dollar — a dramatic shift in the dollar. This would all have to be kind of orchestrated among the major players, and hopefully happen gradually over a period of time.

QUESTIONER: But if there is no deal, how would the market forces right it?

CLYDE PRESTOWITZ: A very good question. The answer is, nobody really knows. Volcker says there is a 75 percent chance of a crisis. But when, how exactly, nobody knows. But take a couple of scenarios. A month or so ago, a minor official in the Central Bank of Korea — Korea is a small player — uses the word "diversification," implying, maybe, that the Koreans will move out of dollars. Instant reaction in the markets. General Motors' bonds go to junk. It turns out that a couple of hedge funds were wrong-footed. A big ripple in the markets.

One could easily imagine another long-term credit management kind of scenario, where a hedge fund or a derivative trader gets caught out. As you know from long-term credit management, it's not even that the bet has to be wrong. Long-term credit management's bet was right. It just didn't happen when it was supposed to. So that kind of thing coming from a minor player.

China and Japan have such a big stake, they're going to be very careful. They're not going to act recklessly, unless it's something like Taiwan. But there are smaller players. Russia is a player. They have $150 billion in the bank. They don't sell much to us. They don't have a stake in exporting to us. Bush makes a trip to Armenia or something and says something Putin doesn't like. Putin calls his finance minister and says, "Let's shoot a shot across the bow. Dump a few billion dollars." Who knows?

More likely, the Bank of New Zealand — I don't know how many dollars the Bank of New Zealand has. But they have to manage their assets. So there is probably some smart MBA down in the Bank of New Zealand who's managing these assets, and he'll try to be a good guy and make a profit for his bank. He's looking around and he says, "We've got too many dollars. We'll sell some off." He does it at the right time — the market is maybe not too busy at that particular moment — and bang, you get a cascade. I don't know exactly how it happens, but the nightmare scenario is that there's something like that, and you get some kind of a cascade effect. Obviously, everybody is watching everybody like hawks, because the first guys out will do better than the last guys out. So there is a rush to the door as soon as there is any kind of movement at all.

But, actually, it's the other scenario that bothers me more. In a way, I'm kind of disappointed in the French vote, because I think that the French vote undermines the credibility of the euro as an alternative to the dollar, which means that there is likely to be an extension of this dollar lending that we've been seeing for much longer. The pernicious aspect of that is that we're already $3 trillion net debtors to the world. So now we get to $6 trillion or $7 trillion or $8 trillion or $9 trillion. I don't know what it is, but it gets really big.

These are claims on future U.S. income streams. These are claims on the standard of living of our kids and our grandchildren. Either you pay it or you inflate it away. But any way you do it, it's costly. The bigger it gets, the more costly it is — and not just costly economically, but it's hard to imagine hyper-power, superpower, uni-power America, with troops all over the place, inflating away $9 trillion of international debt. So it's pretty serious, even in the soft-landing scenario.

JOANNE MYERS: Unfortunately, our time is up. I want to thank you for raising these issues. It was a terrific presentation. I just want to remind you that his book is available for you to purchase at the end of the talk today. Thank you.