

Productivity Spillovers from Foreign Direct Investment in the Manufacturing Sector of India¹

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The paper studies productivity spillovers from foreign direct investment (FDI) in the manufacturing sector of India. Using firm-level data for the period 2000 to 2010, both horizontal and vertical (backward and forward) spillovers have been tested with the help of panel data fixed effects 'within' model. It is inferred that backward vertical spillovers and forward vertical spillovers positively affect Total Factor Productivity (TFP) of the manufacturing sector. Spillovers through horizontal channels are, however, encountered to be negative. Furthermore, productivity spillovers vary across various industries of the manufacturing sector. Spillovers through backward vertical channels are more pronounced than forward vertical spillovers and horizontal spillovers. The absorptive capacity of the manufacturing sector is also encountered to be weak.

I Introduction

The neo liberal reforms of 1991 widened the scope of foreign direct investment (FDI) in India. One of the reasons behind this was to gain from access to new technology, products and processes that multinational enterprises (MNEs), which are the main purveyors of FDI, bring along with them. It is often argued that MNEs possess proprietary advantages in the form of firm-specific non-tangible assets like technical knowhow, marketing and managerial skills, access to cheap raw materials, well-developed export markets, etc., which help them compete with domestic firms in the host country (Hymer 1976). Since these advantages have the characteristics of a public good, domestic firms can benefit through indirect channels known as the productivity spillovers. The latter take place when entry of MNEs leads to productivity increase in the host country firms and MNEs are not able to fully extract the quasi-rents out of it (Blomström and Kokko 1998, Caves 1974, Javorcik 2004, Kokko 1992, Kugler 2006).

Spillovers from MNEs' activities can be classified as 'horizontal spillovers' and 'vertical spillovers'. Horizontal spillovers occur within the industries in

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¹ This paper is a revised edition of the paper titled, "Productivity Spillovers from Foreign Direct Investment in the Manufacturing Sector of India", Working Paper No. UDE46/01/2014, Department of Economics, University of Mumbai.