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Multinational Enterprise Knowledge Flows: The Effect of Government Inward Investment Policy

Abstract

Governments around the world compete with each other to attract foreign direct investment from multinational enterprises (MNEs), using a variety of incentives and supports. Policy makers generally have two objectives for MNE investment that may be summarized under the headings of employment generation and knowledge creation. However, past research has provided little empirical evidence regarding which policies have the most effect on employment and knowledge flows.

Using patent data on foreign-owned firms in the UK, we analyze the effect of inward investment policies on knowledge flows into the local environment, and also estimate the effects of these policies on the headcount employment.

Key Results

At the aggregate level, investment supports appeared to have limited impact. However, an examination of the individual policy components revealed strong effects. Tax abatement and firm-specific infrastructure supports were associated with greater knowledge flows, while training grants and incentives for backward areas were associated with greater employment generation. No single policy incentive was able to generate both knowledge flows and jobs. A striking finding is that incentives for locating in backward areas had a negative effect on knowledge generation, indicating that the MNEs that were attracted by these incentives only located low-tech activities in such resource poor areas.

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