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# Foreign direct investment and local input linkages in Malaysia

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Nigel Driffield and Abd Halim Mohd Noor\*

This article examines variations in local input linkages in foreign transnational corporations in Malaysia. The extent to which transnational corporations foster such linkages, particularly in a developing host economy, has become an important issue for policy makers and others concerned with the long-term benefits associated with foreign direct investment. This article employs a unique data set, covering inward investors in the electrical and electronics industry, and analyzes in detail the determinants of variations in local input uses. The article develops a model of local input linkages, based on a transaction-cost framework using firm-specific factors, such as nationality of ownership, the age of the plant and its technology, and the extent to which firms employ locally recruited managers and engineers. In addition, the impacts of various policy measures on local input levels are discussed, and also the importance of the original motivation for investing in Malaysia. The article demonstrates that policy initiatives that target particular outcomes, such as stimulating exports or technology transfer, will result in a greater beneficial impact on the host country economy than more generic subsidies.

## Introduction

The question of whether transnational corporations (TNCs) are more or less committed to a particular country or region is one that has been examined on numerous occasions and in numerous ways, following John Stewart (1976), Patrick O'Farrell and Brian

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O'Loughlin (1981), Philip McDermott (1979) and Dermot McAleese and Michael Counahan (1979). This issue has become particularly pertinent to the economies of South-East Asia, given the recent economic downturn throughout the region. This article examines this issue with respect to local input linkages in the Malaysian electronics and electrical industry, using detailed firm-specific information on inward investors. The article will begin with a discussion of inward investment into the electrical and electronics industry of Malaysia, while the next section discusses issues concerning TNC-host linkages. Then the article describes and analyzes the data used. The following two sections develop an econometric model of local input usage, and present the results, while the last section includes conclusions and policy implications.

On initial inspection, there are several reasons for believing that inward investors in Malaysia may foster only weak local linkages. Low labour costs and a range of investment incentives (such as generous export subsidies and tax and re-investment allowances) have in general motivated inward investment in Malaysia. This suggests that foreign direct investment (FDI) is motivated by ownership advantages generated at home, and location advantages in the form of subsidies. Shigie Makino and Andrew Delios (1996) show that, in such cases, linkages with host country firms will be weak. This is similar to the result reported by Stewart (1976).

The concept of studying linkages to examine the stability of inward investment, and also its contribution to local development, has been understood for some time, following Albert Hirschman (1958). The greater the linkage between inward investors and local firms, the greater the gain to the local sector, through the transfer of

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