This paper considers how economic globalization has affected opportunities and challenges for developing countries in following a multinational enterprise (MNE)-assisted development strategy, revisiting an earlier article by the authors. The growing share of industrial activity owned and/or controlled by MNEs has not—by and large—led to a proportional increase in sustainable domestic industrial growth. Particular attention is paid to how MNEs have responded proactively to globalization by modifying their strategies, spatial organization and the modalities by which they interact with host economic actors, and how these changes alter our understanding of MNEs and development. What has been learnt over the last decade about embeddedness, institutions, inertia, absorptive capacity, spillovers and linkages, and how they can explain the success of some countries (or regions) in promoting growth, and the failure of others, is examined. The need to link MNE and industrial policies systematically is highlighted. Attracting the “right kinds” of MNE activity remains important, but greater heterogeneity of MNE activity and host locations requires greater customization of policy tools.

JEL Classification: F23, O14, O19

1. Introduction

This paper revisits the question of the role of foreign direct investment (FDI) and multinational enterprises (MNEs) in light of the changing international conditions, notably those associated with growing globalization. In an earlier article (Narula & Dunning, 2000), we examined some of the changing realities associated with globalization, and how they affected the opportunities for developing countries in a global economy where MNEs play a growing role as catalysts, participants and instigators in development. We emphasized that the kinds of FDI a country received were at least as important as the quantity of FDI, and that the motivation underlying FDI was of crucial significance.
In the intervening decade, globalization has wrought many changes. Although much of our analysis still holds true, there is also much that needs clarification and further consideration. A growing share of industrial activity is indeed owned and controlled by MNEs in the developing world, although this has not always resulted in a proportional increase in development effects. This paper seeks to explore why MNEs have influenced domestic industry growth in some circumstances and not in others, drawing on both the international business and economics literature on FDI and MNEs.

As with our earlier contribution, the aim is not to summarize or highlight trends in international development, which form—now as then—a background to our discussion. The earlier article is used as a lens with which to limit the span of our commentary, reviewing and addressing lacunae and suggesting a variety of avenues where further research will help advance the understanding of MNE-assisted development.

We begin by revisiting the investment development path (IDP). Lessons learned over the last decade require us to revise and update the IDP if it is to remain relevant as a tool for understanding the interaction between investment and development. Particular attention is paid to how MNEs have responded proactively to globalization by modifying their strategies, spatial organization and the modalities by which they interact with host economic actors, and how these changes change our understanding of MNEs and development. What have we learnt about (inter alia) embeddedness, institutions, inertia, absorptive capacity, spillovers and linkages, and how can they explain the success of some countries (or regions) in promoting growth, and the failure of others?

2. Revisiting the Investment Development Path

The framework for our discussion is the IDP (see Dunning & Narula, 1996; Narula, 1996; Narula & Dunning, 2000). The basic principles of the IDP can be summarized as follows:

1. There is a systematic relationship between the structure, extent and nature of the FDI activities associated with a given location, and the economic structure of that location, which in turn reflects its level of economic development.

2. There is an interactive effect between three groups of advantages: the ownership (O) advantages of domestic firms; the O advantages of MNEs; and the location (L) advantages of countries. This three-way dynamic interaction is the essence of MNE-assisted development.

3. This relationship can be usefully analysed by categorizing their evolution through five stages, and ceteris paribus this stage-wise progression can be observed in all countries, although the rate of change and points of inflection are unique to every country.

These basic points form the conceptual bedrock of the IDP. However, different strands in the literature have focused on particular elements. We distinguish between two strands in the literature. The first presumes the truth of the first principle above, and emphasizes the third principle, which we shall describe below as the “graphical IDP”. The second—referred to here as the “interaction IDP”—pays especial attention to the first two principles. It is this strand that forms the basis for the rest of this paper.

The graphical IDP. The graphical version of the IDP was originally intended as a mechanism to illustrate the relationship between FDI and development, and utilized the
now well-known J-curve using net outward investment (NOI) and gross domestic product (GDP) (see Figure 1) in Dunning (1981). This curve (modified from its initial J-shape to allow for the fifth stage of evolution) has itself become the subject of empirical studies, which utilize both time series of individual countries and cross-sectional analyses across countries. Many recent studies have analysed the cross-sectional analysis in its own right, although the original intention was that cross-sectional analysis was to be used only as a proxy for time series analysis. Some mistakenly apply such cross-sectional analysis to predict the “optimum” or “appropriate” levels of FDI for a given level of GDP (normalized by population). Such studies ignore the idiosyncratic nature of individual countries, and the fact that GDP is itself a highly imperfect proxy for development. Countries’ economic structure and industrial and technological specialization reflect exogenously determined characteristics such as size, population, geographic location, natural resource endowments, and so forth. Each country follows a unique and individual IDP, and the stages through which it passes are also unique and specific to itself. As the stages are indicative rather than categorical, cross-country comparisons are only to be undertaken with caution, providing little in the way of development implications.

Perhaps most importantly, however, to use the IDP to “predict” how much FDI a country “should” have is to presume a causal relationship between FDI and GDP (however normalized), and as any student of econometrics will affirm, correlations do not imply causality. It is not entirely clear that there is a direct causality between FDI and development. Our view is that while a relationship exists between MNEs and development, there is a very large “black box” of intervening mechanisms and processes (Bell & Marin, 2004). Unless these intervening mechanisms between MNE activity and development are properly understood, all that can be said with certainty is that the determinants of FDI are also the determinants of development (Narula, 1996).

Figure 1. Graphical version of IDP. NOI: net outward investment (not drawn to scale; for illustrative purpose only).
The evidence can be read either way: countries such as Korea, Japan and (to a lesser extent) Taiwan relied extensively on licensing, technology transfer agreements, imitation and other non-FDI-based modalities to catch up, the common element being the use of foreign knowledge sources (which may be tied to MNEs in general), rather than FDI. In other cases, such as Ireland and Singapore, growth can be linked to FDI. Likewise, large amounts of FDI in resource-rich economies have not always resulted in much more than marginal industrial development, nor do high levels of FDI sustain industrial development equally efficiently in different stages. Most indicators suggest that the level and intensity of MNE activities—in terms of share of inward FDI in the overall economic activity of individual economies—have increased generally and across the board in most developing countries. However, we are not convinced that increased inward MNE activity necessarily implies that this will result in greater or more rapid industrial development.

Later in this paper we propose that these ambiguities are better understood when we move to adopting MNE activities as the unit of analysis, and at the country level absorptive capacity as a measure of its potentially successful utilization. We are not postulating that FDI (or MNE) activity per se plays no role in development. We are simply emphasizing that MNE (or FDI) activity is not a conditio sine qua non for sustainable industrial development (Lall & Narula, 2004). Although MNEs may have certain direct benefits (such as employment, balance of payments, etc.), the most significant contribution of MNEs to the growth of productive capacity is indirect: where inward MNE activity results in positive externalities, and when domestic firms have the capacity to internalize these externalities usefully, and if the non-firm sector supports domestic capacity building, there will be industrial development. The alleged growth of outward MNE activity from developing countries raises similar concerns: outward MNE activity does not necessarily imply reverse knowledge transfer between (or indeed systematic links with) the foreign operations and the home country, or indeed that these knowledge flows will have a non-negligible effect on the home country (Narula, 2010). In short, any such association (as is the case with certain late stage 3 countries such as Spain or Korea) presumes that the home country’s firms have the necessary absorptive capability to benefit from them (see e.g. Alvarez & Molero, 2005).

The ‘graphical IDP’ simply cannot do justice to these complex and intricate interactions, because it seeks to reduce the process into a two-dimensional frame.

The interaction IDP. A second group of contributions have emphasized these interactions, and utilize the IDP as a framework within which to analyse development and the MNE: they explore the interactive relationship between the O advantages of firms and the L advantages of countries and how each provides the potential to instigate changes in the other, whether seen at a country, industry or firm level. This approach is succinctly summarized in Table 1. It provides the background against which we can ask: What forces and interactions determine the turning points of a country’s investment development path? Why do some countries demonstrate a positive cumulative causation between MNEs and development in certain industries, yet fail in this regard in others? We seek to apply this version of the IDP to our analysis.

2.1 What Do We Know about the Interaction Process?

The nature of these interactions is an issue to which the burgeoning empirical evidence on MNEs and growth does not offer any firm guide. Some of these gaps in our understanding—for instance, the extent to which FDI spillovers are internalized by domestic firms—may
<table>
<thead>
<tr>
<th>Stages of the IDP</th>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
<th>Stages 4 and 5</th>
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<tbody>
<tr>
<td>Natural resource-based</td>
<td>Little IFDI and negligible OFDI; low intra-industry trade and investment</td>
<td>Increasing IFDI and limited OFDI; low intra-industry investment, increasing intra-industry trade</td>
<td>OFDI increasing faster than IFDI; increasing intra-industry trade and investment</td>
<td>Substantial I and O; O often exceeds I; substantial intra-industry trade and investment; balance between I and O fluctuates around net zero or positive level of in/outward FDI</td>
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<td>Balance of inward FDI (IFDI) and outward FDI (OFDI)</td>
<td></td>
<td></td>
<td></td>
<td>Increasingly market-seeking, efficiency-seeking and asset-augmenting investment</td>
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<tr>
<td>Characteristics of inward MNE activity</td>
<td>Little inward FDI initially. As L advantages improve, resource-based motives, and market-seeking later</td>
<td>Growing presence of market-seeking FDI—attracts labour-intensive manufacturing</td>
<td>Raising IFDI, market-seeking and increasing efficiency-seeking FDI in manufacturing, in activities supplying more sophisticated products for domestic market, or requiring more skilled labour</td>
<td></td>
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<tr>
<td>Characteristics of outward MNE activity</td>
<td>No outward FDI—strategic investments and capital flight</td>
<td>Little OFDI. Mainly resource- and market-seeking investment in other developing countries; some “escape” investment to developed countries; mostly regional greenfield investment; natural resource investment; light manufacturing employing established technologies</td>
<td>Growing OFDI; all kinds of investment, including efficiency-seeking and some asset-augmenting investment; mass-produced differentiated consumer goods, e.g. electrical products, clothing; more service investment, e.g. construction, banking</td>
<td>Increasingly efficiency-seeking and asset-augmenting investment; regional and global; more M&amp;As and alliances; investment in knowledge-intensive sectors, e.g. ICT, biotechnology, and high value-added services, e.g. consultancy, restructuring of global value chains</td>
</tr>
<tr>
<td>O advantages of firms</td>
<td>Few domestic firms with O advantages</td>
<td>Ability to produce low-cost, standardized products, or those based on natural resources of home country</td>
<td>Strong domestic industries; ability to differentiate products and/or adapt to local consumer tastes; some limited product and process innovation</td>
<td>Strong created-asset O advantages of domestic firms; coordination of the internal and external network of the MNE; importance of open innovation</td>
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(Table 1. Continued)
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<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
<th>Stages 4 and 5</th>
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<tbody>
<tr>
<td>Natural resource-based</td>
<td>Investment driven</td>
<td>Innovation driven</td>
<td>Increasing knowledge and service intensity; knowledge economy</td>
</tr>
<tr>
<td>Increasing knowledge and service intensity; knowledge economy</td>
<td>Increasing L advantages, low real wage costs; natural resources; supply capacity and clusters of local industry; growing importance of education, transport and ICT infrastructure</td>
<td>Innovation-intensive Schumpeterian sectors</td>
<td>Increasing importance of supply capabilities, support services and market-facilitating services; government role in minimizing transaction costs, supporting innovation, and fostering economic restructuring; increasing importance of informal institutions</td>
</tr>
<tr>
<td>Industrial upgrading and manufacturing comparative advantages evolution</td>
<td>Hecksher-Ohlin sectors</td>
<td>Undifferentiated Smithian sectors</td>
<td>Differentiated Smithian sectors</td>
</tr>
<tr>
<td>L advantages of the home country</td>
<td>Few L advantages, Mainly presence of natural resources, but infrastructural support also important; government role in setting up legal and commercial system</td>
<td>Growing L advantages, low real wage costs; natural resources; supply capacity and clusters of local industry; growing importance of education, transport and ICT infrastructure</td>
<td>Created-asset L advantages are increasing; entrepreneurship; larger, more sophisticated, markets; government role in economic restructuring and enforcing competitive markets; increasing importance of informal institutions</td>
</tr>
<tr>
<td>Economic structure</td>
<td>PRIMARY sectors</td>
<td>Declining</td>
<td>MANUFACTURING sectors</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Increasing</td>
<td>SERVICE sectors</td>
</tr>
<tr>
<td>Preferred modality of IB(^a) activity</td>
<td>Imperfect markets and peripheral nature imply either trade or FDI linkages</td>
<td>Tendency for firms to prefer more equity ownership to protect proprietary knowledge and to control markets, and more licensing activity</td>
<td>Increasing use of cooperative and/or contractual relationships to manage the external network of the MNE; focus on “core competence” with extensive use of outsourcing</td>
</tr>
</tbody>
</table>

\(^a\)ICT, information & communication technologies.
\(^b\)IB, international business.
well reflect methodological weaknesses, inter alia, to do with the use of the total factor productivity and the production function model, as well as problems with some of the popular proxies used in measuring technology, knowledge and learning (Rasiah, 2008). Nonetheless, the literature has matured to the point that there are some clear certainties. We know that fostering appropriate domestic capabilities in an appropriate sequence can create the conditions for benefits from knowledge flows within an economy and between economies. Such knowledge flows can be engendered in MNE activity, or through arms-length actors or quasi-hierarchical mechanisms such as alliances. Growth in earlier stages depends upon the assimilation and adaptation of more mature knowledge assets in sectors where absorptive capacities have been concurrently developed, and when the technology gap is not too large. Establishing the conditions for adaptation and assimilation of these knowledge flows requires systematic coordination through industrial policy (Amsden, 1989, 2001; Lall, 1996). The level and nature of industrial policy intervention vary both by the stage of the IDP, and the kinds of MNE-related development strategies on which the country may have focused. The strengths or weaknesses of institutions shape the ability of domestic firms to exploit MNE-generated externalities efficiently. Some take a systems perspective to an economy, which subsumes the institutions’ view—that the efficiency of economic actors depends on how much and how efficiently they interact among themselves (Fagerberg & Srøhlec, 2007; Criscuolo & Narula, 2008).

Considerably less is known about the points of inflection. Much of the research points to important threshold levels (of absorptive capacities/human capital/infrastructure, etc.) without which countries fail to “take off”. It is unclear (for instance) what threshold level of L advantages is necessary to begin to attract the right kinds of FDI that promote growth in stage 1 countries. Or why a country such as Malaysia has thus far failed to progress towards being a significant outward investor, despite high growth rates, high levels of inward FDI activity and a vibrant domestic sector. It is the search to provide more understanding of these processes, or at the very least to provide greater richness to the framework for understanding these turning points, that forms part of the motivation behind this paper.

It is important to highlight that while much of the work on the IDP focuses on the country level, learning and absorption take place at the firm level. However, the success or failure of individual firms occurs in orchestration with an entire “system”. Innovation and learning involve complex interactions between a firm and its environment. The environment consists first of interactions between firms, especially between a firm and its network of customers and suppliers. Second, the environment involves broader factors shaping the behaviour of firms: the social and perhaps cultural context; the institutional and organizational framework; infrastructures; the processes that create and distribute scientific knowledge, and so on. Thus, the appropriate level of analysis to understand the effects of MNEs on development may not necessarily be that of the country, but the industry. Aggregation to a national level can lead to obfuscation of important trends (see Durán & Úbeda, 2001 and Bellak, 2001, who undertake an analysis of the IDP at the industry level).

2.2 Supranational Regions, Countries or Regions within Countries?

The IDP is not just restricted to understanding MNEs and development at a country level, but also regions within countries: indeed, it may be more relevant at a disaggregated level. Large differences exist in the developmental levels of regions within given countries, and this disparity is naturally reflected in the quality of L advantages on offer to
MNEs. China provides an excellent illustration of this. The distribution of FDI inflows to its three macro-regions remains very uneven, with the highest concentration on the coastal region, with the vast central (in terms of both land area and population) and western regions having attracted only a small amount of FDI.\(^8\) The coastal region has essentially been converging with the world economy, while the central region and western region have been diverging in relative terms.\(^9\)

Thus, despite close geographical proximity, sub-regions within a country can exhibit vastly different L advantages. It is therefore not inconceivable that a given nation state can exhibit industrial development patterns, MNE activities and policies reminiscent *inter alia* of both a stage 1 location and a stage 3 location simultaneously, and evolve in parallel, but independently so. Situations such as this may explain why (as some commentators have suggested) countries are seen to “jump” stages (Mathews, 2006) and leapfrog, engaging in labour-intensive, Smithian industries as well as Schumpeterian sectors. Many developing countries demonstrate a dual (or even multiple) economy, and *inter alia*, this helps explain why attention has been drawn to the cases of China and India, where pockets of world-class competence in extremely advanced knowledge-intensive sectors have grown rather rapidly, cheek-by-jowl with agrarian and labour-intensive sectors, more typical of a developing country in stage 1 or stage 2. Thus, where regions or countries possess the relevant absorptive capacities, sector-specific industrial catch-up is potentially possible. However, such strategies require considerable complementary investments and large amounts of capital and planning—and are by no means always successful.

On the other hand, policy space is affected in the opposite way, because non-national economic actors (whether other countries, or international and supranational organizations) now play a role. Obviously, there is considerable variation in the extent to which countries are so affected, and roughly speaking, the stage of the IDP reflects the extent to which they are integrated into the world economy, and which non-national institutions and knowledge sources affect them. Globalization implies *de facto* economic, political and social integration, thereby creating a longer-term interdependence between countries and firms, but interdependence implies reciprocity. Countries for whom reciprocity is “unequal” demonstrate fewer cross-border effects of globalization on policy.

Regional integration is an important complementary development to globalization, and has a similar effect on limiting policy space, as well as potentially improving a country’s L advantages. Regional integration schemes also represent an opportunity to redress the inequities of multilateral agreements, and to increase their autonomy from outside forces. Both regional integration and globalization are processes closely associated with cross-border economic activity, although globalization is more a consequence of increased cross-border activity, whereas regional integration is intended to *cause* it (Dunning & Narula, 2004).

Regional integration can also play a significant role in changing the milieu for learning, MNE linkages and general cross-border knowledge flows. The effect of regional integration can strengthen the L advantages of countries and can be crucial in determining the efficiency with which knowledge is acquired, created, diffused and utilized. In deeper integration schemes, rules established at the supranational level can supersede national regulatory frameworks, and membership itself becomes a significant L advantage. They can also act to constrain policy space: international treaties such as World Trade Organization (WTO) agreements also shape policy tools available to countries.
3. Path Dependence in Policy Orientation and the IDP

A weakness of both versions of the IDP is that they oversimplify the role of policy orientation and its influence in determining the nature of the interactions. This is about more than just current policies. Previous policy orientations will have shaped the way in which economic activity is organized, and consequently there is considerable path dependence in economic structure, which often limits the efficacy of current policy. Despite an ostensibly greater openness to inward FDI, countries that had hitherto restricted inward FDI flows continue to show attenuated inward MNE activity, such as Japan, Korea and India. Our earlier work distinguished among economies using the dichotomy of an outward-oriented, export-oriented policy orientation (OL-EO), or an inward-looking, import-substituting orientation (IL-IS), which in hindsight seems an oversimplification. Policy orientation plays a significant role in hindering or promoting MNE activity. This dichotomy also presumed no explicit strategy towards MNEs, but emphasized trade policies.

On the one hand, there is considerably greater overlap in how policy has historically been implemented in most countries, reflecting the fact that most countries’ policies derived at some level from the more generic import-substitution principles. On the other hand, there have been important variations between each country, reflecting the different political, sociological and economic milieu, and how these have evolved over time. These have affected the role of the MNE and associated development strategies, and continue to affect trajectories today.

For instance, the majority of East Asian newly industrialized countries (NICs) implemented similar infant industry programmes in the 1950s, discouraging foreign ownership when possible, and encouraging the development of domestic enterprise in much the same way as had Latin American, African and South Asian countries. While maintaining the basic objective of building up domestic manufacturing capacity, Taiwan modified its import substituting regime in the late 1950s, and Korea followed suit in the mid-1960s, seeking to encourage exports alongside the primary goal of building domestic industrial capacity. Singapore shifted further, dropping IS policies almost completely around the same time. Later, Malaysia and Thailand began to move to a greater export orientation and friendliness towards FDI, although still maintaining an orientation towards building domestic capacity. Yet others reformed their IS policies in the 1990s. The point here is that all these countries pursued industrial policies that maintained significant elements of IS regimes until (and in some cases, beyond) the 1990s.

Thus, it is only really possible to say that the East Asian countries adopted a more outward-looking, export-focused policy orientation at a much earlier period in time. Almost all developing countries actively sought to intervene to support the growth and competitiveness of their domestic sector, but the East Asian NICs did so alongside an export orientation. Most of East Asia was thus—for a period—both export-oriented and import-substituting (EO-IS) at the same time.

The large-scale liberalization of most developing countries from the mid-1980s onwards saw a massive shift away from import substitution, but at different rates and with varying degrees of enthusiasm. In many cases their prior orientations have shaped their subsequent growth. For instance, much of Latin America has moved only reluctantly towards an outward orientation, pressured into structural adjustment programmes by the economic crises in the 1980s. The restructuring entailed large-scale privatization of public sector activities, rapid dismantling of import and FDI restrictions, and the termination or
attenuation of state incentives and public goods aimed at enhancing the competitiveness of domestic firms. Some countries in their subsequent restructuring strategies have taken a largely passive FDI-dependent policy and gone to the other extreme: they have emphasized international markets and export competitiveness, but withdrawn the support structure that allowed firms to internalize the positive externalities that derived from international competition. Others have taken a more strategic and proactive approach—state intervention has been more clearly targeted and coordinated to enhance domestic technological capabilities and competitiveness, while at the same time emphasizing international markets as a benchmark.

The sudden exposure of these economies to the vagaries of international competition has not necessarily facilitated their institutional restructuring. Liberalization did not always take place gradually, but required rapid changes towards a multilateral view on hitherto domestic issues. Institutional inertia in many cases meant that countries were quick to see the costs of globalization (principally the erosion of economic—and political—sovereignty and the growing ineffectuality of IS-era policy tools) as outweighing the benefits associated with it. Although by the mid-2000s many countries had largely overcome institutional inertia, old IS-era perceptions continue to shape the “flavour” of policies. National champions and interest groups from this period continue to hold sway; a suspicion of MNEs continues to limit access in certain sectors.

Policy orientation matters because without a clear industrial policy that is systematically integrated with FDI, strategies will result in suboptimal sustainable industrial growth opportunities. The current OL-EO passive FDI-dependent strategy differs from the strategic FDI-dependent strategy in several important respects, but especially because it underestimates the costs and the difficulties of internalizing technological spillovers. Perhaps most significant, however, is the failure to implement reciprocal control mechanisms and to use international competition to target domestic competitiveness against international norms, which export orientation allowed the East Asian economies to do. Countries such as Brazil, which targeted international markets in particular industries, achieved similar levels of technological competitiveness to the Asian countries in some areas (Amsden, 2001). While the “new” OL-EO model has helped correct many inefficiencies, inter alia, improving important macroeconomic fundamentals, and reduced the excessive role of the state in domestic industrial activity, it has also led to a rapid and overzealous reduction in the state’s involvement in the provision of public and quasi-public goods, which are necessary conditions for industrial development (Katz, 2001).

Inefficient institutions can slow the efficient accumulation and transfer of knowledge between industrial enterprises and other economic actors within their milieu, influencing growth in general (e.g. Rodrik et al., 2004; Lall & Narula, 2004; Meyer & Peng, 2005; Asiedu, 2006). A fundamental shift from one political and/or economic regime or policy stance can represent a discontinuity or “shock” to the system, and this can undermine both formal and informal institutions. There is often strong institutional inertia, which must be overcome, requiring a shift that may be fundamental, as experienced by the former centrally planned economies during their transition, or from an import-substituting stance to a more open, export-oriented one, as experienced by many developing countries, the difference being one of degree (Narula & Jormanainen, 2008).

Inertia can be pervasive at the level of a whole economy, because often there is a self-reinforcing interaction between industrial enterprises, the infrastructure and politics that perpetuates the use of specific technologies, the production of specific products, the
adoption of specific processes, and the use of specific customer–supplier associations. Institutional restructuring is not an instantaneous or costless process and can result in inefficient outcomes, as actors are not always willing to alter their *raison d’être*. Institutions developed for, or specialized around, a particular economic system are not always efficient at responding to the needs of others.

4. Heterogeneity in MNE Activity

4.1 Moving Away from FDI and Towards MNEs

Although there is a tendency to associate the control and coordination of an MNE’s international operations with majority-owned foreign affiliates, both control and coordination may be achieved through minority ownership, and in some cases through non-equity means. Historically, FDI and MNE activity have been synonymous, partly a reflection of the data collection by countries and international agencies. Although FDI remains one of the main modes by which MNEs engage in cross-border value-adding activities, *de jure* ownership of productive assets is no longer a useful benchmark. An MNE may simply be a set of establishments in different locations, which are actively coordinated and controlled, without involving ownership. This has significant implications for development, as we shall discuss in later sections.

As noted elsewhere, alliance capitalism is of growing importance, which implies that the favoured modes of cross-border value-adding activity have begun to shift away from an emphasis on hierarchies towards a richer variety of organizational modes (Dunning & Lundan, 2008). This has occurred along with a systematic shift in certain sectors and a variety of industries away from the vertically integrated firm. Improved enforceability of contracts and declining transaction and monitoring costs have made it easier for firms of all sizes to monitor, identify and establish collaborative ventures than had been the case previously (Narula, 2003). This has implications for our understanding of the potential for non-internalized means of MNE activity to affect industrial development, a matter we shall take up in greater detail later.

This mode of international collaboration has significance for our understanding of the quality and quantity of linkages and the potential for knowledge spillovers. It is important to point out that there are other direct and indirect benefits besides spillovers and linkages. However, in terms of learning potential, these are the most significant. Therefore, attracting MNEs without considering the potential for linkage creation is short-sighted. The modern rationalized and efficiency-seeking MNE can be said to be a global production network (GPN), with its complex set of non-equity and equity associations with suppliers and customers. GPNs do not necessarily represent a single firm in the traditional sense, but are often built around a single dominant MNE “lead firm”. From a development and policy perspective, the important issue is the nature and extent of linkages established, not with whether these linkages are organized intra-firm or inter-firm (see Henderson *et al.* (2002) and Dicken (2007) for a discussion).

Figure 2 illustrates a two-country scenario of a joint venture between an MNE and a domestic firm. With FDI as the unit of analysis, only the organizations linked by the solid arrows matter, as these involve equity relationships. However, when the MNE is the unit of analysis, a variety of other means to engage in knowledge exchange can be included. For instance, technology may be licensed or purchased by the MNE affiliate from
unaffiliated public research organizations based either abroad or locally. A second set of linkages are active two-way collaborations (indicated in Figure 2 by the dashed lines), which may involve a large array of actors, both domestic and foreign. Such agreements represent a higher level of knowledge exchange, and may be undertaken with a variety of partners. In general, these non-equity linkages present considerable potential to increase knowledge flows and the potential technological competitiveness of domestic firms, as they create important new sources of demand for commercially driven economic units engaged in R&D. Of course, as we discuss later, MNEs are reluctant to develop knowledge-intensive linkages with new and untested partners, but they point to the potential for important knowledge flows, assuming the local milieu possesses the appropriate quality of location-specific advantages in terms of infrastructure, human capital and public-sector actors.

Figure 2. Equity and non-equity cross-border knowledge flows.
It is worth mentioning that knowledge flows and linkages can also be associated with second- and even third-level suppliers to an MNE, as well as helping these firms to establish partnerships with other non-related economic actors. Yeung et al. (2006) point to important network effects for firms not directly related to the lead MNE in a cluster, and its role in creating non-cluster external economies for its suppliers.

4.2 Refocusing Analysis on the Role of Subsidiaries

It has largely been assumed that the nature of the MNE affiliate and its potential for spillovers and the creation of domestic linkages is somehow reflected in the nature of the parent firm’s operation as a whole, both in terms of its industry-specific characteristics, as well as the kinds of ownership advantages it possesses and the nature of location advantages it seeks to utilize in conjunction with these O advantages.

Different kinds of subsidiary will provide different kinds of potential linkage and spillover effects (Cantwell & Mudambi, 2000; Marin & Bell, 2006; Jindra et al., 2009). There are at least two reasons for this. First, because the O advantages of a subsidiary are not necessarily a subset of its parent (Birkinshaw, 1996). In addition to the transfer of assets from the parent to the subsidiary, the subsidiary also evolves its own set of managerial and technological capabilities, which may either arise as a response to location-specific characteristics (such as peculiarities in supply conditions, or location-specific demand), or because the subsidiary has evolved independently of the parent firm (either because the subsidiary is an acquisition, or because the MNE’s strategy is based on a “federal” model of freestanding and largely autonomous country affiliates). As a result, such multinationals tend to be organized as a loosely coupled network of relatively autonomous subsidiaries, each with its own strategic goals and activities (Astley & Zajac, 1990; Birkinshaw, 2002). Even where the MNE operates as a tightly coupled organization with a high degree of interdependence and coordination between subsidiaries (Astley & Zajac, 1991), the affiliate in question may possess affiliate-specific O advantages. Each affiliate can evolve its own profile of capabilities, which may overlap with that of the headquarters, but the extent of the overlap is a function of country- and subsidiary-specific path dependency (Birkinshaw & Hood, 1998). In other words, the subsidiary itself may provide unique, subsidiary-specific spillovers to the domestic economy, and for this reason its strategic decisions in terms of sourcing and linkages may differ from that of a sister subsidiary in another host location, not just from that of its headquarters.

Second, the decision to interface with the local economy is not entirely a subsidiary-level decision, particularly with more tightly linked organizations. Thus, there are dangers in taking a purely subsidiary-level view for policies to promote embeddedness, without considering how the subsidiary strategy interfaces with that of the overall parent MNE strategy (Papanastassiou & Pearce, 2009). There are competing forces: those that require local responsiveness of subsidiaries and those that require subsidiaries’ integration into the global umbrella of the MNE’s overall structure. When local responsiveness of a subsidiary is important because local market or industry-specific conditions require a response to individual host-country circumstances, the subsidiary has more decision-making autonomy within the overall MNE set-up. When there are considerable gains to the MNE from greater cross-border coordination, and industry-specific characteristics allow for greater standardization, subsidiaries are afforded limited autonomy.
The extent to which subsidiaries possess unique and potentially valuable subsidiary-specific ownership advantages and the extent to which the subsidiary is autonomous in its decision-making are also closely linked. The subsidiary’s bargaining power *vis-à-vis* the headquarters is greatly enhanced where a given subsidiary is a net contributor towards the MNE’s overall knowledge capabilities, and is therefore able not only to exert greater autonomy in relation to its own activities in its host location, but also may help shape the entire MNE.

One might argue that the ideal situation from a development perspective is when a host subsidiary is *both* deeply integrated within the MNE network (and thus of signal importance to the MNE as a whole) and deeply integrated into the host milieu (which implies considerable linkages with the host economy) (Young & Tavares, 2004; Costa & Filippov, 2008). However, this happy state of affairs is hard to achieve in practice. Less-developed countries are often host to truncated affiliates with very little value-adding, and are of peripheral significance to the MNE’s overall strategy. Governments thus have limited influence on MNE strategy, and can rarely influence how embedded MNEs are locally through incentives, unless they also have specialized L advantages to offer. There are exceptional circumstances where this “double embeddedness” does happen, for instance, where an acquired affiliate has O advantages that are location-bound and are strategically significant, and hard to duplicate or relocate elsewhere.

Double embeddedness is difficult to achieve because there is a trade-off between local embeddedness and MNE embeddedness. Generally, all host countries can expect is to promote local embeddedness. When a strategic affiliate has a long history in a given location and is highly embedded locally, the cost of realigning its supplier base may greatly outweigh the benefits of integrating it more closely into the rest of the MNE. Local embeddedness is mostly only gradually achieved, except where the nature of the product or service requires a multi-domestic strategy, or where embeddedness has been a condition of establishment of the subsidiary (as in the case of, for example, China).

MNEs seek well-established *existing* location advantages, and the initial scale, scope and competence levels tend to match the existing capacity of the innovation system, and the existing potential for backward linkages. This is often modest in the case of most developing countries (and particularly in stage 1 countries). The bulk of their higher value-adding operations tend to be based in countries with the appropriate non-generic specialized L advantages—usually a handful of advanced stage 4 and 5 countries and an even smaller group of stage 3 economies. Attracting more strategic R&D activities to developing economies is especially difficult. MNEs tend to display a strong inertia towards maintaining their R&D activities in a few (carefully selected) locations (Narula, 2002). Of course, operations of less strategic significance within the MNE may not be subject to such high levels of inertia, but it is safe to say that the greater the strategic importance of the activities planned in a given location, the greater the cost to the MNE of a “wrong” decision, both from an economic and from a strategic perspective, and thus the greater the forethought given to such investments and the greater the locational inertia and bias towards proven existing locations.

Locational inertia works both ways: just as it is difficult to persuade MNEs to establish operations in a new location, once a threshold level of activity and embeddedness is achieved, the MNE is less likely to be footloose. It is also worth noting that there is considerable path dependence in the type of subsidiary based in a given location. Prior to economic liberalization, MNEs responded to investment opportunities primarily by
establishing miniature replicas of their facilities at home, although the extent to which they were truncated varied considerably between countries (Dunning & Narula, 2004). Few MNEs still utilize miniature replicas when engaging in greenfield investments. When MNEs have rationalized their operations globally, many miniature replicas have been downgraded to single-activity affiliates. MNEs have taken advantage of liberalization to rationalize production capacity in fewer locations to exploit economies of scale at the plant level, especially where local consumption patterns are not sufficiently different to justify local capacity and where transportation costs are not prohibitive. This has meant that some miniature replicas have been downgraded to sales and marketing affiliates, which can be expected to offer fewer opportunities for spillovers. MNE activities have seen a downgrading in terms of both scope and competence, moving towards sales and marketing operations, although some—rather few—locations (and once again, in countries such as those in or at the cusp of stage 3, such as India, China and South Africa) have seen an increase in scope or competence levels. The use of complex networks by MNEs has by and large been to the benefit of the MNE, while most host countries with generic location advantages have seen a decline in scale, scope and competence. The benefit from subsidiaries in terms of linkages and spillovers varies considerably and is not always reflected in measures of its sales, employment or flows of FDI. A sales office or an assembly unit may have a high turnover and employ a large staff, but the technological spillovers will be relatively fewer than for a manufacturing facility. Countries that are at an early stage of the IDP, with a very limited domestic sector and a poorly defined innovation system, are often host to single-activity subsidiaries, primarily in sales and marketing, as well as natural resource extraction. The most advanced economies in terms of domestic technological capacity, by contrast, have hosted the least truncated subsidiaries, often with R&D departments.

It is only in those sectors where “specialized” location advantages associated with higher value-adding exist that host countries can benefit significantly from MNE activity in the long run. This requires a considerable amount of government interaction and investment in tangible and intangible infrastructure, in which there is a certain threshold level in building up the absorptive capacities required for “take-off”. As countries reach a threshold level of technological capabilities, governments need to provide more active support. This implies developing and fostering specific industries and technological trajectories, such that the location advantages they offer are less “generic” and more specific and immobile, so that they encourage mobile investments to be locked into these assets.

It is worth noting that discussion of MNE-assisted development continues to focus excessively on the attraction of new (initial) MNE affiliate establishments and their associated mode of entry.\textsuperscript{13} From a development perspective, this ignores the fact that any given affiliate is itself subject to undergoing its own ongoing internal dynamics (as discussed earlier). The nature of its activities also relies on a dynamic between the MNE’s value-adding operations and the changing L advantages of the host location over time. We know that MNEs may be more likely to transfer sophisticated technologies and management techniques to their wholly owned subsidiaries than to partially owned affiliates (Javorcik & Saggi, 2004). Nonetheless, the extent of the spillovers and linkages is not always determined \textit{ex ante}. \textit{Ceteris paribus}, initial greenfield investments—no matter how large the initial investment might have been—do not become immediately embedded into the host economy, but evolve over time. Sequential investments imply increased
linkages and thus greater potential for development. The initial investment represents a tentative “bet” by the MNE on the quality of a host’s L advantages. The nature of inertia is such that it is easier to persuade those that have already sunk costs in facilities to expand them (assuming positive returns\textsuperscript{14} to the MNE and constant or improving L advantages) than to seek to attract a new greenfield investment. Thus, investments that take place several years after the initial investment may be more beneficial in terms of spillovers and linkages (Costa & Filippov, 2008).

5. Revisiting the Motivations of MNE Activity

Table 2 lists how the motives for FDI evolved between the 1970s and the early 2000s. In the early period, cross-border organization structures were simple, and motivations for specific subsidiaries tended to be overwhelmingly resource-seeking or market-seeking, with a minority of MNEs engaged in efficiency-seeking or strategic asset-seeking activities. The emphasis has shifted considerably over the last 30 years, in that MNEs have become increasingly sophisticated in managing and integrating activities across borders and even relatively new and smaller MNEs are organized to maximize cross-border efficiencies and take advantage of the economies that derive from multinationality. MNE operations also tend to involve multiple motivations simultaneously (Criscuolo et al., 2005). One can, nonetheless, speak of certain host locations providing L advantages that are especially suited for specific activities, relative to others. One would not expect significant strategic asset-seeking activities in stage 1 countries, where L advantages would be ideally suited to resource-seeking activities. At the same time, a single country might be host to several subsidiaries of the same MNE, each motivated differently, or in different parts of the same country. Given our earlier discussion about subnational regions and differences within countries, it should come as no surprise that such multiple L advantages attract MNE activity simultaneously motivated by such greatly different intentions.

The discussion of motives remains important because they are indicative of the potential consequences of MNE activities, and changing motivations over time reflect how MNEs perceive that L advantages have evolved. However, by themselves, motives cover a multitude of sins, not least because there is considerable overlap between them. In addition, while MNE motives and strategies are interrelated, firms plan in terms of strategies not motives, and these in turn vary by industry. Market-oriented affiliates may purchase more locally than export-oriented affiliates. Resource-seeking FDI in extractive sectors tends to have limited opportunities for vertical linkages, owing to the use of continuous production processes and the capital intensity of operations, and to provide limited avenues for upgrading unless carefully encouraged. In manufacturing the potential for vertical linkages are broader, depending on the extent of intermediate inputs in total production and the types of production process.

6. Crowding-in or Crowding-out? The Effect of MNE Activity on Domestic Firms

In principle, greater participation of MNEs in a developing economy should cause a crowding-in effect, stimulating both new and more efficient domestic enterprises. On the other hand, the contrary result, that of crowding-out—where domestic firms are displaced, out-competed or pre-empted by foreign-owned MNEs—is an outcome that countries seek to avoid.
<table>
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<tr>
<th>Type of FDI</th>
<th>In the 1970s</th>
<th>In the 2000s</th>
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<tbody>
<tr>
<td>A. Resource-seeking</td>
<td>1. Availability, price and quality of natural resources</td>
<td>1. As in the 1970s, but local opportunities for upgrading quality of resources and the processing and transportation of their output is a more important locational incentive</td>
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<td></td>
<td>2. Infrastructure to enable resources to be exploited, and products arising from them to be exported</td>
<td>2. Availability of local partners to promote jointly knowledge and/or capital-intensive resource exploitation</td>
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<td></td>
<td>3. Government restrictions on FDI and/or on capital and dividend remissions</td>
<td>3. Entrepreneurship, trustworthiness and honesty of local partners</td>
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<td></td>
<td>4. Investment incentives, e.g. tax holidays</td>
<td>4. Extent and quality of national or regional enforcement mechanisms</td>
</tr>
<tr>
<td>B. Market-seeking</td>
<td>1. Mainly domestic, and occasionally (e.g. in Europe) adjacent regional markets</td>
<td>1. Mostly large and growing domestic markets, and adjacent regional markets (e.g. NAFTA, EU, etc.)</td>
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<tr>
<td></td>
<td>2. Real wage costs; material costs</td>
<td>2. Availability and price of skilled and professional labour</td>
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<td></td>
<td>3. Transport costs; tariff and non-tariff trade barriers</td>
<td>3. Presence and competitiveness of related firms, e.g. leading industrial suppliers</td>
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<td></td>
<td>4. As A3 above, but also (where relevant) privileged access to import licences</td>
<td>4. Quality of national and local infrastructure, and institutional competence</td>
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<td>5. Less spatially related market distortions, but increased role of agglomerative spatial economies and local service support facilities</td>
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<td>6. Macroeconomic and macro-organizational policies as pursued by host governments</td>
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<td></td>
<td></td>
<td>7. Quality of local norms and standards, and social capital</td>
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<td></td>
<td></td>
<td>8. Growing importance of promotional activities by regional or local development agencies</td>
</tr>
<tr>
<td>C. Efficiency-seeking</td>
<td>1. Mainly production cost related (e.g. labour, materials, machinery, etc.)</td>
<td>1. As in the 1970s, but more emphasis placed on B2, 3, 4, 5 and 7 above, especially for knowledge-intensive and integrated MNE activities, e.g. R&amp;D and some office functions</td>
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<td></td>
<td>2. Freedom to engage in trade in intermediate and final products</td>
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Table 2. Continued

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<th>Type of FDI</th>
<th>In the 1970s</th>
<th>In the 2000s</th>
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<td></td>
<td>3. Presence of agglomerative economies, e.g. export processing zones</td>
<td>3. Availability of specialized spatial clusters, e.g. science and industrial parks, service support systems, etc. and of specialized factor inputs. Opportunities for new initiatives by investing firms; an entrepreneurial environment, and one that encourages competitiveness enhancing cooperation within and between firms</td>
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<td></td>
<td>4. Investment incentives, e.g. tax breaks, accelerated depreciation, grants, subsidized land</td>
<td>4. Ability of locations to offer trust-intensive, covenantal relations of an interpersonal, inter-firm and firm/government kind</td>
</tr>
<tr>
<td>D. Strategic asset-seeking</td>
<td>1. Availability of knowledge-related assets and markets necessary to protect or enhance O-specific advantages of investing firms—and at the right price</td>
<td>1. As in the 1970s, but growing geographical dispersion of knowledge-based assets, and need of firms to harness such assets from foreign locations, makes this a more important motive for FDI</td>
</tr>
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<td></td>
<td>2. Institutional and other variables influencing ease or difficulty at which such assets can be acquired by foreign firms</td>
<td>2. The price and availability of “synergistic” assets to foreign investors</td>
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<td></td>
<td></td>
<td>3. Opportunities offered (often by particular subnational spatial units) for exchange of localized tacit knowledge, ideas and interactive learning</td>
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<td>4. Access to different cultures, institutions and value systems; and different consumer demands and preferences</td>
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<td>5. Ability to form productive relationships with acquired firms</td>
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Based on data for the period 1971–2000 for Latin America, Asia and Africa, Agosin & Machado (2005) found that at best the effect of FDI on domestic investment is a neutral one, with crowding-out having taken place in Latin America in the 1970s and in Africa during the 1990s. Despite the limitations of aggregate data, these results lend support to conclusions of studies on spillovers that once again point to the importance of the appropriateness and quality of FDI, rather than the prevalent focus on quantity. This helps to emphasize the need to match FDI with domestic capacity building, the importance of FDI embedding, and the need to understand FDI not as a discrete single-period FDI flow, but as a multi-period building up of FDI stock through deepening and spreading of value-adding activities, not all of which occur as a consequence of new flows of foreign capital.

Crowding-in is a phenomenon that relies extensively on several separate but interlinked actions. Crowding-in is associated with competition. A positive competition effect implies that the presence of MNE subsidiaries that have a higher productivity in a given industry spurs domestic competitors to raise their productivity in order to compete effectively. A positive competition effect implies existing domestic competitors (and possible new domestic entrants) in the same industry demonstrate increased capacity and market share.15 Efficiency gains also occur through a variety of other means, and indeed in practice it is difficult to separate the different modalities by which MNE subsidiaries may affect domestic industry. For instance, efficiency gain in non-related industries where similar techniques may be applied is known as the demonstration effect. In addition, there are numerous spillover effects that relate to the competition effect, for instance through the more efficient organization of linkages with input suppliers, as well as with customers; these also lead to indirect efficiency gains to competitors who reap the advantage of a more efficient set of suppliers. In addition, there are benefits that derive from indirect spillovers through employment effects, where domestic firms benefit from training provided by the MNE subsidiary to its employees, who subsequently become available to domestic firms through the job market (and who may in subsequent periods establish new competitors themselves, thus constituting a third-degree effect).

Barrios et al. (2005) found that in Ireland a negative competition effect initially prevailed, leading to the exit of domestic competitors. However, they also found that over time the negative relationship reversed itself, owing to positive externalities deriving from linkages and spillovers. This result is a significant one, as it implies that crowding-out is followed by crowding-in, implying domestic firms eventually overcome structural inertia. However, a study by Wang & Yu (2007) using data for China revealed that increases in levels of FDI participation do not always follow a linear relationship, with the extent of spillovers that derive therefrom varying by industry. In technology-intensive sectors, net positive spillovers increased with foreign participation, but in labour-intensive sectors, once foreign capital accounted for more than approximately two-thirds of an industry, there was evidence that net positive spillovers declined, and crowding-out was observed. These various results suggest that there is probably an optimal size of foreign presence to promote domestic industrial development through net positive externalities, and this varies considerably with the industry of activity, as well as the aspect of the value chain in which the MNE subsidiaries and the domestic firms are engaged.

Other complementary arguments have been proposed (see e.g. Aitken & Harrison, 1999; Mody, 2004) that point to the possibility that MNEs enjoy at least two advantages over their domestic counterparts, which do not necessarily cause positive externalities because they are not easily transferable. First, MNEs may have a low marginal cost to
utilize the O advantages of their parent (whether in the form of advertising, brand names, technological assets, or knowledge of networks). Such advantages of multinationality and size are simply not available to smaller firms. Second, they may be much more aggressive and flexible in utilizing these advantages, not being encumbered with the inertia that derives from being integrated into the local system, and the associated path-dependent political and social obligations (Wang & Yu, 2007).

These results—taken together—also point to the significance of the size of the technology gap between the MNEs and their domestic counterparts. Where the gap is too large, crowding-out effects are likely to predominate. It is worth noting that the decline in domestically owned production in a liberalized milieu does not always reflect a crowding-out in the traditional sense that the domestic firm “exits” by virtue of being economically unviable. Narula & Marin (2005) noted that for the case of Argentina, liberalization permitted a number of the more successful domestic firms to be acquired by MNEs.

7. Conclusions and Policy Implications

There has undoubtedly been a systemic change in the world economy with globalization. MNEs, in particular, have been cognizant of the opportunities for cost-economizing, market-share expansion and learning, as well as the risks associated with greater competition. By and large, they have responded proactively to the changing circumstances and have reorganized themselves accordingly.

MNEs are using a richer variety of organizational modes, and although FDI remains the single most important modality by which they engage with developing countries, it is worth emphasizing that there is a variety of other means by which MNEs may engage with, or influence, domestic economic activity. Non-FDI means of engaging with host economies are likely to grow in importance. We have underlined that there is also a need to acknowledge the greater heterogeneity in the kinds of MNE, their subsidiaries, and the potential development effects they might have, and to integrate this into the analysis of MNEs and development.

Developing countries, on the other hand, have mainly reacted to the changing circumstances by liberalizing their policies towards FDI, but this is not the same as developing active FDI policies. Most have taken a passive approach to attracting FDI flows, and pay insufficient attention to the nature of the benefits and costs associated with embedding subsidiaries and exploiting externalities. The adoption of neoliberal policies as part of structural adjustment programmes in many developing countries has meant that few have an explicit or well-considered industrial policy, often applying principles that belong as part of a more closed, import-substituting era. This is increasingly at odds with the economic realities of a post-WTO, interdependent world where such policies have limited purchase; but industrial policy still remains an essential tool to promote development, despite globalization. As Haque (2007, p. 1) put it, “[liberalization has] . . . changed the context but not the importance of policy in industrial development”. Specifically, policies towards MNE investment need to be closely linked and integrated with industrial policy. MNE activity needs to be evaluated by considering the kinds of externality that are generated, whether and how domestic actors can internalize them, and what kinds of L advantage may be required to achieve this. Indeed, the “success stories” of MNE-assisted development have sought to attract MNEs, but have also built up domestic absorptive capacities in tandem. They have then tried to upgrade their L advantages to encourage
MNEs both to deepen and to broaden their local value-adding activities (e.g. Wade, 1990; Kaplinsky, 2000; Henderson et al., 2002; Giroud, 2003; Lorentzen, 2005; Giuliani et al., 2005; Rasiah, 2006; Morris & Barnes 2008). The opportunities to upgrade value chains and link them to non-domestic actors still exist, although the tools available to do so may have changed. Traditional infant industry policies that date back to List (1844) and others are increasingly inapplicable to open economies. Given the heterogeneity of MNE activity, it makes sense that MNE promotion and industrial policies are fine-tuned to specific industries in particular countries rather than a general, one-size-fits-all approach. Nonetheless, it is also clear that completely unfettered access to domestic markets by MNEs can have a detrimental effect on sustainable domestic growth (Chang, 2004).

A crucial point we have constantly repeated is that an increase in FDI (or MNE activity) does not always result in a concomitant increase in development. There is no reason to believe that countries will move any more quickly through the stages of the IDP simply because MNE activity has increased. Quite apart from the dangers of crowding-out and the problems of stage-inappropriate MNE activities, it is not clear that increased MNE activity in terms of stock or flows necessarily implies a proportional increase in spillovers and linkages.

An important issue not dealt with in this paper (or elsewhere) is the potential development effects of MNE activity in the services sector. This has been an important area of growth in terms of inward FDI. However, there is considerable variety in service activities and different knowledge spillovers and linkages derive from each—compare (say) banking with hotels. The relative benefits of FDI in services also need to be compared with similar flows in manufacturing. To our knowledge, there are no studies that evaluate the relative benefits of investments in tertiary sectors, compared with equivalent investments in primary or secondary sectors. Another “new” issue that needs further exploration is outward MNE activity from developing countries. It is not necessarily clear how outward MNE activity benefits home countries, and how this varies by sector, motivation or part of the value chain (Narula, 2010).

The discussion of MNEs and development has not, as yet, addressed the matter of points of inflection within the IDP, and in development in general. What are the threshold levels of MNE activity to promote growth, perhaps focusing on the industrialization “failures”, which are sometimes located in the same geographical space as “successes”? Why has India not been able to move effectively towards manufacturing, unlike China or Brazil, but has proved successful in certain service sectors? It is clear that policies and their systemic implementation matter, but their efficacy varies by sector. Liang (2004), for instance, explored the relative successes of the mobile telecommunications sector and the automobile sector in China and found that although similar industrial policy was applied to the two sectors, very different outcomes have resulted.

We stress that MNE activity is not just about spillovers and linkages; nor is it necessary for policies to focus exclusively on these. Some activity mainly provides low-level employment, or tax revenue streams, and these in themselves can be reasons to attract investments; but this needs to be understood explicitly. In other words, there is a need to match and understand what the potential benefits of specific MNE projects are to specific desired outcomes from the host country perspective.

In discussing MNE-assisted development, economists pay too little attention to the political and sociological aspects. The politics of reform and the social and political costs of structural adjustment and institutional change are seldom taken into account. The extent
to which external (non-national) organizations and countries determine national outcomes can also affect the efficiency with which de facto reforms have taken place. Henisz et al. (2005), for instance, found that there is considerable variation in the efficacy of market-oriented reforms across countries, and that coercion by international agencies may lead to a less than ideal outcome. Interest groups within a society can also impede or promote a specific agenda (e.g. Spiller, 1990; Potters & Sloof, 1996), but this has remained largely unexplored in development studies. Interest groups can engage in regulatory capture, and help shape public policy to suit their own particular commercial or political interests.

Understanding development and MNE activity requires a cross-disciplinary approach, and understanding development in a post-Washington consensus world requires us to advance the analyses beyond aggregate economic growth. It is also about income disparities and what the UNDP defines as human development. Likewise, understanding the possibilities for MNE-assisted development requires us to move towards understanding the globalized world as it is, unconstrained by academic disciplines and oversimplifying theoretical assumptions. It requires us to move away from the two standard dimensions—MNEs and markets—and systematically take into account not only the role of international organizations and institutions, but also the role of civil society.

Notes

1 Although cross-section studies serve to illustrate important issues, panel data sets across countries and specific proxies (such as NOI and GDP) that are used to test the IDP raise several methodological and measurement challenges. Variables such as NOI represent an aggregation of inward and outward FDI, which are themselves also aggregate variables across a variety of sectors and industries, both of which seek to proxy the intensity of MNE activity. Furthermore, all such analyses—with almost no exception—have utilized nominal values of FDI and GDP, and in the case of FDI, variously utilizing stocks, flows, sum-of-flows and average flows as substitutes, a practice for which very little empirical evidence exists. Much the same can be said about the dangers of GDP as a proxy for development.

2 See e.g. Chowdhury & Mavrovatas (2006) and Hansen & Rand (2006).

3 One might even suggest that multinational activity is merely concatenated with host country growth, rather than being responsible for such growth. In other words, multinational activity may represent a placebo effect, indicative of improving domestic activity rather than being the most important cause of it. However, it is not our intention to investigate this possibility.

4 Although there may be growth in GDP, such growth does not imply industrial development.

5 See e.g. Narula & Dunning (2000), Barry et al. (2003), Liu et al. (2005) and Galan et al. (2007).

6 Others may derive from the difficulties of aggregating to the industry level, as spillovers may accrue to actors external to formally organized firms and sectors. Furthermore, economies may also have peculiar inter-industry relationships and interdependencies, some of which may lie in the informal sector.

7 See e.g. Zhang & Van Den Bulcke (1996).

8 Of all registered FDI by the end of 2004, the coastal region had 87.8%, the central region had 8.3% and the western region had 3.9%.

9 On a GDP per capita basis, Shanghai was US$5280, 10 times greater than that of Guizhou Province in 2004.

10 For a discussion of these policies, see Amsden (2001) and Lall (1996).

11 For a discussion of these FDI policy stances, see Lall (1996).

12 Although some research indicates that subsidiaries with greater-than-average competence levels are able to exert higher levels of autonomy (Pearce, 1999; Taggart & Hood, 1999); others have argued that because of the strategic importance of such a subsidiary, headquarters will attempt to exert tighter control (Martinez & Jarillo, 1991).

13 There is a considerable literature on the individual MNE’s choice of mode of entry (see Meyer et al., 2009).

14 Iguchi (2008) found that subsidiaries are more likely to create backward linkages with the host economy when the affiliate is seen to yield positive returns.
It may also occur in non-related industries where similar techniques for efficiency gains may be applied through what is known as the demonstration effect. In addition there are numerous spillover effects, which will be discussed in another section. Indeed, it is difficult in practice to separate these different means by which MNE subsidiaries may affect domestic industry.

References


