Reexaming FDI Horizontal Spillover Effects on Productivity Gain of Developing Countries: Theory and Evidence

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Abstract
This paper is motivated by the dichotomy between empirical studies and theoretical analyses about the horizontal spillover effects of Foreign Direct Investment (FDI). Numerous empirical studies have explored the linkage between multinational enterprises and indigenous firms. Generally, they got a similar conclusion that for most of the cases horizontal spillover effects are either negative or insignificant especially when the recipient is a developing country. Nevertheless, the preceding theoretical studies, like traditional international trade theories, provide support for the practice of attracting FDI, emphasizing that multinational activities could generate technology/knowledge externalities via facilitating more efficient technology and management practices to domestic firms even through the horizontal linkage. So far little effort has been made to investigate this contradiction. This paper gains a new insight by thinking about learning cost and offers one explanation for this dichotomy. According to the research of this paper, in most of the existing empirical work, there is a measurement error in TFP that leads to FDI horizontal externalities generating negative effect on productivity gain of host country via the channel of learning investment. However, after taking learning cost into consideration and remeasuring TFP, FDI spillovers through horizontal linkage will augment economic growth of recipient country in the long run by accelerating productivity growth rate of recipient country.