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# They Are Not Us

## Why American Ownership Still Matters

Laura D'Andrea Tyson

Like "Engine" Charlie Wilson, the colorful chief executive of General Motors in the years after World War II, most Americans intuitively assume that what is good for American companies like GM is good for the nation. The competitiveness of the U.S. economy, most Americans believe, means the competitiveness of corporations based in the United States. This identity of interests has been so widely taken for granted that only a few theoreticians of the obvious, like Engine Charlie and Calvin Coolidge ("The business of America is business"), have ever seen a need to express it.

The tradition of identifying nations and corporations extends far back into the past when corporations served the monarchs who gave them special charters. But whether that premise makes sense today is not at all clear. The actual behavior of many American corporations shows that

they do not always act as if national loyalty were their guiding motivation. Corporations are quick to relocate to remote countries with lower wages, less demanding social standards, or national laws requiring local production.

Indeed, some are now suggesting that national corporations are entirely a thing of the past. In several articles and an upcoming book that have crystallized the issue, Robert B. Reich warns that as American companies have become ever more global in their operations, the links between them and the U.S. economy are rapidly disappearing, and so policymakers must distinguish sharply between American economic interests and the economic interests of American companies.<sup>1</sup> Whether the U.S.

can provide high-wage jobs and support rising living standards depends, in Reich's view, less on the strength of American companies than on the strength and competitiveness of the economic activities located within our borders.

On this fundamental insight, Reich's logic is persuasive. He has framed precisely the right question: How are we to disentangle the interest of the nation-based corporation from that of the nation and its citizens? But the specifics of his analysis and his policy inferences can be challenged in two key respects.

First, his picture is, at best, premature. The economic fate of nations is still tied closely to the success of their domestically based corporations. Second, he assumes that globalization implies a symmetry of national economic policies, when in reality there are wide disparities. Many foreign markets are highly regulated, often to

1. Robert B. Reich, "Who Is Us?" *Harvard Business Review* (Jan.-Feb. 1990), 53-64, and *The Work of Nations: Preparing Ourselves for 21st-Century Capitalism* (Alfred A. Knopf, 1991).

America's disadvantage. Consequently America cannot just foster the best possible workforce and then rely on market forces to bring high-wage jobs to our shores.

Reich argues his case by contrasting two hypothetical corporations. Corporation A, headquartered in the United States and owned by American investors, is an American company. But it is also a global one: Most of its employees are non-Americans, and it undertakes much of its research and development and product design and most of its complex manufacturing outside of the United States.

Corporation B, headquartered in a foreign country and owned primarily by

*Despite globalization, the competitiveness of the U.S. economy remains tightly linked to the competitiveness of U.S. companies.*

foreign investors, is a foreign company. But like Corporation A, it is also a global company: Much of its R&D and product design and most of its employment and manufacturing are located abroad—in the U.S.

Which of these two corporations is more important to the economic future of the United States? Or, as Reich asks, "Who is Us?"—Corporation A, the American company, or Corporation B, the foreign company? The answer seems obvious and counter to conventional wisdom.

But is the question fair? Have a significant number of American companies really globalized to such an extent that most of their economic activities are located abroad? And have foreign companies increased their investment in the United States so much that they now contribute as much or more to national economic com-

petitiveness than American companies? Although both American and foreign companies are indeed becoming more global, as Reich suggests, the answer to both questions, for now and for the foreseeable future, is "no."

### *We Are Us*

Despite several decades of substantial foreign direct investment by U.S. multinationals, the competitiveness of the U.S. economy remains tightly linked to the competitiveness of U.S. companies. U.S. multinationals still locate the lion's share of their worldwide operations within the U.S. In 1988, the last year for which data are available, U.S. parent operations accounted for 78 percent of the total assets, 70 percent of the total sales, and 74 percent of the total employment of U.S. multinationals.<sup>2</sup> All of these shares were actually higher in 1988 than they were in 1977, the reverse of what one would expect if the links between the domestic economy and U.S. multinationals were precipitously disappearing, as Reich argues.

Within manufacturing, U.S. parent operations accounted for 78 percent of the total assets, 70 percent of the total sales, and 70 percent of the total employment of U.S. multinationals in 1988. The data reveal, moreover, that parent operations provided more productive jobs than affiliate operations. Assets per employee in the manufacturing parent operations were about 20 percent higher than in affiliate operations in developed countries and almost 200 percent higher than in affiliate operations in the developing countries. Similarly, compensation per employee in parent operations was about 17 percent higher than in affiliate operations in developed countries and about 360 percent higher than in affiliate operations in the developing countries. In short, American firms locate their "higher-end" jobs and operations at home.

2. My calculations are based on data in Raymond Mataloni, Jr., "U.S. Multinational Companies: Operations in 1988," *Survey of Current Business* 70 (June 1990), 31-44.



*Carlin*

Although American companies may have increased their overseas R&D spending by 33 percent between 1986 and 1988, compared with a 6-percent increase in R&D spending at home, the companies continue to spend the bulk of their R&D budgets within the United States. Between 1966 and 1982, the last year for which data are available, the share of R&D spending by U.S. multinationals in their overseas operations increased from 6.5 percent to only 8.8 percent. This overseas share was far lower than comparable shares for sales (29.4 percent) and assets (26.4 percent).

By 1988 the proportion of the total R&D spending by all U.S. companies that took place overseas had slipped to 8.6 percent, down from 9.4 percent in 1980. Again the trend does not support the notion of increasing globalization. In fact, according to John Dunning, a scholar who has done extensive research on multinationals, the available evidence suggests that except for some European firms and a few U.S. companies, such as IBM, the average share of R&D activity undertaken by global companies outside their home countries is quite small. For Japanese firms it is negligible.<sup>3</sup> Outside of their home environments, global companies mainly produce goods and services, not innovations.

The leadership of American companies also remains overwhelmingly American. Despite innumerable speeches by American corporate leaders on the globalization of American business, most large American companies do not have any foreigners on their boards of directors. According to a recent survey of directors by the executive search firm Korn Ferry reported in *The Economist*, the proportion of the top 1,000 firms with a non-American on the board has declined from a recent peak of 17 percent in 1982 to only 12 percent in 1990.

So, overall, despite globalization, a disproportionate share of the activity of U.S.

multinationals, especially their high-wage, high-productivity, research-intensive activity, remains in the U.S. Of course, many American companies have made huge investments overseas. But these investments have not necessarily weakened domestic economic competitiveness. Indeed, the presumption should run the other way. Since American multinationals continue to locate the bulk of their high-quality productive activities in the U.S., the beneficial competitive effects of their overseas operations spill over into more and better jobs, higher profits, lower prices, and improved products at home.

For the foreseeable future, there are likely to be very few American corporations with a type-A personality—headquartered at home, but with most of their employees and complex manufacturing located abroad. U.S. multinational companies remain “us” in significant ways.

### *But Are “They” Also Us?*

But what about the foreign multinationals that have established affiliate operations in the U.S.? Are they also us? In some industries, such as consumer electronics, U.S. national competitiveness now depends largely on foreign affiliates. In other industries, such as computers, U.S. competitiveness depends almost entirely on American companies, most of which have substantial overseas operations.

Instead of a simple yes or no answer to Reich’s question, I suggest five propositions for assessing the contributions of foreign affiliates to national competitiveness.

*Proposition 1. “They are becoming like us, but they have a long way to go.”*

Growing evidence indicates that, in certain ways, the affiliates of foreign companies operating in the U.S. resemble the domestic operations of American companies. Foreign affiliates are, on average, virtually indistinguishable from domestic firms in value-added per worker, compensation per worker, and R&D spending per worker, according to a recent study by Ed-

J. J. H. Dunning, “Multinational Enterprises and the Globalization of Innovative Capacity” University of Reading, Department of Economics, Sept. 1990.

ward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States*, published by the Institute for International Economics.

The only significant difference found by Graham and Krugman is that the affiliates of foreign firms apparently import significantly more than do the parent operations of U.S. multinationals—almost two and one half times as much. Because many foreign affiliates were established recently—especially in the 1977-1981 period when foreign direct investment in the U.S. grew rapidly—their dependence on imports will quite likely decline over time, as affiliates begin to rely on networks of local suppliers in the U.S. Affiliates of U.S. companies abroad have followed this pattern.

While on average they look increasingly like domestic companies, foreign affiliates differ sharply among themselves. At one extreme are foreign affiliates that are little more than assembly operations for foreign products. The Ricoh copier operation in California, for example, is an assembly plant with little domestic content.

At the other end of the spectrum are the extensive American operations of Honda and Sony. Honda sells more cars in the United States than in Japan and has set up largely independent design, production, and sales facilities in North America. The American content of the automobiles it produces in the U.S. is fast approaching the American content of the automobiles made by Chrysler.

Foreign affiliates, whatever their character, still represent a relatively small fraction of total economic activity within the United States, accounting for only 4.3 percent of all U.S.-business gross product in 1987, up from 2.3 percent in 1977. The comparable figure for manufacturing was 10.5 percent in 1987, up from 5.0 percent in 1977.<sup>4</sup> In 1988, the last year for which data are available, foreign affiliates accounted for 4.1 per-

cent of U.S. nonbank employment, and 8.5 percent of manufacturing employment.

In light of figures such as these, the proposition that foreign firms are as important to national competitiveness as domestic firms is more a prediction of the future than a reflection of the present. In most areas—such as trade, output, employment, and R&D spending—domestic firms still dominate domestic economic activity.

And there are virtually no examples of Corporation B—a foreign-owned firm with most of its employment and manufacturing in the U.S. Nor do current trends indicate that there will be many examples in the near future. Indeed, after a rapid expansion of foreign affiliate operations in the U.S. in 1987 and 1988, foreign direct investment has tapered off. For the foreseeable future, the fate of the U.S. economy in most industries will remain tied to the fate of U.S.-owned businesses.

*Proposition 2. "Where they are most like us, our policies have encouraged them to be so."*

In certain sectors of the economy, however, foreign-owned firms represent a substantial share of domestic economic activity. Foreign companies now control roughly one-half of the U.S. consumer electronics industry, one-third of the U.S. chemical industry, and one-sixth of the U.S. automobile industry.

Why have foreign firms gained such large shares of domestic production in these industries? Both U.S. and other multinationals invest abroad primarily to improve their shares of foreign markets. When protectionist trade barriers block access to markets, or even when barriers are only being discussed, foreign firms often respond by making direct investments in local production facilities. Protectionism is not a sufficient condition to explain foreign direct investment; foreign firms must be able to compete with domestic firms after incurring the higher costs of establishing local production to serve the domestic market. But protectionism may be a neces-

4. Jeffrey H. Lowe, "Gross Product of U.S. Affiliates of Foreign Companies, 1977-87," *Survey of Current Business* 70 (June 1990), 45-53.

only condition to explain such investment, since when they have no reason to fear import barriers, foreign firms typically prefer to supply markets through trade rather than local production.

Trade friction between the U.S. and its trading partners is a major reason for the substantial foreign investment in America's consumer electronics and automobile industries. Honda's extensive operations in the U.S., for example, were largely stimulated by U.S. trade policy. Among Japan's automakers Honda stood the most to lose from the restrictions on Japanese auto exports to the U.S. that were in force between 1981 and 1985 (the so-called "voluntary export restraints"). In Japan itself, Honda's market share had been held in check by Toyota and Nissan, and while the U.S. was Honda's largest and fastest growing over-

*Trade friction is a major reason for the substantial foreign investment in America's electronics and automobile industries.*

seas market, its share of the auto export quota to the United States was small. Honda responded by becoming the first Japanese automaker to produce cars in the United States, and by 1985 it was producing more cars than American Motors, making it the fourth largest automaker in the U.S.<sup>5</sup>

The fact is that most governments—including many state governments in the U.S.—regularly negotiate with global companies to get production facilities and jobs located within their borders. And although the U.S. has no explicit federal policies for attracting foreign investment, it often does so through the back door by the threat or actual practice of import protection.

5. Dennis J. Fucini, "Cross Investment: A Second Front of Economic Rivalry," in Thomas McCraw, ed., *The U.S. Versus Japan* (Boston: Harvard University Press, 1988).

Nations have long used both restrictive and preferential policies to control foreign investment. Indeed, such policies were instrumental in bringing about much of the global reach of American companies into Europe, Japan, and the developing world. The heads of many American companies argue convincingly that they went global because the countries where they sold their products insisted on it, or because they were offered more attractive terms by foreign governments than by our own.

For both the U.S. and other governments, the most desirable foreign production is not the kind of "screwdriver assembly" plant that Ricoh set up in California, but extensive production facilities like those of Honda. Governments compete most vigorously for the parts of a firm's production that provide high-wage jobs and technological advance.

As an illustration of what is at stake, one need only look at a recent "clarification" by the European Community of its rules regarding integrated circuits. The EC has sought to nurture European suppliers by adopting rules against the dumping of cheap imports. But it will now define the origin of an integrated circuit, not by the national ownership of the corporation that makes it, but by the country where the "process of diffusion" takes place. In short, if Europeans are learning the technology, they will overlook who owns the plant. The decision set in motion a number of investment decisions by Japanese and American firms to establish or expand semiconductor fabrication facilities in Europe. As the chairman of Intel says, "You can't pick up a piece of paper that says why Intel has got to manufacture in Europe. The rules don't exist. But customer decisions are driving important decisions right now."<sup>6</sup>

And you can't pick up a piece of paper

6. Quoted in Sylvia Ostry, *Governments and Corporations in a Striking World* (New York: Council on Foreign Relations, 1990), 49. The European Community in fact has no explicit restrictions on foreign direct investment, except in broadcasting and government procurement.



indicating that Japanese automobile firms need to have substantial operations in the United States to serve the U.S. market. Continued trade friction on automobiles and auto parts, however, clearly sends a message to the Japanese that, in the long run, the best guarantee of access to the U.S. market is to locate a substantial share of production in the U.S. The Japanese have also received the same message more directly and clearly from the Europeans.

In short, there is nothing inevitable about the globalization of industry. Advances in production techniques, transportation, and communications have certainly made it more feasible and attractive for multinational companies to disperse their production around the globe. But government policies have also played an important role in shaping corporate decisions. As flows of investment become ever more important relative to flows of trade, the rivalry between the U.S. and its trading partners will increasingly take the form of locational competition—vying with one another for shares of the world's high-technology production base regardless of ownership.

In the long run, rules to regulate exactly when and how nations can either restrict or encourage foreign direct investment are needed. Without multilateral discipline, each nation is tempted to act on its own, but if each does, the danger is that all will be worse off.

Ideally, an internationally negotiated framework would call for symmetrical national policies on foreign investment. In the absence of such a framework, which is likely to be a long time coming, I agree with Reich that a high priority for U.S. trade policy should be discouraging other governments from invoking domestic content rules, explicitly or by threat of trade protection. At the same time, however, it makes no sense for the U.S. to disarm unilaterally. We must not sacrifice our ability to use trade and other policies to attract foreign investment as long as other

nations continue to do so. If we disarm unilaterally, we leave decisions about the future composition of our economy and its trade, not to the free market, but to the policy decisions of other governments.

*Proposition 3. "They are good for us in the short run, but the long-run dynamic effects may be different."*

From a static point of view, a foreign firm operating in the United States may look like a domestic firm on such traditional indicators as wages per worker, value-added per worker, R&D per worker, or trade per worker. But the long-run implications may be very different.

First, over time the foreign firm may actually displace or deter the entry or expansion of American companies that might normally be expected to locate more of their production in the United States, thereby generating better jobs, more R&D, closer linkages with local suppliers, and more local technological spillovers.

Second, the foreign firm and the domestic firm may have different long-term effects on industry structure. Suppose, for example, that the foreign firm knocks out one or more domestic competitors, buying them out directly or gradually squeezing them out. The final result may be a more oligopolized industry, where the remaining firms exercise significant market power.

The dangers to national economic welfare from relying on a small number of foreign suppliers in an oligopolistic market are nowhere more apparent than in the semiconductor industry. (Our dependence on a limited number of foreign suppliers of oil also illustrates the point.) Today the dominant global suppliers of DRAMS—the memory chips that are key inputs in all electronic products—are six vertically integrated Japanese companies, which still have the bulk of their operations in Japan. In the Japanese market, a complex web of business and government practices limit access by foreign firms, antitrust regulations are lenient or largely unenforced, and most R&D is financed and executed in

proprietary channels that limit the diffusion of technological knowledge to foreign competitors and users.

The Japanese companies, moreover, have substantial and growing shares in systems products, like computers and sophisticated telecommunications equipment. The markets for such products are also highly oligopolized, offering significant potential for the exercise of market power, and the Japanese companies are clearly focused on increasing their penetration into these markets at the expense of American and European producers.

One way for the Japanese companies to pursue this objective is to control the terms and availability of semiconductor supplies to American and European computer companies. There is compelling evidence that the Japanese firms used such techniques in 1987 and 1988, when the worldwide market for DRAMs was extremely tight. And more recent evidence indicates that many of the same Japanese firms have been trying to control the terms and availability of advanced display technologies—such as the liquid crystal displays on laptop computers—to strengthen further their positions in computers and other products.

The practices employed by the Japanese firms to control the prices or deliveries of DRAMs or displays to foreign users are not necessarily illegal or unfair. Indeed, U.S. firms have often done the same when they had comparable market power in input industries. But when they reduce competition in important industries, such practices can be detrimental to the long-term interests of the U.S. and the world economy. Under these circumstances, American policies aimed at maintaining viable domestic producers as a counterweight to the Japanese may make sense as a kind of anti-cartel insurance.

Once we consider the effects of foreign direct investment on industry structure, the "who is us" debate becomes more complicated. It may be prudent, for example, for policy makers

to prevent a merger or acquisition by a foreign firm that poses a significant anticompetitive threat. Or it may make sense for policymakers to finance projects, like Sematech, that foster a more competitive supply base in a key input, even if such projects are not commercially viable, and to exclude foreign suppliers—in this case Japanese suppliers—if they exercise significant market power.

From this perspective, the U.S. should be using trade policy to open the Japanese semiconductor market to U.S. and other non-Japanese companies, including American affiliates operating in Japan. Semiconductors produced by Texas Instruments in Japan may promote more competition in the worldwide semiconductor industry than do semiconductors produced by Fujitsu in the United States. In that respect, we might legitimately favor an American company's operations abroad over a foreign company's operations in the U.S.

*Proposition 4. "They are allowed to compete with us here, but we are not allowed to compete with them there."*

Foreign operations that look like domestic operations in the U.S. economy may be treated differently in their home markets. For example, Motorola, a U.S. company with significant domestic operations, has needed the support of U.S. trade law to penetrate the Japanese market. But, obviously, no Japanese company would find it necessary to get U.S. government assistance to help sell products in Japan that were made in America. Non-Japanese firms have trouble selling to Japan, whether their operations are located in Japan or abroad, but Japanese firms have no trouble selling to Japan from either their domestic or foreign operations.

Japanese import trade is dominated by Japan's own companies. In fact, shipments from Japanese subsidiaries abroad to their parent companies at home represent most of Japanese imports. In 1986, for example, intra-firm trade accounted for 72 percent of U.S. exports to Japan, compared to 48.5 per-

cent of U.S. exports to Europe.<sup>7</sup> In short, Japan's import trade, as well as its export trade, is conducted to a distinctive degree by its own multinationals.

In addition, because of the control of distribution channels in Japan, foreign companies remain highly dependent on Japanese distributors for the sale of their products in Japan. If foreign goods compete directly with domestic products, they have trouble entering Japan. Imports that are complementary with the interests of domestic companies, on the other hand, get in easily.<sup>8</sup> In both cases, corporate control over Japan's trade rests in the hands of Japanese companies.

The same is certainly not the case in the United States. Japanese firms in America can easily distribute their products through their own channels, and most big Japanese firms do. Foreign direct investment in wholesale and retail trade in the U.S. is so substantial, in fact, that by 1986 foreign affiliates accounted for 75 percent of total U.S. imports and nearly 70 percent of U.S. exports. So while Japanese firms control Japanese trade with the rest of the world, foreign firms dominate America's trade.

The barriers to sales by foreign companies in Japan are another justification for America's emphasis in its negotiations with Japan on market-opening for all foreign-owned companies, not just American ones. Trade negotiations between the U.S. and

Japan on specific industries known as the MOSS ("market-oriented, sector-specific") talks, the U.S.-Japan Semiconductor Trade Agreement, and the U.S.-Japan talks on beef, citrus, and more recently rice imports, have all demanded market access for all foreign companies, including the affiliates of foreign companies inside Japan.

In Japan, as in most other parts of the world, a wide variety of factors may favor indigenous over American firms. Some of these factors involve discriminatory policies, the traditional subject matter of trade disputes. Other factors involve policies or institutions that, even if not designed as barriers, effectively block access by American firms. Some examples are product standards and testing, laws regarding intellectual property rights, health and safety rules, and consumer product regulations.

In a world of deep and persistent structural differences among nations, competition is unlikely to be perfect—or perfectly fair. To contain the inevitable friction between nations and between global companies, the U.S. and the other developed countries must achieve two goals.

First, they must scale back policies and dismantle institutions that intentionally discriminate between domestic and foreign companies. Second, they must agree either to harmonize structural differences that hurt foreign producers or to recognize the persistence of such differences and accept them as fair.

Achieving both goals is the best approach to freer and fairer world trade. But neither will be easily or quickly accomplished. In the meantime, what should the U.S. do when national policy differences "slant the playing field" against American producers? Should foreign firms be allowed to compete with us in the relatively open U.S. marketplace, while American firms are precluded from competing with them abroad? Should the American government treat foreign firms exactly like domestic firms in our home market even though foreign

7. See Dennis Encarnation, *Inventing to Trade: American and Japanese Multinationals in the Pacific Basin*, unpublished manuscript, Harvard Business School, February, 1990; and Robert Z. Lawrence, "How Open Is Japan?" paper presented to the Conference on the U.S. and Japan: Trade and Investment, National Bureau of Economic Research, Cambridge, Mass., October 1989.

8. John Zysman and I describe this pattern as a "moving band of protection." See Laura D'-Andrea Tyson and John Zysman, "The Politics of Productivity: Developmental Strategy and Production Innovation in Japan," in Chaimers Johnson, Laura Tyson, and John Zysman, eds., *Politics and Productivity: The Real Story of How Japan Works* (Cambridge, Mass.: Ballinger Press, 1989).

governments are discriminating against American firms in their home markets?

The principles of broad-based reciprocity, most favored nation treatment, and national treatment on which U.S. policy has traditionally been based suggest affirmative answers to these questions. These principles imply three conditions: First, overall access to the U.S. market across a broad range of goods and trading partners should be comparable to overall access to foreign markets (comparable access in particular products and with particular trading partners is not required). Second, whatever rights of access the U.S. accords to one of its trading partners should be accorded to all such partners. And third, all foreign-owned firms operating in the U.S., regardless of ownership, should be treated like domestically owned firms.

When American companies are discriminated against by particular foreign partners in particular industries, however, the principle of selective reciprocity may sometimes be a more appropriate guide to U.S. policy. According to this principle, access to the U.S. market by particular foreign firms through trade or investment should depend on comparable access of American firms to the home markets of these firms. Unlike the traditional approach, the selective reciprocity approach focuses on particular industries and trading partners. Selective reciprocity implies that foreign companies will not have access to the U.S. market unless their home countries provide U.S. companies comparable access. Under selective reciprocity there is no guarantee that a right of access accorded by the U.S. to a particular trading partner would be extended to all trading partners, nor is there any guarantee of national treatment. If a foreign country does not accord national treatment to an American company, selective reciprocity might lead U.S. policymakers to act reciprocally toward companies based in that country.

The selective reciprocity principle is a serious and dangerous departure from normal U.S. policy. A world in which market

access arrangements were negotiated on a bilateral, sector-specific basis would be a world in which the benefits of broad-based reciprocity, most-favored-nation treatment, and national treatment would be lost. Selective reciprocity encourages preferential trading blocs, retaliation, and bilateral trade deals that carve up national markets to achieve "reciprocal" outcomes in particular industries. Consequently, selective reciprocity should be invoked sparingly and only under exceptional circumstances.

But reciprocity should be the principle behind U.S. policy when there is a long history of foreign restrictions on the sales and investments of U.S. companies, when there is clear evidence of promotional industrial targeting policies that have benefited foreign producers at the expense of American producers, and when the industry in question is particularly important to our future living standards. Under such circumstances, there should be no presumption—and certainly no simple rule—that "they are us."

*Proposition 5. "They are not us."*

For purposes of national security, foreign companies may not be interchangeable with American companies even if they have never benefitted from preferential policies in their home markets and their U.S. operations look exactly like those of American companies.

What, if anything, should be done to regulate foreign ownership and control of production in industries or products that are critical to national security? (Here I define national security in the classic, restricted military sense.) Are foreign affiliates equivalent to domestically owned operations for such purposes?

In a global world economy, a sensible economic strategy for national defense should have three goals.

First, it should use requirements for national ownership, or local production by foreign suppliers, to enhance national control over suppliers regardless of their nationality.

Second, it should seek to stimulate a diversity of suppliers to maintain an honest or competitive supply base.

And, third, it should avoid condemning the nation to mediocre technologies and unnecessarily high costs in the process.<sup>9</sup>

The U.S. cannot rely on a wholly owned U.S. industrial base for military purposes. Such a strategy is simply too expensive and keeps out foreign technology. Many military technologies are dual-use technologies in which U.S. companies no longer have the leading positions or are no longer the low-cost, high-quality producers. Where foreign commercial technology essential to defense has a distinct lead, the U.S. should actively seek foreign investors and encourage them to invest in manufacturing and research facilities within the U.S.

To maintain a strong national defense, control of production is sometimes more important than ownership. What matters may not be the extent of our dependence on foreign suppliers for a critical technology but whether that dependence is concentrated on a few suppliers. In military technologies, an honest, competitive supply base is especially important. Consequently, defense-related activities should be subject to more stringent antitrust supervision than industries unrelated to defense, and this supervision should apply to domestic firms as well as to foreign firms.<sup>10</sup>

If an activity deemed vital to the national defense is subject to excessive market control by foreign producers, we have a num-

ber of possible remedies. As Edward Graham and Paul Krugman suggest, we can, first, require licensing of the capability to provide the good or service to domestic producers; second, pass local content requirements, including provisions that R&D capabilities be maintained in laboratories and plants within the U.S. and that their facilities employ American citizens; and, third, enact policies to promote the entry or deter the exit of U.S. suppliers.

When defense goods and technologies are involved, the assumption that foreign firms are "us" must be subject to careful scrutiny. And sometimes domestic policies may be required to make them more like us or to protect and promote our domestically owned competitors.

U.S. national security law now, in fact, does distinguish between "them and us." Under the Exon-Florio amendment, the president can block mergers, acquisitions, or takeovers of U.S. companies by foreign interests when those actions might threaten national security. All of the other advanced industrial countries have similar national security provisions in their laws on foreign investment. In the U.S., as elsewhere, such a provision may be misused as a protectionist device. But not to recognize legitimate security concerns posed by foreign takeovers would be a great mistake.

### *Us, Them, and National Economic Competitiveness*

Unlike Reich, I read the evidence as proving a strong, continuing link between American companies and the vitality of the U.S. economy. Who is us? American companies still are. And while foreign firms represent bigger shares of the domestic economy, especially in a few major industries, they are still not as important as American firms. "They are not yet us, although they are beginning to bear a strong family resemblance. And for national defense purposes, they will never be just like us."

But although my assessment of the current situation differs from Reich's assess-

9. These objectives are suggested by Theodore Moran, "The Globalization of America's Defense Industries: Managing the Threat of Foreign Dependence," *International Security* 15 (Summer 1990), 57-99.

10. For more on the significance of an honest supply base, see Michael Borras, "Power, Wealth and Technology: Industrial Decline and American National Security," in Wayne Sandholtz et al., eds., *The Highest Stakes: Economic Change and International Security* (Oxford, England: Oxford University Press, forthcoming.)

ment, I do not disagree with him on the trend. Globalization is here to stay. Over time, U.S. companies are likely to send larger shares of their operations abroad, while foreign companies are likely to bring more of their economic activity here.

There is no evidence, however, to suggest that this trend is accelerating. Indeed, the most recent numbers suggest a slow-down of foreign direct investment. The surge of foreign investment into the U.S. during the 1980s may have been an aberration, encouraged by special factors such as restrictions on auto imports, the boom in mergers and acquisitions, and changes in the dollar's value.

**A**s I agree with Reich about the long-term trend, so I agree with him about what the overarching goal of U.S. policy should be. According to Reich, the goal should be American competitiveness, which he defines as the capacity of Americans to add value to the world economy and thereby gain a higher standard of living in the future without going into ever deeper debt. With this goal in mind, national economic policies should be formulated to make the U.S. an attractive production location for the high-productivity, high-wage, research-intensive activities of both domestic and foreign firms.

Not surprisingly, Reich and I share a policy agenda that gives priority to enhancing the education and skills of the American work force, to building America's economic infrastructure, and to fostering research and development. The nation's human capital, infrastructure, and research base are its most important immovable assets.

We also agree that as a general rule, the U.S. should continue to welcome foreign direct investment, which can bring technology, jobs, greater efficiency, and other benefits. Nonetheless, in some circumstances, these benefits carry attendant risks—in particular, the risk of a more concentrated industrial structure with less competition or the risk of excessive dependence on foreign suppliers for national defense. It is

prudent, therefore, to monitor foreign direct investment for antitrust and national security purposes, as other nations do.

It is also sensible to invoke the principle of reciprocity under some circumstances. If American firms are kept out of foreign markets by overt discriminatory trade or investment barriers, the U.S. may legitimately demand those barriers be reduced as the price for access to the American marketplace.

The judicious use of the reciprocity principle in U.S. negotiations with its trading partners in the second half of the 1980s has had some beneficial results. The U.S. has successfully used the reciprocity idea to get foreign governments to revise their treatment of intellectual property to conform to U.S. standards. The principle of reciprocity has also been behind U.S. efforts to reduce market access barriers in Japan in a variety of products, including telecommunications and supercomputers.

**R**eciprocity is also a useful principle in thinking about mergers and acquisitions. The advanced countries differ sharply in their rules regarding foreign acquisitions of domestic companies. At one extreme are the U.S. and Great Britain, where foreigners can make acquisitions easily. At the other extreme are Japan and Germany, where mergers and acquisitions are more limited and dominated by domestic companies and domestic financial institutions. These differences are the result chiefly of structural patterns in financial markets, rather than overt discrimination. Consequently, reciprocity implies a gradual harmonization of financial institutions to make markets equally accessible. In the meantime, the U.S. should continue to contest overt barriers to foreign investment in bilateral negotiations.

The principle of reciprocity is also applicable to public support for research and development. As a general rule, the U.S. might want to make publicly funded R&D programs available on the same terms to

any company regardless of national origin, provided the home country of a foreign company reciprocates. Foreign firms perceived to hold significant market power might be excluded from such programs on antitrust grounds, particularly where the objective of government funding is to stimulate a more competitive supply.

As companies become more footloose in their location decisions, policies to contain scientific and technical knowledge within national boundaries become increasingly ineffective. And as foreign direct investment in U.S. high-technology industries grows, policies to restrict R&D support to domestic companies become increasingly outdated. For example, U.S. policies to support generic R&D related to high-definition television should be open to both domestic and foreign companies, as long as they agree to do the research here and similar programs in their home countries are open to U.S. firms. In high-definition TV, as in other high-technology pursuits, the U.S. cannot afford the price of relying on national champions and excluding foreign ones,

especially those like Sony, Phillips, and Thomson, that have substantial R&D facilities in the United States.

Nevertheless, America's strength in high-technology industries still depends disproportionately on American firms, even those with large overseas operations that have contributed to the growing high-tech strength of America's major trading partners. Moreover, America's ability to compete with other nations for the investment and R&D activities of foreign multinationals depends in part on the health of its own multinationals. Foreign firms want to be near their healthy American competitors to key into their knowledge and the network of skilled people who carry that knowledge with them. The major attraction to foreign investors is the health of the domestic economy; that in turn depends on the health of domestic companies.

Engine Charlie Wilson may have been right for the 1950s, and Robert Reich may well be right for the next century. But, for now, we need to improvise in a world that fits no ideal model.