VOLUME 8 NUMBER 3 DECEMBER 1999

TRANSNATIONAL CORPORATIONS

United Nations
United Nations Conference on Trade and Development
Division on Investment, Technology and Enterprise Development

Editorial statement

Transnational Corporations (formerly *The CTC Reporter*) is a refereed journal published three times a year by UNCTAD. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975–1992) and by the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992–1993). The basic objective of this journal is to publish articles and research notes that provide insights into the economic, legal, social and cultural impacts of transnational corporations in an increasingly global economy and the policy implications that arise therefrom. It focuses especially on political and economic issues related to transnational corporations. In addition, *Transnational Corporations* features book reviews. The journal welcomes contributions from the academic community, policy makers and staff members of research institutions and international organizations. Guidelines for contributors are given at the end of this issue.

home page: http://www.unctad.org/en/subsites/dite/1_itncs/1_tncs.tm

Subscriptions

A subscription to *Transnational Corporations* for one year is US$ 45 (single issues are US$ 20). See p. 153 for details of how to subscribe, or contact any distributor of United Nations publications. United Nations, Sales Section, Room DC2-853, New York, NY 10017, United States – tel.: 1 212 963 3552; fax: 1 212 963 3062; e-mail: publications@un.org; or Palais des Nations, 1211 Geneva 10, Switzerland – tel.: 41 22 917 1234; fax: 41 22 917 0123; e-mail: unpubli@unog.ch.

Note

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the United Nations. The term "country" as used in this journal also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

Unless stated otherwise, all references to dollars ($) are to United States dollars.

ISSN 1014-9562

Printed in Switzerland

Transnational Corporations

Volume 8, Number 3, December 1999

Contents

Foreign direct investment and local input linkages in Malaysia

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

* The authors are, respectively, Senior Lecturer in Industrial Economics, Birmingham Business School, Birmingham University and Senior Researcher, Institut Teknologi MARA, Shah Alam, Malaysia. They are grateful to Max Munday and two anonymous referees for their comments on an earlier draft of this article.

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