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**Book Review — Digitized Version**

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cerned with the maximization of drug sales. Health maintenance organizations seek to minimize ill health. They are therefore concerned with the maintenance of good eating habits and other activities which are beyond the interests of pharmaceutical producers. Health maintenance incidentally is much more service-intensive than the manufacture of drugs.

In a world where economic life is dominated by periodic processes and life-cycle value accounting, economic efficiency depends more and more on the availability, quality and cost of information, its processing and its transmission. Bearing in mind the subjective nature of information, this factor introduces an additional and unavoidable element of uncertainty into the Service Economy world. The attitude towards risk and risk management must consequently be changed. Risk is not something which can be avoided, it must be *managed*. Consequently, insurance which has hitherto been relegated to the role of a tertiary activity will in future be regarded as a major economic instrument of maintaining stability and prosperity. The recognition of the role of risk in economic life will, according to the authors, lead to a revolution in economic thinking comparable to the revolution which Heisenberg's Principles of Uncertainty and Indeterminacy introduced in physics.

The book is probably not quite as original as the authors would have us think. "Life Cycle Costs" have been used by engineers and economists for decades to evaluate the economic worth of long-term capital investment projects. The idea of incorporating risk and uncertainty into the analysis is also not new. The Service Economy has similarly been with us for some time, and many of its components have been explored in detail. The book is nevertheless highly recommended. It is clearly written. The authors develop a useful and sensible terminology, and they manage to capture the interest and imagination of the reader with their insights and impassioned arguments.

The final pages contain a proposal for the establishment of a new institution – the Centre for Reflection on Uncertainty. The centre will be instrumental in getting Europe to better face the crisis it is facing: "Europe is in a crisis because it is set in frustrating and outdated certitudes . . . On the other hand, if the uncertainties of the present are accepted, the future becomes a raw material for action, the probability of active creation, the possibility of life" (p. 139). These words were written in 1989, some time before the collapse of the Communist regimes of Eastern Europe. The Centre for Reflection on Uncertainty which Giarini and Stahel want to serve the New Service Economy will undoubtedly have even more urgent topics to consider, following these momentous events.

See v Hirsch

**Graham, Edward M., Paul R. Krugman, Foreign Direct Investment in the United States.** Washington 1989. Institute for International Economics. XIII; 161 pp.

The rôle of foreign firms in the US economy has grown rapidly over the past decade. This growing foreign presence has sparked a flood of popular articles and books in the United States, most of them expressing concern, and many alarm. Their authors worry that foreign firms will behave differently from domestic ones in ways that reduce employment, worsen the trade deficit, or inhibit technological progress. In this book, Graham and Krugman examine the economic relevance of these arguments. The study is divided in two main parts. In the first part (Chs. 1–3), the authors try to shed some light on the extent, trend, determinants and economic consequences of foreign direct investments (FDI) in the United States. The second part deals with the political effects of FDI and aims at identifying national security implications of inward FDI.

The study starts with an inventory of inward FDI in the United States. By looking at several alternative measures of the rôle of foreign firms in the US economy – e.g., the stock of FDI as measured by cumulative investments, the assets of US affiliates of foreign firms, the employment of these affiliates, and their value added – the authors show that the foreign presence in the US economy has tripled since 1977. It is also shown that, in quantitative terms, acquisitions are clearly the larger source of growth in foreign control than the construction of new production facilities in the US. Graham and Krugman conclude, that the US after being an almost pure host country in the 1960s and 1970s is becoming, like other nations, a host as well as a home for multinational firms.

To identify the reasons for this development of inward FDI, the authors compare the explanatory power of two competing hypotheses on the determinants of FDI. The first hypothesis is called “cost-of-capital explanation” of FDI. It states that the motivation for FDI is similar to that of foreign investment (including portfolio investment) in general, it is simply a matter of resources in search of the highest return. The second hypothesis can be referred to as “industrial-organization explanation” of FDI. This theory based on the work of Hymer, Kindleberger, Dunning, Casson and Rugman assumes FDI as one mode of exploiting intangible assets and serving foreign markets. According to the industrial-organization approach, a firm will engage in FDI if the following three necessary and collectively sufficient conditions are satisfied:

- the potential investor possesses firm-specific advantages sufficient to outweigh the costs of serving an unfamiliar or distant market;
- the potential host country offers location-specific advantages for the investing firm;
- the potential investor gains from internalization advantages in serving foreign markets by FDI. The advantages arise because of the costs involved in establishing and monitoring effective contractual arrangements with foreign firms.

According to Graham and Krugman, the development of FDI in the US suggests that the industrial-organization motivation dominates the cost-of-capital motive. This conclusion is of high political relevance since it implies that rising FDI and debt in the US in the 1980s is simply a coincidence, and that future growth of FDI may have little to do with the US balance of payments.

Although this conclusion seems to be true, some considerations of the authors are not quite in line with the industrial-organization approach. For example, in considering protectionist measures as an explanation of the rise of foreign firms in the US, Graham and Krugman state that “we need to ask not whether protection makes it more attractive for a foreign firm to produce in the United States, but whether it makes production by foreign-owned firms more attractive relative to production by domestic firms” (p. 39). Thus, to explain why foreign firms establish or expand their US subsidiaries, it is – according to the authors – necessary to start with some explanation of why foreign firms have an advantage over domestic ones. This firm-specific advantage rather than protection should be regarded as the underlying source of FDI. In the framework of the industrial-organization approach, firm-specific advantages cannot be regarded as underlying source of FDI since – in this approach – the possession of ownership advantages determines which firm will supply a particular foreign market, whereas the pattern of location endowments explains whether the firm will supply that market by exports (trade) or by local production (non-trade). Thus, the existence of location-specific advantages is causal for the substitution between foreign trade and foreign investment. Since protection measures can be seen as locational factors in a broader sense, they are an important determinant of FDI.

In the third chapter, Graham and Krugman examine the economic impact of inward FDI in the United States. They conclude that the evidence on FDI does not justify great

concern about its effects. In contradiction to public opinion, foreign firms do not shift high-value or high-compensation activities to their home countries, nor do they perform less research and development in the United States than their US counterparts. Their only discernible difference is a higher propensity to import which may represent a difference in behaviour but may instead represent a selection bias in the activities in which foreign firms engage. Moreover, the discomfort felt by most politicians about the Japanese presence in the United States cannot be justified by economic reasons. Japanese firms show little difference in their behaviour from other foreign firms. Their value-added and compensation per worker are similar to those of other foreign firms, as is their research and development effort in the United States.

The second part of the book deals with the political effects of FDI and aims at identifying national security implications of inward FDI. The authors show that US policy toward FDI is based on the general principle of neutrality, qualified by considerations of national security and marred by occasional lapses. Inward FDI takes place with few restrictions, except in federally regulated industries where the ostensible justification is national security. Graham and Krugman pose the question whether the United States should change this course in light of the upsurge of FDI that began in the mid-1970s. They conclude that from an economic perspective the case in favour of an open policy toward FDI, including investment from Japan, remains strong. Even where the case against direct investment is strongest, on the import issue, the maximum possible cost is small, and it is quite possible that there is in fact a gain because direct investment may displace imports. The major threat to US welfare comes not from the growing foreign presence but from the potential for an "investment war" in which governments attempt unilaterally to capture greater benefits from foreign investment through such measures as performance requirements. Thus cooperative actions between home and host countries are essential if investment wars are to be avoided.

Although the European reader of this book, who wishes to learn more about the determinants of inward FDI in the United States, will be a little bit disappointed since this question only is dealt with in a small chapter of the study, the analysis of the economic, political and national security consequences of inward FDI is a skillful and much needed contribution to the current debate in the United States.

Jürgen Stehn

**Kiefer, Nicholas M., George R. Neumann, Search Models and Applied Labor Economics.** New York, New Rochelle, Melbourne, Sydney 1989. Cambridge University Press. IX, 297 S.

Das vorliegende Buch enthält eine Sammlung von vielen bereits veröffentlichten und einigen bisher nicht publizierten Aufsätzen zum Thema mikroökonomische Arbeitsmarktmodelle und -analysen. Enthalten sind acht Aufsätze, die von einem der beiden Autoren oder von beiden gemeinsam verfaßt wurden, und fünf Aufsätze, die von ihnen oder einem von ihnen zusammen mit weiteren Autoren geschrieben wurden; hinzu kommt eine Einleitung. „Neu“ – d.h. bisher nicht publiziert – sind nur das einleitende Kapitel, das einen gewissen Überblick über das Generalthema gibt und somit eine Klammer für die anschließenden Aufsätze darstellt, sowie die Kapitel über „Employment risk and labor market diversification“ bzw. „Interfirm mobility and earnings“. Die übrigen Kapitel wurden bereits in jüngster Zeit, nämlich zwischen 1979 und 1987, in Sammelbänden und Zeitschriften, die nicht schwer zugänglich sind, veröffentlicht. Das Buch macht so den Eindruck, als sei es ein Rechenschaftsbericht über die von dritter Seite finanziell geförderten Arbeiten aus den Jahren von 1977 bis 1987; keineswegs stellt es eine Monographie dar, wie es der Titel vermuten läßt. Dann hätten