Linkages can Help Develop a Vibrant Enterprise Sector

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From Mr. Karl Sauvant.
Sir, Virtually all countries today seek to attract foreign direct investment to advance their development strategies. This becomes all the more important as the volume of new FDI inflows declines.

FDI can offer important advantages for a recipient economy. In addition to capital inflows, benefits include knowledge transfers, access to international markets and more competition. However, these benefits cannot be taken for granted but require an appropriate policy framework.

One area that has had little attention is the supply linkages between foreign affiliates of transnational corporations (TNCs) and local firms. Foreign affiliates, local companies and host countries can all gain from the creation of linkages. By using suppliers in a host country, foreign affiliates can obtain inputs in a cost-effective, flexible and revenue-yielding manner. A local company can benefit through increased sales and by becoming linked to the global production network of a TNC and its stock of information and knowledge. Host economies, particularly in the developing world, may also have advantages in terms of income and employment generation or knowledge transfers.

Some TNCs have organized special programmes to assist their suppliers to upgrade the suppliers' technology, productivity and ability to compete internationally. However, the extent to which foreign affiliates form linkages with domestic suppliers (as opposed to, say, using imports) is determined by the end benefit ratio of such efforts. The lack of effective local suppliers can be an efficient obstacle to the creation of such supply linkages.

Policy makers can influence the willingness of foreign affiliates to use local suppliers by raising the benefits and/or reducing the costs involved. Specific policy measures that have been applied include the provision of information and matchmaking; encouraging foreign affiliates to participate in programmes aimed at upgrading the technological capabilities of domestic suppliers; and various schemes to enhance access to finance. This year's World Investment Report documents a range of such experiments.

A few countries, for example Costa Rica, the Czech Republic, Ireland, Malaysia, Singapore and the United Kingdom, have often with considerable success, set up carefully targeted linkage development programmes involving a combination of different policy measures and close public-private-sector collaboration. The area of linkages deserves attention from countries: searching for ways to benefit from FDI and to better integrate it into their development strategies. Experience shows that government support can tilt the balance in favor of more linkages, thereby contributing to the development of a vibrant domestic enterprise sector.

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