Introduction chapter in book

Multinational corporations and local firms in emerging economies

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Multinational corporations and local firms in emerging economies: An introduction

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1. Introduction

One of the most heated issues within current development debates relates to the role played by multinational corporations (MNCs) in economic development. On the one hand, MNCs may help emerging economies\(^1\) in the modernization of their economies and industries by transferring technology, know how and skills, by providing access to export markets, by intensifying competition, or by making available goods and services that are better and/or cheaper than those offered by local producers (De Mello, 1999; UNCTAD, 1999; JBIC Institute, 2002). On the other hand, beneficial effects are not given and MNCs may stifle economic development by locking in host economies in low value added activities and by crowding out local investments and jobs. Furthermore, anti-competitive practices of MNCs may reduce consumer welfare and MNCs may help build consumption patterns that are unsuited for host countries (Caves, 1996; Buckley and Ghaury, 2002; Cypher and Diez, 2004).

As noted by numerous authors, at the end of the day it must be concluded that MNCs obviously are both ‘boon’ and ‘bane’ for emerging economies (Caves, 1996; Nunnenkamp, 2004; Dicken, 2004; Görg and Greenaway, 2004; Endewick, 2005; Pearce, 2006) and that the key issue thus becomes when foreign direct investment (FDI) by MNCs is beneficial to economic development and when it is not. In this regard, the literature has pointed out numerous factors that condition FDI impacts, such as government policies (Dunning, 1997), MNC investment motives (Endewick, 2005), MNC entry strategies (Görg and Greenaway, 2004), absorptive capacity of local industry (Narula and Lall, 2004), or the extent to which MNCs link up to local firms and industries (Altenburg, 2000; Giroud and Scott-Kennel, 2006).

One of the key issues related to MNCs’ role in economic development is the way in which MNCs interact with local firms and industries. This issue is increasingly pivotal as MNCs’ role in

\(^1\) ‘Emerging economies’ are defined as countries with rapid growth but low income using economic liberalization as a primary engine of growth (Hoskisson et al, 2000). They are encompassing the developing countries of Asia, Latinamerica, the Middle East and Africa as well as the transition economies of mainly Central and Eastern Europe.
organizing global economic activity grows and as private sector development becomes an overarching development priority in more and more countries. In this situation, it is crucial to ask whether and how MNCs contribute to development of the local private sector. Are MNCs inciting local industries to become more effective by exposing them to competition and demonstrating advanced production methods, or are they on the contrary using their market power to crowd out local firms? Are MNCs building broad local networks of related and supporting industries in host countries or are they rather creating enclave economies with few local linkages? And are MNCs investing in upgrading competencies of local firms and industries or are they on the contrary keeping local firms in low value adding routine functions and activities? In short, would indigenous industries and firms be better or worse off without the entry of MNCs?

The aim of this book is to provide insights into the nature and dynamics of MNC-local firm interaction in the new global context of private sector driven economic development and growing importance of MNC activity in emerging economies. This will be done by offering evidence from a variety of emerging economies on MNC-local firm interaction and on how governments have dealt with this issue. It is hoped that the book will assist in developing a better understanding of the complexities and variations in MNC-local firm interaction, and thereby contribute to better informed policy intervention on MNCs.

In the following we will describe what we have called ‘the new global context’ of the MNC - local firm relationship. We will then move on to provide a conceptual and theoretical framework for the book, as well as a review of the extant literature on MNC-local firm interaction. Finally, we will position the contributions of the book within the existing literature and assess how we see these studies contributing to the literature.

2. The new global context of MNC-local firm relations

2.1. The changing map of FDI

One of the most striking aspects of FDI in recent decades is the growing FDI in emerging economies, rising from a level of 20-30% of all FDI flows in the early 1990s to 30-40% in the mid 2000s. While the financial crises significantly has reduced the absolute amount of FDI, FDI in emerging economies has continued to rise relative to total FDI as growth in these countries is relatively high and as the need of western MNCs to streamline their cost structures and access resources continue to drive FDI in these countries. Indeed, it is predicted that FDI flows to
emerging economies will exceed those of developed countries by the early 2010s (UNCTAD, 2009). The vast majority of FDI in emerging economies is concentrated in a small group of Asian countries (in particular China) and rapidly growing Eastern European countries. However, while the least developed countries receive negligible flows of FDI, these flows can be just as significant if measured in relation to the size of their economies (Nunnenkamp, 2004; UNCTAD, 2009).

The composition of FDI in emerging economies has changed significantly in recent years. Where FDI in these countries traditionally was concentrated in extractive industries or was market seeking in relation to intermediary and consumer goods, there has recently been a surge in services FDI. Moreover, we have witnessed growing efficiency and strategic asset seeking investments, in particular in some of the more advanced Asian countries. Much of the FDI is in the form of acquisitions, an indication that emerging economies are building advanced local industries that are attractive investment targets for MNCs. Finally, the source of FDI has changed; the share of FDI originating from emerging economies themselves has risen from approximately 10% of global FDI around 2000, to more than 20% by the end of the decade (UNCTAD, 2009).

The changing map of FDI is driven by a number of developments, first among them the more FDI conducive environments in many parts of the world with reduced formal and informal barriers to investment (Rugraff, 2008); larger, rapidly growing, and increasingly sophisticated markets; improved infrastructures; improved skill bases and education levels; and the development of vibrant local supply industries capable of supporting foreign investors with goods and services (see e.g. Kapur et al., 2001 or Jiang et al., 2005). Simultaneously, MNCs are making fundamental changes to their strategies: they are increasingly disintegrating their value chains and sourcing more and more activities globally (Porter, 1986; Sturgeon and Lester, 2003). Moreover, MNCs are changing their competitive horizons from mainly national and regional arenas to increasingly global arenas. The changing strategies of MNCs match the improved conditions of emerging economies well and consequently, we see a widening and deepening of MNC activity in such countries. All this takes place against the backdrop of advances in communication technology and decreases in transportation costs, which together reduce the importance of geographical proximity (Dicken, 2004).

2.2. Implications for emerging economies

Potentially, the changing map of FDI has huge positive and negative implications for industrial and more broadly, economic development. Apart from offering injection of scarce investment capital,
FDI comes with a package of technology, skills, connections and market opportunities. Moreover, FDI may introduce better and cheaper products and sharpen competition, thereby improving consumer welfare. The growing sophistication of MNC activities enhances the potential impact of MNCs on host countries’ skills and technology base. On the other hand, foreign investors’ market-power may suppress competition and subject whole sectors of the host countries to the strategies of MNCs (Gereffi, 1999). As MNCs are looking for increasingly advanced and reliable types of assets in the countries they are investing in, and as the number of locations offering favorable conditions is growing, competition for FDI increases and the danger of competitive bidding and deepened divisions between catching up and falling behind countries grows (Dunning and Narula, 2004).

FDI is not least a two edged sword for local firms and industries in emerging economies; on the one hand, the arrival of foreign firms introduces discomforting and sometimes, unfair competition not only in product markets but also in labor and capital markets. Furthermore, they may use their bargaining power to get privileges and exemptions from governments not extended to local firms. On the other hand, if local firms succeed in linking up to the foreign investors, FDI may offer vast opportunities for expanding activities as suppliers and subcontractors to the MNCs. Moreover, the local firms may learn from the collaboration, for example learn about more advanced standards and organizations, and thus upgrade into more advanced activities. With regard to firms unrelated to the MNCs, MNCs may demonstrate new production technologies, marketing practices and managerial approaches that may be adopted by the local firms, and former employees of MNCs may inject dynamism into local firms if hired there. Finally, MNCs may use their financial and organizational strength to push for further development of the commercial infrastructure and regulation in the host country, something that also may benefit local firms.

This book seeks to improve our understanding of the positive and negative aspects of MNC-local firm relations, the conditions under which they occur, and how governments, through various policy measures, can promote positive MNC-local firm interaction.

3. The main concepts of MNC-local firm relations: Spillovers and linkages

The literature on MNC-local firm interaction essentially revolves around two concepts, spillovers and linkages. The term ‘spillovers’ denotes the impact or effect of an interaction between the MNC and the local firm, the term ‘linkages’ denotes the organizational modality of the interaction. We will clarify these concepts and their relation in the following.
3.1. Spillovers

The initial theoretical and empirical literature on effects of FDI focused on the direct impacts of the multinationals such as additional capital brought into the country, the creation of jobs, the effect on the balance of payment, and so on (MacDougall, 1962). Another part of the FDI impact literature that took on a real importance at the beginning of the 1990s (UNCTAD, 1992), tried to evaluate the macro economic effect of FDI on the growth rate of developing countries, some studies detecting positive impacts (see for example Borensztein et al., 1998; De Mello, 1999; Chan, 2000), other studies failing to detect such effects (Hein, 1992; Singh, 1998). One of the most fecund avenues in the FDI study of impacts however, was opened by the seminal work of Caves (1974), who considered that spillover effects of MNCs on local firms were the crux of the matter. Since then, the research on FDI effects has increasingly acknowledged that technological, organizational and managerial spillovers on local firms probably represent the most influential role of MNCs in host country development.

Spillovers from FDI are essentially positive externalities from the presence of MNCs on the local economy (Blomström and Kokko, 1998). Spillovers derive from the fact that a firm which internationalizes possesses an intrinsic advantage over firms in the host country (Dunning, 1988). In foreign countries, a MNC is particularly incited to secure its knowledge, management and information assets due to the fact that its competitive advantage is directly linked to its capacity to limit diffusion to local competitors. But at the same time, a foreign investor is not able to, or necessarily interested in, hindering totally its advantages from leaking out to the local environment as spill overs. Hence, spillovers take place when multinationals are unable to, or uninterested in, extracting the full value of the resulting productivity increase of their activity in the host economy. Since a MNC often is profoundly different from a (non-internationalized) local firm in terms of technology, capital, organizational and managerial capabilities, and international market access, there is a potential for significant spillovers on the local economy and local firms.

The spillover can happen through indirect means (for example spillovers on local competitors) or it can happen through direct means (for example spillovers through subcontracting, outsourcing, licensing, franchising, and so on).

The literature typically identifies two main catalyst effects of a multinational on local firms: horizontal spillovers on local competitors and vertical spillovers on indigenous suppliers, distributors and customers linked to foreign-owned firms in the value chain.
Spillovers may take the form of knowledge spillovers or pecuniary spillovers. Knowledge externalities represent technology and know-how that may spill over from multinationals to local firms. Pecuniary spillovers take the form of a rent for the local industry: multinationals’ activity improves the quality of the local production that is only partially incorporated in the prices of the products and services delivered by the multinational. The rent may also result from an additional demand addressed to the local intermediate-goods industry that enables the local industry to produce with increasing return to scale and to deliver cheaper products and services to local buyers.

One may consider five main situations regarding the global effect of the multinationals on the local firms (Table 1):

**Table 1. Spillovers (+) and negative externalities (-) of multinationals on local firms**

<table>
<thead>
<tr>
<th>Vertical effect</th>
<th>Horizontal Effect</th>
<th>Total effect</th>
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<tr>
<td>Case 1</td>
<td>+</td>
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<td>Case 2</td>
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<td>Case 4</td>
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<td>0</td>
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<td>Case 5</td>
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*Note: 0 = insignificant effect; ? = undetermined effect.*

Case 1 is the best option for the local industry. MNCs source locally and have a catalyst effect on the local intermediate goods industry. The entry of multinationals also has a positive impact on the local rivals who have increased their performances by imitating the multinationals and by reacting to the competitive pressure of the newcomers. A positive horizontal effect may result from a moderate technological gap between multinationals and local firms, fostering imitation and competitive reaction (Kokko et al., 1996).

In case 2, the total impact remains positive, despite the absence of horizontal spillovers. Absence of horizontal spillovers may be due to differences in the sectoral specialization between foreign and
local firms for example when multinationals invest in new sectors with no local firms. It may also be linked to the export-orientation of the multinationals, which do not reduce the local market share of the local firms (Blyde et al., 2004).

In case 3, multinationals have a negative vertical effect and a negative horizontal effect. The latter may result from the difference in efficiency between the foreign and the indigenous actors that jeopardizes the development of the local industry and crowds out local rivals. Inward-looking multinationals which have invested in a country to serve the local market may reduce the number of local firms and/or oblige them to specialize in low value-added products and a production based on weak economies of scale. A multinational may also displace pre-existing connections between local firms and their suppliers and have negative vertical effects. Multinationals have negative effects when they crowd out local rivals which were used to purchasing more abundantly from local suppliers than multinationals do. In case 4, multinationals have only very few forward relationships with the local customers and very limited backward relationships with local suppliers: the multinational reveals “enclave” behavior. This kind of behavior may emerge especially in backward countries in which the human skills and the technological level are low and the quality of institutions is weak. The absence of horizontal effects may be due to the dominant position that has been granted to a foreign firm (monopoly) or to a handful of foreign firms (oligopoly) in the privatization process of the local industry.

Case 5 is a classical case of the spillover literature in developing countries and transition economies. Although the multinationals crowd out local rivals in the final goods industry thanks to their ownership advantages, the net gain for the local suppliers and/or for the local customers is positive.

3.2. Linkages

Local firms may benefit from spillovers from MNCs despite limited direct interaction with the MNCs, for example through competition and demonstration. But many authors hold that direct interaction - typically labeled linkages - will facilitate spillovers. Thus, a long tradition dating back to Hirschman’s seminal work on the role of linkages in economic development (1958) has argued that lack of linkages in the developing economy leads to lack of industrial development. While Hirschman’s argument did not specifically relate to foreign firms, it has inspired much of the later research on MNCs and linkages. The general assumption of this research is that from a development perspective, linkages between MNCs and local firms are better than no linkages, and the more and
the deeper linkages are, the better it is for the host economy (Altenburg, 2000; Scott-Kennel and Enderwick, 2005; Hansen et al, 2006).

While some authors prefer a broad definition of MNC linkages as encompassing transactions between MNCs and local firms as well as non-business institutions and organizations (Altenburg, 2000), we will here focus on linkages between MNCs and local firms. Thus we define linkages as inter-firm transactions that go beyond arm’s length, one-off transactions and involve some level of collaboration between the transacting parties (Hansen et al., 2009). Linkages can be long term (for example a long term strategic partnership on R&D) or they can be short term (for instance an intermittent purchase on contract). They can be equity-based (a joint venture between the MNC and a local firm) or they can be non-equity based (for example subcontracting, licensing, franchising, or outsourcing). Sometimes linkages are ‘backward’ to suppliers and subcontractors (‘upstream’), sometimes they are ‘forward’ to distributors, agents or franchise holders (‘downstream’). To these two forms can be added ‘horizontal’ linkages between firms operating within similar activities – for example strategic alliances between competitors and/or technology partners (see Table 2).

{Insert Table 2 about here}
The nature of the linkage between a foreign investor and a local firm obviously has implications for the scope and content of spillover effects on host country firms\(^1\). One may easily accept that a short term contractual agreement on a specific task may create less opportunities for learning and upgrading for the local firm than a long term subcontracting collaboration involving large resource exchange between the MNC and the local firm. It has been argued that with economic development, linkages between MNCs and local firms becomes deeper and more reciprocal because the absorptive capacity and skills of the local industrial base increases (Scott-Kennel and Enderwick, 2005). The literature also argues that it makes a difference where in the value chain the linkage partners are placed: Especially backward linkages to suppliers and subcontractors are considered to have large spillover potential whereas horizontal linkages are believed to produce less spillovers on local firms (UNCTAD, 2001; Nunnenkamp, 2004). The spillover potential of forward linkages to agents, distributors and franchise holders is less researched, but it is argued that also forward linkages may have profound spillover potential (Hansen et al, 2006).

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\(^1\) There is a conceptual ambiguity in much of the literature concerning the exact relation between linkages and spillovers (Giroud and Scott-Kennel, 2009). Thus, there is a tendency to view any effect of linkage collaborations between MNCs and local firms as spillovers. However, linkages are typically planned and contract based and the value of the transaction is more or less fully appropriated by the transacting parties. Strictly speaking such effects are not 'spillovers, if spillovers are understood as positive externalities from a market transaction. The confusion of spillover effects and other effects deriving from linkage collaborations is probably due to the fact that researchers typically are unable to untangle the spillover effect from the direct effect at the aggregate level (Giroud and Scott-Kennel, 2009).
4. The theory of MNC-local firm relations

The theory on MNC-local firm relations is mainly informed by three economic traditions, namely trade economics, industrial organization and international business:

4.1. Trade economics

In the original trade theory based on comparative advantages, production factors were assumed to be immobile while goods could move freely. Trade economics later included capital movements in the equation by allowing for capital flows between capital rich and capital poor countries. A partial equilibrium comparative-static approach was developed, aiming to evaluate the distribution of the gain for a capital-scarce country of additional investments coming from a capital-abundant country (MacDougall, 1962). Aliber (1971), in a similar way, argued that FDI was a consequence of a kind of arbitrage between countries with strong and weak currencies. From a welfare perspective, it was implied that the additional foreign capital could enhance welfare by increasing production and improving the allocation of scarce resources. The main disadvantage of these early models was that they viewed the multinationals as part of the theory of portfolio capital flows and considered the effects of FDI as being equal to those of other forms of capital.

Relaxing the assumptions of the original neoclassical trade economic framework, New Trade Economics allowed for the possibility of economies-of-scale and product differentiation (Helpman, 1984; Helpman and Krugman, 1985; Markusen, 1984), paving the way for an understanding of MNCs in equilibrium models. The New Trade Economic theory materialized into two main frameworks, the vertical-multinational and the horizontal-multinational framework. The vertical multinational separates the stages of production geographically and localizes labor-intensive activities in developing countries to take advantage of relatively abundant unskilled labor, whereas the horizontal multinationals duplicate the same product or service in different locations (Markusen, 1984). In terms of MNC effects, New Trade Economics predicted that MNCs produce both crowding-in effects and crowding-out effects (Markusen and Venables, 1999). As MNCs possess some special advantages over the indigenous host-country rivals, such as superior technology or lower costs due to economies of scale, they may initially produce crowding-out of local investment. On the other hand, they may in the longer run ‘crowd in’ due to high transportation costs that force

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3 Yet in reality, each vertical multinational has some horizontal features and horizontal firm do not replicate the totality of activities of the headquarter.
the MNCs to source locally, thereby creating a catalyst impact on local firms in the intermediate goods industry. The catalyst effect results from MNCs’ demand for a larger variety of intermediate goods and a rise in the quantities supplied which stimulates economies-of-scale. The equilibrium that will emerge depends on the impact of both opposed effects.

While New Trade Economic models abandoned the strict assumptions of the original neoclassical theory thus empirically producing more robust predictions, they still belong to the neoclassical body, which may be effective in tackling problems of resource allocation and equilibrium thanks to prize- and/or quantity-based adjustment mechanisms, but is inadequate in conceptualizing the variations and complexity in MNC strategy and effects.

4.2. Industrial Organization

By the late 1950s and early 1960s, the trade economic partial equilibrium models were fundamentally challenged from an industrial organization perspective. The industrial organization literature on MNCs aimed to study the consequences of ‘the entry into a national industry of a firm established in a foreign market’ (Caves, 1971, p.1). Markets are full of imperfections of the structural type - proprietary technology, privileged access to inputs, economies of scale, control of distribution systems and product differentiation (Bain, 1956) - that can be used by firms to increase their monopoly power and to internationalize. The main idea of this school of thought is that the characteristics of the industry fundamentally affect the strategy and performance of firms, and indeed, the effects that MNCs may have on host countries. Thus, industry characteristics may impact whether or not MNCs crowd in or crowd out local firms; whether they transfer technology and knowledge from parents to affiliates; whether they foster linkages to local firms; and whether they suppress or foster competition in the host country (Nunnenkamp and Spat, 2002).

4.3. International Business

From the mid-1970s, micro economic literature on MNCs emerged, literature that later would provide one of the main pillars of International Business. Inspired by Stephen Hymer’s seminal PhD thesis in 1960, early International Business literature, in line with the Industrial Organization ‘Structure Conduct Performance paradigm’, argued that multinationals possess special assets in comparison to local firms that allow them to overcome the disadvantage of foreignness (Hymer, 1960). The firm-specific know how, its knowledge-capital and its technology assets appear to be key ownership advantages. Internationalization per se reinforces the multinational’s advantages by
providing opportunities to divide marketing risks, by slicing up the value chain on the base of the territories’ comparative advantages, and by providing access to new resources and assets. The multinationals’ ownership advantage is often reinforced by the ability they have to access finance, internationally and in the host economy, compared with local firms which are most of the time financially constrained.

Later, the International Business theory of MNCs has directed more attention to advantages related to the ability to organize cross-border transactions in the face of market imperfections (Buckley and Casson, 1976), the ability to leverage resources across borders (Peteraf, 1993) or the advantages related to coordinating knowledge diffusion and development across borders (Kogut and Zander, 1993). Dunning (1988; 2001) sought to integrate many of these understandings of MNCs in his ‘eclectic’ OLI framework, which has become a dominant framework for understanding MNCs within the International Business literature.

International Business is essentially about understanding the existence, conduct and performance of firms involved in cross border business transactions and therefore the efficiency or welfare effects of these transactions received little attention. Basically, welfare issues remained the domain of trade economists and industrial economists and to some extent political scientists analyzing the role played by MNCs in policy formulation at the national and international level (see for example Spar and Yoffie, 1999; Moran, 2002). In so far as International Business analyzed spillovers, it was mainly in the context of finding effectively controlled strategies avoiding spillovers; indeed, to many International Business theorists, the very purpose of the MNC was to avoid knowledge and technology being spilled over to other firms.4

Nevertheless, as argued by Forsgren (2002), the received International Business theory embodies some fairly straight forward assumptions and predictions regarding MNC effects on host countries. The early market power current within International Business argued that MNCs were essentially extensions of market power in foreign locations (Hymer, 1960). As such, MNCs would by implication tend to crowd out local investment and reduce consumer welfare by suppressing competition. Moreover, host countries would have great problems matching the bargaining power of MNCs and would tend to strike unfavorable deals with the MNCs. By the mid-1970s, this critical view was challenged by a number of scholars who argued that MNCs existed mainly to bridge

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4 More recently, International Business has taken an interest in spillovers insofar as they have implications for the conduct and performance of MNCs. The prospects of large spillovers may ease approval of large investment projects and a MNCs reputation and brand may gain from strong spill over performance.
market imperfections in cross border markets for intermediary goods, for example transaction costs. As such, MNCs were expressions of efficiency and therefore welfare enhancing (Rugman, 1981). Similarly, more recent resource-based perspectives (Peteraf, 1993) and knowledge-based perspectives (Kogut and Zander, 1993) look at MNCs as superior vehicles for cross border knowledge and resource transfer and thereby as potentially benefiting host countries. International Business theory says little about the extent to which MNCs produce spillovers on local firms. But it can be inferred from the market power view that if MNCs are about extending market power to foreign locations, local firms may be harmed. And if MNCs are about the effective transfer of superior knowledge and technology to subsidiaries, they may have a high potential for producing demonstration and competition effects. Moreover, as recognized by modern international business theory, as MNC boundaries are becoming increasingly fuzzy (Cantwell and Narula, 2001) and as MNCs are increasingly locating the development and exploitation of their ownership specific advantages in business networks and strategic alliances (Ghoshal and Bartlett, 1990), new opportunities for acquiring technology, knowledge and market access for local firms in emerging markets are provided.

5. Research on MNC-local firm relations

A great deal of empirical literature on linkages and spillovers has evolved in recent years. This literature is theoretically informed by the above-mentioned Trade Economic, Industrial Organization and International Business literatures. The empirical literature essentially studies the multinational-local firm nexus through three main methods: formal modeling (see for example Rodriguez-Clare (1996) or Markusen and Venable (1999)), statistical analysis (for overviews, see for example Caves, 1996; Blomström and Kokko, 1997; Nunnenkamp, 2004; Görg and Greenaway, 2003; Merlevede and Schoors, 2005), and case studies (Altenburg, 2000; Hansen and Schaumburg Müller, 2006; Giroud, 2007). The three methods are based on different kinds of reasoning regarding fundamental issues such as case selection, operationalization of variables and the use of inductive and deductive logic and each has comparative strengths and limits.

Thematically, the empirical literature focuses on different aspects of the MNC-local firm nexus. One group of studies treats MNCs as more or less homogenous actors producing similar effects on host countries and little differentiation between industries, MNC strategies and countries are made. Another group of studies takes its point of departure in the heterogeneity of MNCs and countries
and differentiates MNC effects based on factors such as industry characteristics, MNC strategy, and host country characteristics. Finally, a group of studies looks at the effects of MNCs on local firms according to the specificities of the transaction relationship – the linkage – between the MNC and the local firm. The three groups of studies and their interrelationship are depicted in Figure 1.

{Insert Figure 1 about here}

**Figure 1. An overview of research on spillover effects**

In the following, we will organize our review of the literature according to this figure.

### 5.1. General effects of FDI (A)

The question of the magnitude of the MNC spillovers on a host-developing country has been tackled by several generations of economists since the seminal work of Caves in 1974. In general, these produce mixed results in regard to the overall state of spillover effects in developing countries and transition economies. Some find that MNCs have positive spillover effects on local firms in developing countries and transition economies in terms of productivity (Blomström and Pearson,
1983; Dobson and Chia, 1997), technology transfer to local industry (Rhee and Belot, 1990; JBIC Institute, 2002), wages (Lipsey and Sjöholm, 2004) or integration by imitation into international trade (Aitken et al., 1997) As stated by Dunning (1992, p.456 (from Altenburg, 2000)), ‘the findings of a large number of studies over the past 30 years are virtually unanimous that the presence of foreign owned firms has helped raise the standards and productivity of many domestic suppliers and that this has often had beneficial spillover effects on the rest of their operation.’ Others find that these generalized interpretations of FDI spillovers rest on shaky empirical foundations. Rodrik (1999, p.39) argues that ‘today’s policy literature is filled with extravagant claims about positive spillovers from FDI…[yet]…the hard evidence is sobering.’ Thus, it is questioned whether FDI produce statistically significant effects on economic growth (Caves, 1996; Nunnenkamp, 2004), total factor-productivity growth (Haddad and Harisson, 1993; Kokko, 2002; Lipse and Sjöholm, 2005; Ayyagari and Kosova, 2006), wages (Lipsey and Sjöholm, 2004) competition (Kugler, 2000; Blalock and Gertler, 2007), or exports (Kokko et al., 2001). Indeed, some studies find negative impacts of FDI on local firms in developing countries (Aitken and Harisson, 1999) and in transition economies (Djankov and Hoekman, 2000; Konings, 2000).

Thus, the extensive empirical literature analyzing the multinational-local firms nexus neither provide conclusive results on the general impact –positive or negative- of multinationals on the productivity of the local firms, nor on the impact’s magnitude. The lack of firm conclusions in regard to spillovers is of course related to the fact that MNCs may produce different amounts of spillovers under different conditions. Thus it has emphatically been argued that the spillover literature needs to discriminate better between different factors shaping spillovers (Nunnemkamp, 2004; Görg and Greenaway, 2004). In the following we will review the research on spillovers that qualify under which conditions MNC spillovers may take place and when not.

5.2. Industry factors (B1)

It is commonly argued that much of the variation in interpretation of MNC spillovers depends on whether we are talking about vertical or horizontal spillovers (also called inter industry and intra industry spillovers). In his seminal study of spillovers, Caves (1974) used cross-sectoral data on the correlation between FDI and local industry productivity. Here significant positive productivity effects of FDI were detected. However, one main problem of Caves’ approach was that MNCs may be entering high productivity sectors rather than being the cause of high productivity. Indeed, later panel data analysis produced results that were somewhat more ambiguous with regard to intra-
industry spillover effects (Görg and Strobl, 2001); some studies showed direct negative effects of FDI (Aitken and Harrison, 1999; Kathuria, 2000), while others detected no effects (Haddad and Harrison, 1993; Kugler, 2000). Meyer concludes that “overall evidence does not support the proposition of positive intra-industry productivity spillovers, with the possible exception of special circumstances such as the transition from central planning to a market economy.” (Meyer, 2004)

In contrast, studies of vertical spillovers produce more robust results. Thus several studies find evidence of productivity spillovers on related industries in Lithuania (Javorcik, 2004), Indonesia (Blalock and Gertler, 2007), Columbia (Kugler, 2000), Hungary (Schoors and van der Tool, 2002; Halpern and Muraközy, 2005) and the Czech Republic, Poland and Slovenia (Damijan et al., 2003). Most of these studies are focusing on effects upstream in the value chain, but there are also studies that find positive downstream effects for example franchise holders (Altenburg, 2000) or distributors and agents (Hansen et al., 2006). The reason why we tend to find more evidence of vertical spillovers than horizontal spillovers is obviously that MNCs are less concerned with sharing technology and know how with firms in other industries as these are less likely to become competitors.

Much of the spillover literature focuses on the effects of manufacturing MNCs. However, as pointed out by UNCTAD (2004), services are increasingly being internationalized, both service industries proper and service value chain activities within manufacturing firms. The internationalization of information technology (IT) and other business services offers new opportunities for the integration of firms in emerging economies into the global economy as evidenced by the successful growth of Indian IT and business process outsourcing (BPO) firms. The empirical material focusing on spillovers in services is still very poor and inconclusive. Alfaro (2003) for example, finds that FDI has exerted an ambiguous effect on economic growth in the service sector of a sample of 47 countries (including developed and developing countries) over the 1985-1999 period. So too is the academic research differentiating the FDI impact on the basis of technology intensity of the foreign investor. Bosco (2001) for example, suggests that the Hungarian firms did not benefit from the presence of foreign firms in high technology industries. On the one hand, foreign high technology industries have a higher spillover potential than low technology companies, but on the other hand, they particularly want to prevent their technology from leaking over to local firms (especially in countries with weak intellectual property rights), and local firms in less developed countries might fail to absorb advanced technologies and information.
5.3. Country factors (B2)

It is increasingly acknowledged that many of the detected FDI spillover effects depend on the characteristics of the host economy (Nunnenkamp and Spatz, 2003). Some countries have a higher capacity to absorb effects of MNC activity than others. Thus, a recurring theme in the literature on spillovers is that the direction and magnitude of the impact are conditioned by a certain threshold of development. In particular, it appears that spillovers depend on GDP per capita so that the higher the GDP per capita, the larger the spillovers (Blomström et al., 1994).

The underlying dynamic here is, of course, that the sophistication of the local business environment to a large extent influences spillovers. In particular, the technology gap between local firms and MNCs has been seen as an important determinant of spillovers. While some have argued that a high technology gap produces more spillovers (Kojima, 1973), most observers argue that low technology gap is conducive of spillovers (De Mello, 1999) as is high skills level in the local labor force (Borensztein et al., 1998). Görg and Greenaway (2002) conclude that economic backwardness functions as an impediment to spillovers and Nunnenkamp (2004) suggests that spillovers are higher when the technology gap between the foreign investor and the local economy is small. Kathuria (2000) finds that spillovers depend on the extent to which local firms have invested in developing learning and innovation capabilities and Kokko et al. (1996) argue that when the efficiency distance between multinationals and local firms is too large, local firms may be unable to absorb new technology and know how, and multinationals may be dissuaded from interacting with local firms. Thus, we have a dilemma with regard to spillovers: spillovers increase in significance and importance when the differences in technology levels are high (Gerschenkron, 1962); however the ability to absorb falls when the technology gap is wide.

The ability of local industry to absorb spillovers has been intensely explored in the growing research on absorptive capacity (see for example Cohen and Levinthal, 1990; Narula and Lall, 2004; Zahra and George, 2002), where absorptive capacity refers to the ability of local firms to identify, integrate and exploit knowledge from MNCs. In countries with low levels of industrial development, typically the least developed countries, there will be no or few firms that can absorb the knowledge and technology of MNCs and thereby few spillovers will occur. As an infant local industry emerges, we will see growing arms-length spillovers in the form of competition and demonstration effects. As local industry becomes more advanced - partly as a consequence of arms-
length spillovers from MNCs— we will see the evolution of deeper and more reciprocal linkages between MNCs and local firms with higher spillover potential (Scott Kennel and Enderwick, 2004).

**The role of governments**

It is broadly acknowledged that government policy plays a pivotal role in producing spillovers although government intervention does not always produce the spillover effects intended. A general observation is that open trade regimes tend to produce types of spillovers different from those produced by restrictive, inward-oriented policies (Balasubramanyam et al., 1996; UNCTAD, 1998; Altenburg, 2000; Nunnenkamp, 2004). Open trade regimes may on the one hand reduce spillover as they allow for the import of intermediate products and resources as an alternative to local sourcing. On the other hand, open trade regimes may encourage MNCs to transfer more advanced types of production to host countries and use them as export platforms thus increasing the likelihood of knowledge and technology spillovers. Likewise, intellectual property rights policies may make a huge difference; if there is lax intellectual property rights protection, MNCs may be reluctant to share any knowledge or technology with local firms, for example in licensing agreements.

Where host governments, a few decades ago, used highly crude discriminatory measures to tame and domesticate FDI (for example local ownership requirements or local content requirements), the investment measures in the post-Washington consensus era tended to opt for across the board FDI attraction. Today, a broad variety of measures are adopted which are constantly assessed against the constraint provided by international trade rules of non-discrimination. Thus, governments actively seek to promote spillovers directly through local content regulations, tariffs or subsidies, indirectly through infrastructure programs, and education policies (Altenburg, 2000; Spar, 2008). Many emerging economies are further promoting FDI spillovers by developing the capabilities of local supply industries to link up to MNCs and thereby potentially absorb the technology and knowledge. A particular issue concerns subsidies and other incentives which are widely used to promote spillover generating FDI. The literature intensely debates whether such measures are effective in achieving spillovers on local industry (Blomström and Kokko, 2003; Tavares and Young, 2005). Finally, some countries promote the development of clusters as a way to enhance spillovers. The idea is that a cluster of related and supporting industries may enhance the likelihood of MNC location and increase the chances of local firms benefiting from the MNC presence due to industrial specialization, higher concentration of specialized labor skills and geographical proximity (Thompson, 2002; De Propis and Driffield, 2005).
5.4. The strategies of multinationals (B3)

Spillovers will also depend on the strategies of MNCs, a fact that is often ignored by the more macro-oriented spillover literature. Thus, most spillover research employs relatively aggregated FDI data, typically at country or industry level and little distinction of spillover impacts based on the specificities of MNC strategies are made (Nunnenkamp, 2004). However, a growing literature emphasizes the heterogeneity of MNCs when determining spillover effects, arguing that spillovers depend on MNC specific factors such as ownership configuration (Javorcik and Spatareanu, 2008), export orientation of the subsidiary (Sgard, 2001), subsidiary mandate (Tavares and Young, 2005) or corporate governance (Meyer, 2004). The investment motive of the MNC appears to be a particularly crucial determinant of spillovers (Reuber et al., 1973; Papanastassiou and Pearce, 1999; Altenburg, 2000; UNCTAD, 2000a; Belderbos et al., 2001; Dicken, 2003). Generally, it is argued that efficiency seeking investors foster deeper but less extensive spillovers on local firms than market seeking investors (Nunnenkamp, 2004; Hansen et al., 2009). The organization of the MNC also appears to have implications for the amount and quality of spillover; for instance, Forsgren (2002) has argued that MNCs which are organized as network or matrix organizations have higher knowledge spillover potential than MNCs organized as multi-domestic or global companies.

5.5. The nature of linkages (C)

In recent years, emerging literature has directed attention toward the organizational modalities through which spillovers occur, that is linkages. This literature is relatively novel; as argued by Meyer in his review of the spillover literature, ‘future research ought to prioritize the study of vertical relationships by analyzing how spillovers arise in individual interactions of a multinational firm and a local agent or firm. What characteristics of relationships facilitate spillovers?’ (Meyer, 2004).

The linkage literature essentially treats linkages as an intermediary variable, moderating and shaping FDI spillover effects. Thus with one-sided and hierarchical relations between foreign and local firms, we may get dependent linkages with few catalytic effects on the local business environment, with collaborative and interactive relations, we may get developmental linkages with huge catalytic effects in terms of technology and skills upgrading (Dicken, 2004; Scott-Kennel and Enderwick, 2005). The early linkage literature (see for example Singer, 1950) argued that MNCs often fail to integrate in local industries and sectors, providing little impetus for development. Thus, the presence of a multinational or several multinationals could take the form of ‘enclaves’ which do
not communicate with the rest of the economy. Linkages were mostly found to be missing in sectors in which multinationals are internalizing their activity and/or importing the bulk of the needed intermediates (UNCTAD, 2001) for example in agriculture and in mining activities (Larsen et al., 2009). On the other hand, multinationals in other industries appeared to foster broad linkages in the host economy by creating industries that supply the MNC and by inducing forward industries to use the multinational’s output as inputs, the so-called crowding-in effect of FDI (Wilkins, 1998). Some have even argued that some MNCs may be ‘developmental’ in the sense that they have the creation of linkages as a key component in their strategy (Altenburg, 2000). Rodriguez-Clare (1996) argued that linkages will become more intense, the more complex the good produced by the multinationals, the higher the transport costs, and the more similar the intermediate products produced in the host and home country. Enclave behavior results from low communication costs and from the production of different varieties of intermediate products in the home and host countries of the multinationals. Lin and Saggi (2007) found that MNCs either choose an anonymous short-term market interaction with suppliers or prefer a long-term contractual relationship and engage in technology transfer to suppliers who in turn accept to serve the multinational exclusively. The multinational’s entry under the exclusivity clause has a de-linking effect by which the multinational displaces pre-existing linkages between local firms and their suppliers. The exclusivity clause reduces the rivalry among local suppliers which tends to reduce the aggregate output level of the intermediate goods industry but increases the technology transferred to local suppliers. The net effect can either be positive or negative. When the multinational chooses an anonymous market interaction, the number of competing suppliers that serve the multinational is large, but the technology transferred is poor.

Giroud and Scott-Kennel (2009) consider that three key attributes determine the spillover impact of linkages: quality, quantity and scope. Quality is linked to the magnitude of transfer of resources, which occurs between subsidiaries of MNCs and local firms. Duration of the relation is central because the development of trust between firms positively influences inter-firm exchange and learning. Quantity refers to the number of inter-firm relationships formed in the host country, as well as the value added by local firms in value chains managed by MNCs. Scope refers to the types of linkages: they may concern other firms in the value chain or take the form of collaboration with competitors or firms in other industries and collaboration with local institutions. The larger the types of linkages formed (supply-chain, collaborative) and the industries/institutions concerned the more developmental impact are expected.
The nature of integration between MNCs and local firms in global value chains may also be of importance to spillovers. Thus, the global value chain literature (see for example - Gereffi, Sturgeon and Humphrey, 2005; Sturgeon, 2008 for overviews) examines how global value chains configure production patterns globally. Large dominant lead firms in the North organize these value chains, with developing country firms being integrated in more or less dependent positions. The literature essentially identifies five different linkage structures between MNCs and local firms: integrated, captive, modular, relational and market. These linkage structures provide different spillover opportunities for developing country firms in terms of upgrading and learning. A distinction between four types of upgrading spillovers is made; process upgrading, product upgrading, functional upgrading and value-chain upgrading. Whereas there may be opportunities for process upgrading and even product upgrading for developing country firms in linkage collaborations within global value chains, MNCs will rarely be willing to assist local firms in moving into higher value adding activities such as R&D or marketing and sales. Thus, due to the linkage structure inherent in global value chains, the spillover potential on emerging economy firms appears to be restricted.

6. Contributions of the book

We have now provided an overview of the extant literature on spillovers in terms of theoretical orientation as well as the main issues debated. In the following section we will present the main findings of the spillover studies presented in this book and discuss how the studies are all contributing to our understanding of MNC-local firm interaction.

Part II of the book provides four spillovers case studies

During the last twenty years, Hungary has attracted significant FDI in the manufacturing industry and especially in the automotive and electronics sectors. Empirical literature assessing the impacts of FDI in these industries is relatively abundant. On the other hand, the FDI phenomenon in business services - which is relatively new in economies in transition and still in its infancy -, has hardly been studied at all. The extant literature, with the notable exception of Alfaro’s study (2003), is short of studies of spillovers of MNCs in the services sector. The chapter ‘The impact of FDI in business services on the local economy – the case of Hungary’, written by Magdolna Sass aims precisely at filling this gap by assessing the impact on the local economy of offshore outsourcing and offshoring of services by MNCs. Hungary has become one of the leading locations in attracting
FDI in business services projects in the East-Central European area. Thanks to interviews taken from eight large companies which created approximately 5500 jobs (out of roughly 20,000 jobs in the business service activity), Magdolna Sass suggests that spillovers are scarce because backward linkages but also forward linkages with indigenous firms remain limited. This can be explained by at least three main factors. (1) FDI is recent in the business services and linkages only develop progressively with the growing embeddedness of MNCs in their new host environment. (2) Since almost the totality of the services are ‘exported’, forward spillovers are absent. (3) Finally, Magdolna Sass detects ‘endogamy’ behavior, that is, cooperative relationships between the foreign-owned firms while sourcing from local firms is confined to buying various ‘basic’ services, such as cleaning, security services, catering, and certain training services, and to the use of local infrastructures (telecommunications, electricity, financial services, other infrastructures). In a near future, potential spillovers may transit through the mobility of workers. Indeed, most of the jobs in the MNCs providing business services belong to the medium- and medium-high skilled categories, and some young trained employees (who represent the bulk of the workforce in the MNCs) may create their own company or go to locally-owned companies, although, currently, employees move more between foreign-owned companies than from MNCs to local firms.

The chapter ‘Do Multinational companies transfer technology to local small and medium sized enterprises? The case of the Tegal metalworking industry cluster in Indonesia’ by Tulus Tambunan consists of a case study of clustered metal workshops in the automotive and shipbuilding sub-sectors in the district of Tegal in Indonesia. Based on a sample consisting of 34 respondents including owners of inti (first tier supplier) and plasma (second tier supplier) who have subcontracting businesses, local workshops owners who supply only to retail markets, local government officials, and non-government organizations, the author assesses the MNCs’ role in technology transfer to SMEs in Indonesia. Our review of the literature in part I has demonstrated that the technological capacity of local firms is a decisive determinant of spillovers. Tulus Tambunan’s case study confirms this relation. The author suggests that among the different channels through which technology is transferred internationally, subcontracting arrangements managed by MNCs is probably the most promising channel for the metal industry in Indonesia. The author highlights the prominent role played by the Japanese company Komatsu which has actively developed subcontracting production linkages with Tegal metal workshops and hitherto contributed to the development of the Tegal metalworking industry cluster. Yet Tulus Tambunan suggests that technology transfer concerns a limited number of local firms: only firms which have already
succeeded in mastering a certain level of technology capability become long-term partners of MNCs. The Tegal case study also demonstrates that small enterprises lack the technological, financial and management capabilities required to gain benefit from the presence of MNCs. In order to avoid a dualistic development of the Tegal metalworking industry the government should focus on the capacity building of the less advanced SMEs and especially of the smallest firms.

In the chapter ‘African SMEs and the challenges in global value chains: The case of Nigerian garment enterprises’ Osmund Osinachi Uzor adopts an international business perspective and focuses on the nature of linkages linking multinationals to local enterprises. He argues that it has become of central importance for African garment producers to integrate the Global Value Chains (GVCs) driven by MNCs. Yet with the exemption of South Africa, SMEs in sub-Saharan Africa are marginalized in GVCs. This is also the case for the garment producers in Nigeria. To highlight the challenges small and medium Nigerian garment producers face in order to participate in the GVCs activities, Osmund O. Uzor organized interviews with 60 entrepreneurs and their workers in Aba -in Abia state in Nigeria, between 2003 and 2008. The empirical study suggests that the poor integration in GVCs results from insufficient production upgrading. Most of the firms in Aba are small firms which face a double constraint: a financial constraint preventing them from acquiring more modern equipment and a human resource constraint owed to the low level of skilled workforce. This empirical work demonstrates that even in low technology industries such as the garment industry, with the globalization of value chains, countries with insufficient capabilities fail to integrate the buyers’ world networks and consequently do not have access to the information concerning the consumer tastes, market niches and so on, that would allow them to adapt their production to world standards. Policies should de facto focus on how the capability gap in micro and small enterprises could be reduced so that linkages with large firms and global buyers might be developed.

In the chapter ‘Mutual productivity spillovers and regional clusters in Eastern Europe: some empirical evidence’ Chiara Franco and Kornelia Kozovska question whether spillovers between MNCs and local firms are more present in clusters than outside. Our theoretical framework (part I) has suggested that industry factors matter and some empirical research has tended to demonstrate that clusters facilitate linkages and spillovers. Hence, one may expect spillovers - that is ‘direct’ spillovers from MNCs to local firms but also ‘reverse’ spillovers from local firms to MNCs, to be larger in clusters than outside since industrial specialization, higher concentration of specialized labor skills and geographical proximity should foster linkages between the two kinds of firms. In
order to assess the presence of a positive ‘cluster effect’ the two authors use a econometric model in which they put in firm-level data of 4111 firms from Poland and 1547 from Romania over the 2000-06 period. Contrary to expectations the two authors fail to find direct spillovers in clusters in Poland and Romania. Although some local firms are part of regional clusters, they are still not able to effectively create linkages and benefit from the various externalities which are present in clusters. ‘Direct’ spillovers are neither detected in low technology sectors nor in high technology sectors. Looking into the reverse effect, even though not statistically significant in many cases, the results suggest that foreign firms benefit from being located within clusters. These results question policies of many developing countries and transition economies, and especially the Central European countries, who have put at a high position in their economic agenda the creation of clusters as a catalyst for the upgrading of local firms. The presence of local firms in clusters may facilitate the creation of linkages, yet it does not guarantee that they will benefit from positive externalities resulting from the activity of MNCs.

Part III of the book moves into discussions of policies and programs to promote linkages and spillovers from FDI.

In part I we have suggested that the literature intensely debates whether incentives policies are effective in achieving spillovers on local industry. In the chapter ‘Scope and effectiveness of FDI policies in transition economies’, Črt Kostevc, Tjaša Redek and Matija Rojec analyze the investment incentives policies of transition economies from the point of view of their effectiveness in attracting more and better FDI, and contribute de facto to adding new material to the incentives policy issue. Although investment incentives are a secondary determinant of FDI they are increasingly expected by foreign investors when looking for an investment location. The chapter provides an overview of measures adopted in various transition economies. Transition economies’ investment incentives are predominantly of the behavioral type, targeted towards high-tech sectors, transfer of technology, R&D and training. In principle, incentives are equally available for foreign and domestic firms, but implicitly most of them seem to target foreign investors. Increasing attention is also paid to the delivery of incentives, that is to the assurance that the incentives granted will really bring the expected payoffs. The overview of the incentives schemes of selected transition economies broadly suggests that such incentives have limited effectiveness. The main message for FDI policies of transition economies may be that, conceptually, FDI-related policies should primarily be regarded in terms of potential spillover effects, meaning that an increase of local firms’ absorption capacity is of paramount importance if FDI is really to be an agent of development.
In the chapter ‘Policies for attracting FDI and enhancing its spillovers to indigenous firms: the case of Hungary’, Katalin Antalóczy, Magdolna Sass, and Miklós Szanyi also evaluate the measures adopted by Hungary to attract FDI and focus on the measures aiming at enhancing backward linkages. Three phases of Hungarian FDI policy are identified: an early phase starting already before 1989 where Hungary as one of the first Central and Eastern European (CEE) countries opened up for FDI and continuing to around 1996. In this phase, FDI was aggressively promoted and FDI attraction became closely tied to privatization programs. A second phase (1996-2003) was a normalization phase, where FDI policy became more selective. Hungary offered extensive incentives to foreign investors, but was increasingly challenged by other CEE countries offering even more generous incentives, leading to an incentive escalation. The third phase is closely connected to EU enlargement where competition concerns moved to the forefront at the expense of selective incentive schemes. In this phase, Hungary had to move towards non-discriminatory measures to attract FDI, for example tax reductions, infrastructure developments or the establishment of industrial parks. One of the key points of the chapter is that Hungary realized at an early stage that simply attracting FDI was not enough to benefit from FDI. Thus, the country, as one of the first CEE countries, adopted accompanying supplier development programs. The chapter provides a detailed account of the evolution of these programs and raises the question of whether they have been effective. As there is little empirical research on the effectiveness of Hungarian linkage promotion policies, the chapter offers two short company case studies of large MNCs’ investments receiving substantial support from the Hungarian government. One of the companies, Electrolux, facilitated the formation of many local linkages but of low technical sophistication, while the other company, Nokia, created few linkages as the production was technically advanced. The two cases offer a paradox for FDI policy, as from a development perspective highly desirable advanced technologies are often associated with MNCs that have closely integrated global value chains and therefore result in relatively few local linkages, whereas less advanced technologies will be associated with MNCs that create larger linkages to the local economy.

In the chapter ‘Policies and Institutions on MNC-SME Linkages: The Brazilian Case’, Delane Botelho and Mike Pfister observe that Business Linkages (BL) between MNCs and local suppliers can create significant spillovers on local SMEs in the form of information and technical knowledge exchange, production efficiency, productivity growth, and market diversification. Investment Promotion Agencies (IPAs) can play a crucial role in promoting such linkages. The chapter evaluates current BL policies and programs in Brazil, the largest FDI recipient in Latin America.
The chapter starts out by describing the complex FDI promotion architecture which exists in Brazil at the federal and regional level and which dates back to the late 1980s, emphasizing programs that seek to promote BL between MNCs and SMEs. The chapter moves on to present the results of an empirical study of BL in Brazil, how they are structured, where they are leading to the development of local firms, and what role BL programs have played in promoting these BLs. One of the conclusions is that while Brazil has many policies promoting SMEs, it still lacks effective BL promotion policies and BLs are mainly driven by the business sector rather than the government. The chapter ends with a number of tangible policy recommendations, for example that BL programs should be further developed, that education and capacity-building activities should be intensified vis-a-vis SMEs, and that BL programs should be anchored outside governments (for example in business service providers). Overall, the chapter warns that linkage dynamics are highly context-dependent and that it is therefore essential for BL programs to be flexible and anchored at the local/regional rather than the federal level.

In the chapter ‘Is attracting Foreign Direct Investment the only route to industrial development in an era of globalization? The case of the clothing and textiles sector in South Africa’ Søren Jeppesen and Justin Barnes analyze the industrial development strategy adopted by South Africa for its textile industry and the role played by FDI in this strategy. In recent years this industry has seen a profound decline in terms of the employment generation, the contribution to GDP, turnover and performance. Simultaneously, foreign producers have thrived and imports especially from China have increased many times. The chapter essentially examines whether the demise of the South African textile industry can be attributed to a failed industrialization strategy. Theoretically, four generic industrialization strategies can be envisioned; FDI attraction; integration into Global Value Chains; licensing and joint venture agreements; and the export of own-designed products. The South African government has clearly chosen to follow the latter strategy of export orientation without relying directly or indirectly on FDI. This in contrast to other African countries such as Lesotho, Mauritius, Kenya, all relying extensively on FDI. Thus, the chapter traces the failure of the South African strategy to its inability to use FDI to access technology, designs, and markets through licensing, subcontracting and joint ventures with MNCs. Only through closer linkages between foreign firms and local producers would South African producers have been able to close the ‘gap’ related to technology or marketing; indeed, the chosen export-oriented strategy with no FDI linkages is the only option South Africa should not have opted for.
7. Conclusion

Taken together, we believe that the chapters of this volume have contributed to the received literature on MNC-local firm interaction in emerging economies in a number of ways. **First**, the studies have provided new insights into spillover dynamics in the hitherto little-analyzed empirical contexts of emerging economies of Eastern Europe, Asia, Africa and Latin America. As the methodologies and thematic focus of the chapters varies too much to allow for formal comparison, we get some interesting glimpses of spillover dynamics in different regions of the world. However this book sheds additional light on the spillover literature of economies in transition in a comparative perspective to developing countries. Spillovers and consequently the upgrading of indigenous firms in transition economies has been less present than was initially expected in the economics of transition literature. Despite the pre-existence of an industrial tradition and a relatively high level of human capital, but also active FDI policies, spillovers from MNCs onto local firms have been rather disappointing. Although transition economies differ from developing countries regarding the quality of institutions, geography, industrial structure and so on, they share many similarities with developing countries concerning the determinants and impacts of FDI on local firms.

**Second**, the book suggests that there are indeed huge spillover potentials from FDI. From Hungary, from Brazil, from Indonesia and from South Africa, we find evidence of technology transfer, learning and upgrading in the relationship between MNCs and local firms. Indeed, as some authors have argued, from a development perspective these spillover effects may be the single most important contribution that MNCs may have made to economic development. The studies have further documented how these spillovers may occur sometimes through arms-length relations, sometimes through more or less intense collaboration. However, a key message coming out of the studies is that spillovers do not occur automatically and under any circumstances. Indeed, the main message of the book is that spillovers are highly context dependent. Spillover dynamics thus vary enormously between countries, industries and MNCs. Moreover, different linkage practices may moderate the spillover effects of FDI.

**Third**, the chapters have contributed to the literature on spillovers on specific aspects, for example the importance (or rather lack of importance) of clusters, the role of linkages, the constraints and limitations on spillovers provided by global value chain dynamics, the importance
and limitations of policy-induced spillovers. In this way, the contributions of this book bring the literature forward and add to the accumulated knowledge in the field.

Fourth, the book demonstrates why standard econometrics fails to find a conclusive relation between FDI and the development and upgrading of indigenous firms in developing countries and transition economies. Indeed the book suggests that **five main factors interact and determine the magnitude of spillovers**: (1) the ‘rules of the game’ of the industry; (2) the technological intensity of the industry; (3) the ‘genetic code’ of the multinational; (4) the capacities of local firms; (5) the quality of FDI policies. Each of these factors opens new avenues for future research.

(1) the rules of the game vary from industry to industry and contribute to determine the nature of linkages between MNCs and indigenous firms. Whereas in the metalworking industry in Indonesia, MNCs have actively developed their local embeddedness, MNCs have only very limited linkages in the business services industry in Hungary. Global value chains’ perspectives have introduced an inter-industrial comparative approach and contributed to a better understanding of the mode of governance of different value chains (automobile, electronics, garments and so on). Yet the empirical material remains poor on services activities. Further research should focus on the spillovers of services activities in developing countries and transition economies, and assess the impact of MNCs in services compared to manufacturing activities. Do services open new upgrading opportunities in countries in which spillovers in manufacturing activities have been disappointing?

(2) The technological intensity of the industry also matters. The spillover potential should be particularly high in high technology industries, especially in clusters. Yet in Poland and Romania, the presence of spillovers in high-technology industries has not been detected. There is clearly a dilemma between the easy-to-achieve but limited spillover potential of low technology activities and the difficult-to-achieve but high spillover potential of high technology activities. Further research needs to address this dilemma by entering into the ‘black box’ and focusing on the specific capacities that prevent local companies from benefiting from advanced technology.

(3) International business studies have largely demonstrated that the ‘genetic code’ of the MNC also determines spillovers. This ‘code’ results from several factors such as the nationality of the firm, its competitive advantages, its history, and so on. In this book it has been suggested, for example, that the Japanese company Komatsu has actively developed its production linkages
with the Tegal metal workshops. Since some companies have a developmental attitude whereas others tend to limit their interaction with local firms, further research might break up this ‘code’ to assess the common features of the ‘spillover-MNCs’.

(4) The limited absorption capacities by local firms of new management practices and technology, appears clearly in all the chapters of the book as the Achilles’ heel for spillovers in developing countries, but also in transition economies. Local firms fail to adopt new technology or practices when they do not attain a certain threshold of development and/or when technology is too sophisticated. Several factors such as financial constraints, insufficient human capital and failing institutions interact and limit the learning potential of developing countries.

(5) Part III of the book also suggests that the quality of FDI policies matters. FDI open-doors policies and generous incentive packages do not support spillovers. Since spillovers are a catalyst for development, this book suggests that policies aiming at promoting MNCs-local firms relationships should be a priority in the upgrading agenda of developing countries and transition economies. Moreover, spillovers have idiosyncratic characteristics and de facto policy makers should adapt policies ex ante and ex post to the three dimensions: industry, strategy of the MNCs and host country endowments. As a consequence, and this is indeed a key message of the policy-oriented chapters of the book, any policy measures to promote spillovers should carefully scrutinize the specific context in which these measures are adopted.
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