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Introduction

Americans have a large stake in further global integration. Although on some measures ours is already the most open economy in the world, there are sizable gains to be won from becoming more open still, according to new research. Because this research is quite recent and not yet widely understood, we summarize it in this introduction and explore it in more detail in later chapters.

New research on real plants, workers, and local communities suggests sizable gains to further global integration, even for a country as large, prosperous, and relatively open as the United States. These gains flow from deeper integration of many types: stronger export engagement *and* deeper import dependence, inward *and* outward investment *and* technology transfer. Plants, workers, and communities are prospering by linking to the global economy through a whole family of commitments that involve *most or all* of these types of engagement. In this research, the fact of commitment usually matters more than the intensity of that commitment. The biggest gains come from the choice to become globally linked; the additional gains from deepening those linkages are real, but smaller.

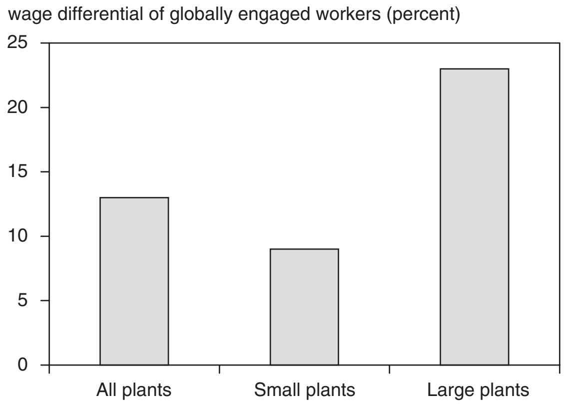
The gains from globalization found by this new research suggest that global commitment is like a tonic, a therapeutic cocktail of several diverse activities. A firm, a worker, or a community that takes the tonic is likely to be healthier in numerous ways than a comparable firm, worker, or community that does not. Those that take the tonic grow faster and are less prone to fail than those that do not; as a consequence, the share of tonic-takers in the population and in the economy rises. That is good on average for the economy as a whole, but not necessarily for those that choose not to take the tonic. And that is the news in this new research.

Global engagement may not be the only tonic available, of course. Technology and education are two other potential tonics. And global engagement is certainly not a cure for everything that ails us. But its value as a tonic is not widely appreciated, nor are the reasons why it works, nor is it clear whether it will work for everybody who tries it. This report aims to illuminate all of these questions.

Chapter 2 describes the new research itself. It reveals previously unappreciated patterns in the lives of real Americans, their workplaces, and their neighborhoods. For example, a typical assembly-line worker in an American plant that exports or outsources abroad earns more than an otherwise comparable assembly-line worker in an American plant that does neither. A typical American plant with investment links to foreign plants has higher productivity than a typical plant without such links, and this holds true even for plants that are otherwise twins—that is, com-

Figure 1.1 Globally engaged workers do better . . .

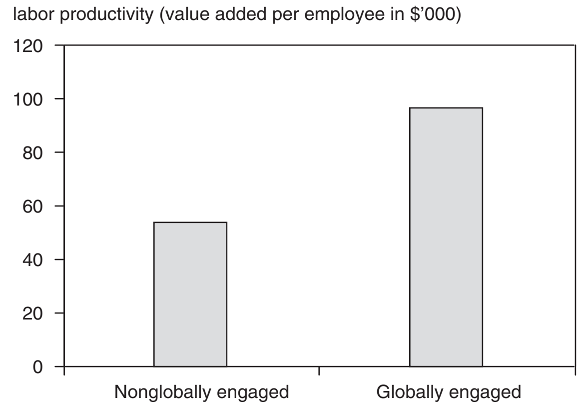
Global engagement in this figure is measured by blue-collar workers in exporting plants versus those in nonexporting plants. Other measures of global engagement for workers produce similar results. See chapter 2 for details.



Source: See figure 2.5.

Figure 1.2 Globally engaged companies do better . . .

Global engagement in this figure is measured by foreign investment in American plants. Other measures of global engagement for plants produce similar results. See chapter 2 for details.



Source: See figure 2.2.

parable in size, location, and industry. And American communities with dense links to foreign investors and active export involvement have higher standards of living and larger tax bases than otherwise similar communities with less global engagement. Figures 1.1–1.3 preview these gains, all of which are described with more precision in chapter 2. Chapter 2 also summarizes new research from other countries that reveals similar gains to firms, workers, and communities that commit to global integration.

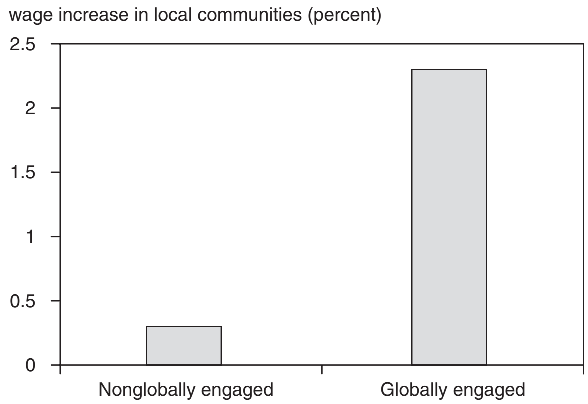
But the research so far is only suggestive. Although the patterns observed are ubiquitous and uncontradicted by other studies their interpretation remains controversial, as chapter 3 discusses. There are basically two interpretations. One is innocuous, in that it carries no obvious implications for changes in economic policy. The other, in contrast, carries important policy implications and is therefore more provocative. Each interpretation has its own account of what causes what:

- *The innocuous version.* Some new research finds that the observed patterns are due simply to the fact that good firms seek out good communities in which to locate and are able to hire good workers.[1] This leads to success in global markets and in attracting foreign partners as suppliers, investors, and coinnovators. In other words, good workers, good firms, and good communities are good to begin with, and naturally, they are the ones that succeed, at the local, the national, *and* the global level. "Goodness" (perhaps with an element of luck), in this view, is the cause, and global engagement the effect, not vice versa.
- *The provocative version***.** Other new research does not dispute the first explanation but suggests that causation *also* works in the other direction. A commitment to global integration stimulates improved performance and, especially, stronger and more stable growth for

1. See Doms, Dunne, and Troske (1997), who report microdata evidence that firms that are good at choosing advanced technologies also hire good workers, but that there is little evidence that those workers' performances are *further* upgraded by the complementary presence of good technologies.

Figure 1.3 Globally engaged communities do better . . .

Global engagement in this figure is measured by new foreign investment in local communities Other measures of global engagement for communities produce similar results. See chapter 2 for details.



Source: Figlio and Bloningen (1999).

firms, workers, and communities. Sidebar 1.1 provides a revealing illustration.

Why might conscious global commitment improve performance? The new research is just beginning to find the answer. For firms, diverse global integration often brings access to best-practice technologies and inducements for industrial rationalization, more efficient sourcing, and competitive discipline. These in turn enhance productivity, both among workers in the globalizing firm and among other firms in the community. More surprising, diversified sourcing and marketing by the globalized firm also enhance the stability of jobs and thus the economic stability of the community.

Traditional calculations of the welfare benefits from trade and foreign investment fail to capture these sorts of gains. Such calculations, for example, neglect the fact that almost 70 percent of US trade is in inputs, not final consumer goods. (Inputs are goods and services either used to produce other products and services or embodied in them.) When US firms buy foreign inputs that outperform those available at home, they im-

Sidebar 1.1 Old local economy meets new global economy in Western Maryland

It is the fall of 2000, and we leave Northern Virginia just as the sun comes up. This is high-tech country, the heartland of the New Economy. Fairfax and Loudoun counties are home to some of the most important Internet and telecommunications companies in the world, and incubators for hundreds of high-tech startup firms.

We are headed to Western Maryland: Cumberland, to be precise. Most people view this part of the world, in the heart of the Appalachians, as the Old Economy, the Really Old Economy. Long a center of the textile industry, Cumberland was also the western terminus of the Chesapeake and Ohio Canal, which reached there exactly 150 years ago—a vital crossroads between the eastern and western parts of the country. But these days the C&O is a bike path, and many factories have long since been shuttered. What could global engagement possibly do for places like Cumberland?

We are looking for an answer to our familiar question in what might seem to be one of the most unlikely places of all: an Appalachian apparel company. We find the Schwab Company, a family-owned maker of children's clothes that has been in business for 80 years, in an industrial park just off Interstate 68. Schwab has built itself around its Little Me brand of children's clothing, and its success here led to a second product line as worldwide licensee for Ralph Lauren, when that company decided to enter this end of the clothing business.

Many of the people who work in those high-tech companies in Northern Virginia (and Maryland) pass through Cumberland on their way to the summer and winter resorts a little farther west. Although some have probably been dressing their children in Schwab products for years, they probably do not give this place a second glance. But they should. They should be praying that a lot of other companies start doing what Schwab has done.

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Sidebar 1.1 Old local economy meets new global economy in Western Maryland *(continued)*

Schwab is a company that has plugged itself into both the global economy and the technological revolution. In a modest CEO's office, we do hear about both. Parts for its embroidery machines come from Japan. Designs for its newest product line come from Ralph Lauren, whose polo player insignia is recognized all over the world. Product development and sales are handled out of Schwab's New York office. The actual garments are made in over 30 countries around the world from Mexico to Asia.

But most important for Schwab's Maryland employees, all of whom are eligible for profit sharing, coordination of this global production takes place in Cumberland, which handles everything from purchase orders to shipping to customs clearance. Distribution of Little Me products to stores throughout the United States takes place from Cumberland, and the Ralph Lauren products are handled out of Martinsburg, West Virginia, just down the road. Exports to Canada are also shipped from Martinsburg, when Canadian quotas allow, but Schwab is looking into investing in a Canadian distribution center to avoid these quotas. Schwab is already an indirect worldwide exporter: drop shipments to foreign stores are made directly from production sites abroad but supervised out of Cumberland—by Pam (see sidebar 2.4).

We visitors quickly learn that adjustment to the world economy has meant big changes for the company and its employees. Sewing jobs started vanishing years ago at Schwab's Cumberland plant. Cutting jobs followed. There now are no more cutting jobs in Cumberland; all have gone overseas. That is the stuff that makes the newspaper headlines.

But there is more to the story than that. There still are plenty of jobs at Schwab—good jobs. In fact, there are just as many as 10 years ago. The stack of applications is high. The jobs are different, however.

Just how different quickly jumps out at us when we talk to Kitty. Her great-grandmother, her grandmother, and her mother all worked for Schwab as sewers. She shows us pages from her mother's *Home Worker's Handbook,* dutifully forwarded to the US Labor Department to prove she was making minimum wage (which she regularly did, barely, exactly). But Kitty isn't sewing for Schwab, and she isn't just making minimum wage. She is in customer service, working with the smaller US retail stores that Schwab sells to. Her son works at the Schwab distribution center in Martinsburg. One family, five generations, and big changes. But we do not get the sense that Kitty is upset by these changes. Just the opposite.

We also quickly realize that this is not just a story about globalization. The changing technology of the retail business in the United States has forced many of these changes on Schwab. The big department stores, for example, expect shipments to arrive at the store ready to move from the truck right to the sales floor. Obviously, product quality and price still matter. But talking to executives at Schwab, one gets the feeling that, in the apparel industry today, distribution is king. Efficient distribution is critical in keeping Schwab's customers happy. Wrong bar codes, mislabeled boxes, or wrong price tags, for example, can result in huge penalty payments for the company. That is why Schwab pays people well to handle this end of the business. The building in Cumberland where the cutting once was done for the Little Me brand is now a distribution center for the same product line.

So this is also a story of technology, and Schwab seems just about as high tech as you can get. It is hard to imagine how any manufacturer could have managed global production from Cumberland before the Internet. But that is what is happening now. Computers and modern telecommunications have brought the world to Cumberland's front door, and Schwab is taking advantage of it. Nor does it stop there. Modern technology can be found from one end of the apparel business to the other, from the factory floor to the distribution centers.

Even more startling, "body scans" may be just around the corner. A laser beam will take a cus-

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Sidebar 1.1 *(continued)*

tomer's whole set of body measurements, and then clothes will be produced just for that individual. This is mass customization taken to the *n*th degree. There is no more local sort of globalization.

After an hour and a half of talking to managers and workers, we walk away with the feeling that people here know as much about how to handle the global economy as do many of those highbrow, high-tech types back in Northern Virginia. Maybe even more. Schwab is using the globe-spanning technology of the New Economy to stay competitive in the Old Economy. Its global engagement is paying off.

In trying to understand how a company like Schwab succeeds in the global economy, we quickly realize that we have to shed a lot of conventional wisdom and discard conventional categories. We have to stop thinking about companies as either importers or exporters. A company may well have to wear both hats at once. We have to stop dividing the world into high tech and low tech, as they do on Wall Street. Everyone has to use appropriate technology. And we have to stop thinking that only college graduates can succeed in today's economy. A morning spent talking to people at Schwab has convinced us that common sense, trust, and loyalty, as well as judicious use of community college programs (sidebar 2.4), still count for a lot, even in the global economy.

Technology, education, and globalization. Those may be the three big forces that make life a lot better for a lot of people.

prove American productivity and earnings as well as expand consumer choice. One should perhaps think of the microprocessor (a component part), not the microwave oven (a consumer product), as the poster child for global linkage in America today.

Of course, when US firms buy imports to use as inputs—and when consumers buy imported final goods directly—some American firms and workers are displaced. We discuss this issue at several junctures below. But other firms and workers earn significant productivity returns from importing components and capital goods. Their gains should be weighed against the losses of those who are displaced.

Furthermore, a very large share of US trade is linked to international investment: much "trade" today consists of transactions within multinational enterprises, rather than between independent firms at arm's length. It is becoming increasingly meaningless, if not outright impossible, to think of trade as something separate from cross-border investment, or of exporting as something separate from importing products and innovative ideas. All are tied together in the extended family of global commitments.

Thus a second piece of news coming out of microdata research is that global engagement is an integrated *family* of activities. American exporters tend to be importers, international investors, and international technology traders, too. It is increasingly rare, difficult, and unwise to be a "pure" exporter, shunning these other linkages.

Finally, traditional assessments of globalization fail to take into account the power of global linkages to rejuvenate firms and industries. Whereas traditional calculations trace only how certain whole industries retreat under the global glare while others expand, microdata research shows how global integration refines, sifts, and sorts firms *within* every industry. Rejuvenation within industries, not the more efficient reallocation of resources across industries, is the dominant source of economywide gains in this new research. In the US studies at least, this rejuvenation happens in two ways. First, because globally engaged firms usually grow faster and fail less often than do other comparable firms, their market share in their industry rises, and overall industry performance measures come to reflect more and more their greater prowess. Second, globally engaged firms that are brand-new entrants to an industry usually have far more favorable performance measures than comparable firms that are dying out and exiting the industry. Thus global integration can often contribute to productivity and growth in *every sector* of the economy, not just in certain "advantaged" sectors.[2]

But global integration does not just improve the lot of American firms; it does the same for American workers. It boosts wages as well as profits. Almost any way one chooses to measure it, globally engaged workers have better jobs, with higher pay, better benefits, and greater job stability—and globally engaged firms see faster growth of these better jobs.

This finding might not be surprising for workers in exporting plants and in foreign-owned plants in the United States. Indeed, its wide acceptance is evidenced by the fact that almost every state in the union now has an office to promote exports and inward foreign investment. But microdata research also suggests higher earnings for those workers employed by US companies that actively invest abroad and import outsourced components. And this finding applies not just for workers in large firms but for those in smaller firms as well, as demonstrated in figure 2.11. A large segment of the American workforce is enjoying the benefits of global engagement, especially in industries that are deeply integrated with the rest of the world through two-way trade and investment.

The new research has also begun to examine what happens to communities that are globally engaged. Here, too, the finding is that communities that are hosts either to foreign investment or to American multinational companies are better off than more insular communities. One of the more intriguing findings of this research involves wage spillovers. Several studies have found that the average resident in a globally engaged community sees faster wage growth, not just those employed directly by an international firm. New investment in a community, of course, should lift all boats, but the boats seem to rise higher when part of this investment is by foreigners.

In short, global engagement energizes, informs, motivates, insures, and renews. But it hands out penalties as well as rewards. On the one hand, global integration encourages and ratifies innovation and smart management (by both firms and unions) and it rewards best practice in production techniques, in supplier and distributor arrangements, in labor relations, and in cooperation with government. It rewards workers whose educational decisions, choice of employer, and efforts to build experience match the requirements of globally engaged firms. And it rewards communities whose governments make choices that do the same.

On the other hand, myopia, insularity, nonchalance, and a "business as usual" attitude may be fatally unsustainable. These are not a viable set of choices in the long run for anybody, because firms, workers, and communities with those characteristics grow more slowly and erratically than their globally engaged counterparts. In the long run, perhaps, only the globally engaged survive.

But unlike biological evolution, global engagement is not dictated by genetics. For most, it is a *choice*. To be sure, it may be a choice to leave behind old, comfortable habits, to take risks, and to work hard globally. But most Americans would prefer that to extinction or stagnation.

Three important policy implications flow from this perspective. Global integration needs to be encouraged. But so do domestic policies that help typical Americans choose global engagement and, having chosen it, succeed. And so do policies that ease the burden on those who cannot or will not make that choice. Chapter 5 expands on these implications.

2. Bernard and Jensen (1999b, table 15), for example, show how export commitment benefits firms even in import-pressured industries.