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**CLUSTER OR CAPTURE? MANUFACTURING FOREIGN DIRECT INVESTMENT, EXTERNAL ECONOMIES AND AGGLOMERATION**

**By**

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1  
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3 ABSTRACT  
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8 This paper presents reviews the nature and significance of external economies associated  
9 with MNE participation in the manufacturing industries of host economies. It argues that  
10 the balance of forces of internalisation and externalisation is currently skewed towards  
11 the former and the interests of MNEs rather than the latter and the interests of local and  
12 national communities and governments. A stylised comparison of developmental and  
13 competition state interventions in relation to MNEs and their FDI suggests that in the  
14 absence of co-ordinated interventions by governments, there will commonly be a failure  
15 of the logic of internalisation to permit localised processes of externalisation. Indeed, the  
16 experiences of the 'competition states' of the UK and the USA, the potential for the  
17 partial internalisation or 'capture' of local institutions and collective consumption  
18 expenditures rather than the externalisation associated with clustering is highlighted.  
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36 JEL Classification: F23, F2, L52, R11.  
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40 Key words: Industry clusters, multinational enterprises (MNEs), foreign direct  
41 investment (FDI), internalisation, externalisation.  
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13 1. INTRODUCTION  
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17 A series of criticisms of the economic development contributions of MNEs consistently  
18 levelled through much of the post war Fordist boom and into the early 1980s have given  
19 way to a new policy and academic orthodoxy that instead has highlighted the role of  
20 foreign direct investment (FDI) as a bearer of scarce capital and technology (Dunning,  
21 1997). (1) These past concerns - of lack of local linkages and technology transfer,  
22 'truncation' and the like - were developed in connection with manufacturing FDI and  
23 could be encapsulated in the widespread belief that FDI did not generate broader clusters  
24 but rather enclaves of economic activity (Kindleberger, 1969). The academic criticisms  
25 of MNEs were related to the policy community's specific concerns over failed attempts  
26 to create growth poles around FDI. Whilst the criticisms of MNEs and their associated  
27 FDI have not completely disappeared, there is now somewhat of an assumption in recent  
28 academic and policy literature that FDI almost inevitably delivers economic development  
29 benefits.(2) Indeed, the view that foreign ownership is bad for the development of  
30 industry clusters 'is a curious argument, in that there is currently very little academic  
31 support for it' (Birkinshaw, 2000: 96). In short, the new belief might be encapsulated in  
32 the thought that FDI can and does contribute to cluster formation.  
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3 Are we to assume that these earlier concerns were unfounded? Or ought we, as I explain  
4 in this paper, to retain important critical insights and the sort of questioning policy  
5 stances implicit in such earlier literature in a contemporary reappraisal of the contribution  
6 of FDI to national and local economic development? It is ironic that such criticisms were  
7  
8 voiced in a period of strong nation states with active industrial policies and  
9  
10 unprecedented and sustained economic growth in developed countries and indeed many  
11  
12 developing countries. Yet such concerns seem to have disappeared in a period of  
13  
14 widespread and possibly cavalier opening and de-regulation of national economies and  
15  
16 substantive disengagement of states from industrial policy in a context of comparatively  
17  
18 slow economic growth. New policy prescriptions – such as the promotion of clusters –  
19  
20 often are over-generalised and rhetorical since they actually require the sorts of active  
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22 policy interventions that rarely are now countenanced by governments, at least those in  
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24 western ‘competition states’ (Cerny, 1997).  
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36 This paper focuses on the potential for manufacturing FDI to promote clusters of  
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38 economic activity. The argument is that, in an increasingly internationally integrated and  
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40 neoliberalising world economy, the economic benefits assumed to derive from FDI  
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42 cannot be taken for granted. They remain to be obtained in the marrying of government  
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44 policy with FDI motives. The continued need for government interventions - and an  
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46 enhanced analytical base from which they can draw - is more important than ever. This is  
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48 because of the fundamental tension between the logic of ‘internalisation’ that is the  
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50 essence of the MNE and the ‘externalisation’ desired by states in order to produce wider  
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3 benefits to society but also because of the asymmetries between the sophistication of  
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5 MNE strategy and national and local government bargaining with MNEs.  
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10 The paper begins by first considering the equivocal benefits of manufacturing FDI due to  
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12 the tension between internalisation and externalisation played out at the subnational scale  
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14 in the form of clustering.(3) After noting that the external economies presumed to derive  
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16 from clustering are the exception rather than the rule in instances of MNE-dominated  
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18 clusters, the paper goes on to consider the opposite scenario – of capture or  
19  
20 internalisation of important local and national resources by MNEs. The paper concludes  
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22 by urging a more careful and critical appraisal of the benefits to be gained from  
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24 manufacturing FDI and the sorts of policy interventions required to make these happen.  
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## 32 2. MNEs, INTERNALISATION, EXTERNALISATION AND LOCAL ECONOMIC 33 34 DEVELOPMENT 35 36 37 38

39 The pioneering work of economists stressed the logic to internalisation that has driven the  
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41 rise of MNEs (Hymer, 1976; Vernon, 1969). Subsequent work also stressed the co-  
42  
43 ordination or transaction costs involved in exploiting ownership advantages overseas  
44  
45 (Buckley and Casson, 1976; Dunning, 1979). Indeed the costs of coordinating production  
46  
47 overseas are central to understanding the potential for externalisation or outsourcing and  
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49 industrial upgrading within global production networks.(4) Notwithstanding these trends,  
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51 the point I wish to develop in this section is that the logic of internalisation within MNEs  
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3 is only rarely met by an equal force of states' attempts to coordinate the externalisation  
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5 process and the generation of local economic benefits.  
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### 10 **Internalisation<sup>2</sup> versus externalisation**

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15 In any analysis of the economic development implications of MNEs it is salutary to begin  
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17 with what is commonly regarded as *the* fundamental insight. The essence of the MNE has  
18  
19 been recognised as one of a desire to exploit firm-specific advantages across borders  
20  
21 internally within the corporate entity. It is precisely this that prompted concerns of the  
22  
23 substitution of international intra-firm sourcing for localised inter-firm linkages,  
24  
25 associated transfer pricing manoeuvres, and the limited nature of technological spillovers.  
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29 As Streeten notes  
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34 the packaged or complete nature of the contribution of the transnational enterprise  
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36 usually claimed as its characteristic blessing is then the cause of the unequal  
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38 international division of gains. If the package broke, or leaked, some of the rents  
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40 and monopoly rewards would spillover into the host country. But if it is secured  
41  
42 tightly, only the least scarce and weakest factor in the host country derives a  
43  
44 limited income from the operations of the transnational firm (Streeten, 1999: 52).  
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47 The process of international economic integration is, then, a contradictory one 'that  
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49 necessarily produces, as its support, a space of flows and, as its nemesis, the importance  
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51 of place, a place of objective and subjective resistance' (Jessop, 1999: 37). For a number  
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53 of inter-related reasons, this opposition between internalisation or the space of flows on  
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55 the one hand and externalisation and the space of places on the other is asymmetrical and  
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57 becoming increasingly so in today's policy environment. The logic of internalisation is at  
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3 least an order of magnitude greater than the logic of local (i.e. sub-national)  
4 externalisation. Some of these asymmetries are illustrated in this section which contrasts  
5 the relative absence of state interventions surrounding manufacturing FDI in the  
6 competition states of the UK and USA when compared to the more interventionist  
7 stances adopted in Northeast and some Southeast Asian states. The key features of this  
8 contrast as described below are highlighted in figures 1 and 2.  
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20 INSERT FIGURES 1 AND 2 ABOUT HERE  
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24 First, firms, and MNEs perhaps more so, possess a degree of structural power in relation to  
25 governments (Lindblom, 1977). They are able to reduce their goals to a single common  
26 denominator – money - unlike states, which have competing constituencies and hence  
27 policy objectives to balance (Boddeyn, 1993). As a consequence, in figures 1 and 2, the  
28 coordinative links between parts of the MNE are generally stronger than those emanating  
29 from state bodies.  
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41 Second, if we agree that the essence of the modern corporation is a single centre of  
42 control (Cowling and Sugden, 1998), then there are always and everywhere two tiers of  
43 internalisation processes at play in MNEs in many industry sectors: the internalisation  
44 embodied at the level of individual subsidiaries in diverse locations and the  
45 internalisation or coordination among a group of subsidiaries exerted by parent company  
46 headquarters. (5) The same can only infrequently (in the case of successful Northeast  
47 Asian developmental states) be said in the case of local and central governmental  
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3 institutions within nations. Widespread liberalisation, withdrawal from intervention and  
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5 the difficulties of maintaining territorial integrity mean that central governments fail to  
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7 exert the sort of co-ordinating role among their subsidiary institutions necessary to ensure  
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9 processes of externalisation and hence industry cluster formation associated with FDI.  
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12 There may also be disarticulation among, and even dysfunctional behaviours of,  
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14 subnational government and quasi-governmental bodies. Moreover, the developmental  
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16 states of Northeast Asia stand in contrast to the competition states of the UK and USA in  
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18 their desire to coordinate the competitive capacities of indigenous enterprise and its  
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20 interactions with the foreign owned sector. In this connection, the specific policy  
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22 interventions that may be required to promote industrial clusters may pose additional  
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24 problems due to the inverse relationship between policy credibility and specificity that is  
25  
26 hypothesised to exist (Murtha and Lenway, 1994). Some sense of these differences in the  
27  
28 coordinative capacity of states is illustrated in figures 1 and 2 which stylistically contrast  
29  
30 the competition and developmental state models. The key differences between figures 1  
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32 and 2 centre on: (i) the overall density of coordinative links emanating from  
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34 governmental institutions in the host country; (ii) the density of coordinative links  
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36 between central and decentralised governmental bodies; and the density of coordinating  
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38 links between governmental bodies and (iii) indigenous and (iv) foreign enterprise; and  
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40 (v) the extent to which these coordinating links are consistently reinforced by different  
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42 arms of government. In the MNE-competition state relationship depicted in figure 1, the  
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44 lack of these coordinative links means that where clusters do develop they are likely to be  
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46 of the 'contingent' or production-complex variety discussed later in the paper. The logic  
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3 of internalisation associated with the FDI of MNEs is matched by the coordinative  
4 capacities of developmental states to produce viable clusters as depicted in figure 2.  
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10 Third, the asymmetry between the logics of internalisation and externalisation is actually  
11 greater than represented in figure 1 when we remind ourselves that MNEs' formidable  
12 competencies in coordinating activities are international in scope whereas states rarely  
13 are able to exert such a coordinative role within their national territories let alone  
14 internationally. This again is visible in figures 1 and 2. The emphasis in both figures is  
15 upon the host economy partly because coordinating links from host government bodies  
16 rarely extend overseas.  
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20 Fourth, we might add, à la Williamson (1975), that MNEs add opportunism or  
21 business/political strategy to the economic logic of internalisation. That is, not only are  
22 they in the business of protecting or internalising their ownership advantages but they  
23 also internalise with opportunism - they are open to opportunities to capture or internalise  
24 the competitive advantages represented by localised external economies where  
25 possible.(6)  
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29 Fifth, and finally, these specific asymmetries in the bargaining position of states and  
30 MNEs appear to have become accentuated by recent developments in the international  
31 economic and institutional environment (Stopford and Strange, 1991). The widespread  
32 liberalisation of FDI policies, the ceding of certain powers and competencies by nation  
33 states to supranational bodies has diluted the bargaining power of states – especially  
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3 developing country governments – in what could be regarded as a two-tier bargaining  
4 process (Ramamurti, 2000). This increasingly asymmetrical bargaining position may well  
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8 have contributed to a reduction in the economic development effects of FDI. As Buckley  
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10  
11 and Ghauri note ‘Increasing locational “tournaments” to attract FDI ... may have reduced  
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13 the benefits to the host countries as have the increasing skill of the managers of MNEs in  
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15 making their investments more “footloose”. Corresponding strategy on the part of host  
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17 countries to make FDI “sticky” are not developing at the same rate’ (Buckley and Ghauri  
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19 2004: 84). What this uneven bargaining position highlights is the very real potential for  
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21 corporate capture of national and local institutions and resources which I go on to  
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23 consider in the penultimate section of the paper.  
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### 29 **Externalisation and clustering**

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34 While ‘establishing viable clusters – of subcontractors and suppliers – around an  
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36 important principal plant has been fashionable. ... analysis, and the impact of e-  
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38 commerce, suggests that these clusters are becoming increasingly dispersed and virtual’  
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40 (Buckley, 2004: 30). So, for example, some of the ingredients of the pure or Marshallian  
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42 agglomerative forms have become available over extended - even global - geographic  
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44 scales (Phelps, 2004a; Phelps and Ozawa, 2003). Moreover, recent work on global  
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46 production networks indicates that even those Marshallian ingredients thought to be most  
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48 geographically immobile are now subject to international patterns of diffusion. As Ernst  
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50 et al (2001: 137) have recently argued, ‘the most important caveat to the agglomeration  
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52 economies argument is that dispersion is no longer restricted to low-end activities’.  
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6 Theoretical understanding of agglomeration and clustering has been developed  
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8 inductively from successful instances of industry clusters (Phelps, 1992; Phelps and  
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10 Ozawa, 2003). Moreover, within this tradition, the question of the origins of such clusters  
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12 is one that rarely has been addressed directly. As such, the theory of agglomeration or  
13  
14 clustering is often circular in nature (Phelps, 1992), resting on positive or negative  
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16 processes of cumulative causation derived from within the agglomeration or cluster itself,  
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18 and with instances of agglomeration being taken as evidence of the existence of localised  
19  
20 external economies and localised external economies being used to explain the existence  
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22 of agglomeration. Something of this circularity is evident in that work which has  
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24 explored the relationship of FDI to clustering processes – much of which is framed from  
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26 the perspective of the contribution FDI makes to *existing* clusters. The literature that has  
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28 dealt with FDI as an instigator of potential clustering processes, perhaps understandably,  
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30 has remained obscure – focusing on the likes of failed attempts to produce growth poles  
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32 or industrial complexes from scratch through FDI.  
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42 Something of this circularity is also apparent in the fact that, ‘studies corroborate the  
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44 hypothesis that developing countries must have reached a minimum level of economic  
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46 development before they can capture the growth enhancing effects of FDI’  
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48 (Nunnenkamp, 2004: 669). This also applies when we are concerned with localities  
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50 within nations such that industrial clusters cannot develop without these preconditions  
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52 being met (Enright, 1999). Certainly, the geographic concentration of FDI at a global  
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54 scale reflects the entrenched favourable conditions in developed nations. (7) Until very  
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3 recently, many developed nation economies could indeed rely on the externalities  
4 associated with this inertia in MNE organisation and patterns of FDI. In fact, until the  
5  
6 associated with this inertia in MNE organisation and patterns of FDI. In fact, until the  
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8 1980s, MNEs actually reinforced the economic cohesiveness of national territories  
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10 (Agnew, 2005; Kobrin, 2000) when operating multi-domestic strategies under which  
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12 there was a ‘duplication of the value chain across countries, and local outsourcing’  
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14 (Young, 2000: 5). There are now signs in certain economies – such as the UK and the  
15  
16 USA – that, as the global production networks of MNEs continue to expand and become  
17  
18 more complex, it cannot be assumed that external economies will flow in quite the same  
19  
20 way. In-line with this reasoning, it is clear that ‘the development of a national economy is  
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22 more about internal integration than external integration’, however, the new world  
23  
24 agenda makes it more difficult to ‘capture the synergies between internal and external  
25  
26 integration’ (Wade, 2003: 635 and 636). Thus the national investment development path  
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28 (IDP) that can be stimulated by FDI (Dunning, 1981) depends on more than merely the  
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30 upgrading of MNE affiliates in isolation. In intermediate stages of the IDP, government  
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32 policy to enhance the locational and ownership advantages of domestic industry is vital to  
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34 stimulating linkages with the FDI sector (Scott-Kennel and Enderwick, 2005). (8) In  
35  
36 short ‘even in a world of capital mobility, there is still a virtuous circle between activist  
37  
38 government and international openness’ (Garrett, 1998: 789). The internal integrity – and  
39  
40 in particular a diverse, robust and competitive indigenous set of industries - of a national  
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42 and local economy is important because in its absence the economic benefits of FDI  
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44 essentially may circulate among the foreign-owned sector producing externality effects  
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46 somewhat less than we commonly regard as agglomeration or clustering proper.  
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3 In fact, ‘if there has been relatively little research on the contribution that clusters make  
4 to MNEs, there has been even less on the contribution that MNEs make to clusters’  
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6 (Enright, 2000: 118). Partly because of the opposing economic logics of internalisation  
7  
8 and externalisation noted above, much of the literature on the economic impacts of FDI  
9  
10 has been framed in terms of binary scenarios which have proved hard to escape. These  
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12 are apparent in the recent literature focused specifically on the contribution of FDI to  
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14 industrial clusters. So, for example,  
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22 foreign firms may add to the local cluster by bringing in valuable capabilities and  
23 resources such as new knowledge and technology, capital, expatriates and other  
24 inputs ... However, the entry of foreign firms may also erode the basis of future  
25 cluster dynamics by “taking out” resources and competencies from the cluster.  
26 This may be done either by actively transferring resources from one  
27 subsidiary/cluster to another, or more indirectly by not making continuous  
28 investment in the build-up of the competencies and resources of the local unit  
29 (Malmberg and Solvell, 2002: 72).  
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34 There is evidence that while the type of industry cluster is important to understanding the  
35 capabilities and characteristics of MNE subsidiaries, industry clusters with high levels of  
36 foreign ownership have subsidiaries with less autonomy and weaker capabilities  
37 (Birkinshaw and Hood, 2000: 150). These findings are amplified by others from the UK  
38 that indicate that spillovers from FDI tend only to be associated with FDI into *existing*  
39 clusters founded on indigenous industry and are much reduced or even negative in new  
40 FDI-led clusters (De Propis and Driffield, 2006).  
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53 Following on from these findings, and as implied by the reference to the “taking out” of  
54 resources and competencies in the quotation above, there may, by the same token, be  
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3 important instances of capture of local institutions and resources (Phelps, 2000). Indeed,  
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5 in light of much of the policy advocacy surrounding FDI and in light of the retreat of  
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7 many states from active intervention, there is a strand of thought that suggests that  
8  
9 incentives have come to be viewed as compensation for the spillovers generated by  
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11 MNEs (Li, 2005). This is a curious line of argument either in analytical or in policy  
12  
13 terms, since the wider economic benefits in the form of externalities constitute a major  
14  
15 argument for liberalisation of world trade and investment and ought not to need financial  
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17 incentives from governments. In fact, as both neoclassical economics (Tiebout, 1956) and  
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19 Marxian political-economy (Castells, 1982) stresses, some of the external economies  
20  
21 most vital to the reproduction of private enterprise – such as communications  
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23 infrastructure, education and welfare provision – have been provided by the state. Why  
24  
25 should there be an expectation that states should underpin private enterprise through  
26  
27 expenditures for ‘collective consumption’ while *also* having to pay for any private sector-  
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29 generated externalities in the form of incentives for FDI? Moreover, the ‘splintering’  
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31 (Graham and Marvin, 2000) of such state-provided urban externalities may have opened  
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33 up policy vacuums in which there is potential for the customisation or capture of  
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35 expenditures intended for collective consumption.  
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46 The point I want to draw out from this part of the discussion is simply that the  
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48 significance and sustainability of the sorts of clusters associated with manufacturing FDI  
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50 remain open to question. As one recent review notes, ‘If country and industry differences  
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52 are important to the impact of inward FDI on host countries, the main lesson might be  
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54 that the search for universal relationships is futile’ (Lipsey and Sjöholm, 2005: 40).  
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### MNEs, externalisation and types of clustering

Of more immediate concern at this point in the argument is to establish the point that there are different types of clustering process to which FDI may or may not contribute. In a recent review of the literature, Gordon and McCann (2000) draw attention to three types of clustering: (i) the pure or Marshallian agglomeration, (ii) industrial complexes and co-location, and (iii) social networks. While the contribution of MNEs to each of these clustering processes is not an explicit element in their review, a major purpose of their work is to highlight the different logics and generative effects of clustering. Here they note then that ‘discussion of industrial clustering has tended to conflate ideas arising from quite different perspectives ... The effect can be to buttress a rather generalised notion of the benefits of clustering’ (Gordon and McCann, 2000: 515). More to the point, as McCann and Mudambi have argued, ‘the inter-firm spillover arguments implicit in the pure agglomeration and social network models of industrial clustering are largely not applicable to MNEs’ (McCann and Mudambi, 2004:509). This is because the information internalisation logic favouring the MNE is largely inconsistent with either the externality argument, favouring pure agglomeration, or the inter-personal relations of the social network’ (McCann and Mudambi, 2005: 1871). This is particularly the case for MNE establishments that are part of oligopolistic industry structures (McCann and Mudambi, 2005: 1871)

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3 None of this is to deny a degree of permeability of the highly self-contained nature of  
4 MNEs - their FDI and other arm's length economic development effects they have - that  
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6 has come to light recently. There is evidence to suggest that firm-specific advantages are  
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8 increasingly produced not just from sources internal to the MNE but also from without,  
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10 through its alliances with other MNEs, local institutions such as universities and technical  
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12 institutes and associated pools of highly skilled labour (Dunning, 1997; Cantwell, 1995;  
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14 Rugman and D'Cruz, 1997). More importantly still, recent sourcing strategies in some  
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16 sectors have seen the stretching of the division of labour internal and external to MNEs  
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18 and the re-emergence of an old principle of 'triangulation' responsible historically for the  
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20 growth of new collections of industry on the back of old ones (Jacobs, 1969). The  
21  
22 principle of triangulation and spillovers manifested through new arms length relations  
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24 with independent suppliers in emerging market locations in the 'buyer-driven' global  
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26 production chains of the food, clothing, textiles and footwear sectors do appear to have  
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28 contributed to economic development in some Southeast Asian (Gereffi, 1999) and Latin  
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30 American countries (Bair and Gereffi, 2000) though not in African nations (Gibbon and  
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32 Ponte, 2005). Indeed, retail MNEs may be further distinguished by their high degree of  
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34 localisation (Coe and Lee, 2005) or host nation 'territorial embeddedness', by virtue of  
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36 responsiveness to cultures of consumption, the necessity to engage with local planning  
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38 and property markets and the competitive advantages embodied in extensive logistical  
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40 and supply chain activities (Wrigley, Coe and Currah, 2005). (9)  
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53 Greater local engagement by MNEs and the principle of triangulation may indeed be  
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55 apparent in the genesis of clusters of industrial activity and associated wider economic  
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3 benefits – though the question remains, what type of clusters are generated? In what  
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5 follows, the case of ‘contingent clustering’ in Southeast Asia is instructive for the  
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7 argument of this paper and is one that resonates in FDI-dominated regions in western  
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9 ‘competition state’ nations such as the UK and the USA. The point being that, in the  
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11 main, though not exclusively, manufacturing FDI contributes to variations on the  
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13 production complex model of clustering distinguished by Gordon and McCann (2000).  
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20 Despite the rise of East Asia as a destination not only for Japanese but also European and  
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22 North American FDI, the evidence regarding the precise contribution of FDI to economic  
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24 development via clustering is open to question. Global production network analysis has  
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26 highlighted the opportunities for industrial upgrading in certain developing countries as  
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28 part of the process of triangulation. As developed country MNEs externalise and offshore  
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30 production to a ‘first-tier’ of developing countries, production cost savings are made  
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32 partly at the expense of increased co-ordination costs. It is these increased co-ordination  
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34 or transaction costs that signal the leakage of otherwise internalised MNE capabilities –  
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36 and hence the build up of external economies – to developing country producers who  
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38 then in turn further outsource and externalise production to a third set of countries and  
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40 producers. However, different phases of MNE expansion in East Asia may have offered  
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42 distinctly different, and on the whole diminishing, possibilities for local industry cluster  
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44 formation from the ‘triangulation’ of trade within global production networks as Felker  
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51 (2003, 2004) has detailed.  
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3 The industrialisation of Northeast Asian developing countries such as South Korea and  
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5 Taiwan began in the 1950s and 1960s - a very different era of MNE expansion in which  
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7 the character of FDI did indeed interact with domestic industry to promote what Cantwell  
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9 (1988) refers to as a virtuous circle of industry development. Nevertheless, such success  
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11 stories are also based on a congruence of conditions that (a) have involved  
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13 'developmental state' intervention and (b) have taken decades to mature. As Ernst argues  
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20 interorganizational knowledge creation is *not confined to regional clusters* or to  
21 the nation state. In industrialized countries, many of these external knowledge  
22 linkages are within domestic organizations. This is very different from a small  
23 developing country ... [where] benefits from international linkages do not come  
24 automatically. Of critical importance are *government policies* that have created a  
25 set of innovative institutions and incentives conducive for interorganizational  
26 knowledge creation (Ernst, 2001: 125-126 original emphasis).  
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30 As the case of the Taiwanese electronics and computer industry illustrates, foreign  
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32 enterprise can indeed play an important role in cluster development but is just one of at  
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34 least four elements including the parallel government support of the indigenous sector  
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36 (Ernst, 2001).  
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42 In a recent article charting the growth of a new high technology cluster in Beijing, China  
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44 centred on the arrival of Finnish telecommunications company Nokia, Yeung, Liu and  
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46 Dicken are actually more specific in identifying these international knowledge flows that  
47  
48 are possible in global production networks. They term such flows 'non-cluster  
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50 economies' whose 'realization ... is not necessarily an outcome of proximity *per se*, but  
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52 rather a product of *relational networks* that ... allow [firms] to tap into external  
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54 economies outside ... clusters' (Yeung, Liu and Dicken, 2006: 521, original emphasis).  
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Their interest here is in demonstrating the role of a lead FDI project in leveraging knowledge assets in existing clusters to initiate the formation of a new cluster. Their study is instructive in pinpointing the origins of new clusters in developing countries but they are right to leave the question of the longer-term sustainability of such new clusters as an open one. As McCann and Mudambi (2005: 1871) stress, ‘many industrial clusters which include large oligopolistic competitors will generally be plagued by adverse selection and should either fail to form, or become concentrations of mediocrity’. What Yeung, Liu and Dicken’s study confirms is that ‘as developing countries are scrambling to develop industrial clusters, much more policy attention needs to be paid to how preconditions in specific localities in these countries can interact with the strategic requirements of lead firms and their key suppliers in global production networks’ (Yeung, Liu and Dicken, 2006: 537). The interesting point regarding China’s FDI-led industrialisation is whether the preconditions represented by the sheer scale and diversity within the stock of human capital and indigenous business present more favourable initial conditions for sustaining significant new clusters than is perhaps the case in Southeast Asian countries as I now consider below.

It is the likes of Taiwan and South Korea (and Hong Kong) that developed sufficient domestic industry capabilities to act as first-tier loci of coordination from which global production networks can be further articulated with a ‘second-tier’ of lower cost locations. With the exception of Singapore, the upgrading dynamics among those (principally Southeast Asian) developing country clusters that now constitute the ‘second tier’ of processes of triangulation are less clear. Industrialisation took place in the 1980s

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3 and 1990s in which MNE strategies and organisational structures had evolved  
4 significantly. Although producing some clustering effects at least partly as a result of  
5 government industry policies these have not been based on localised factors. Thus, the  
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and 1990s in which MNE strategies and organisational structures had evolved significantly. Although producing some clustering effects at least partly as a result of government industry policies these have not been based on localised factors. Thus, the 'industrial supply linkages, based on the "flying geese" model ... find modern expression as "growth triangles" operating in Southeast Asia. This relative lack of industrial diversity ... and hence the "thinness" of ASEAN's capital asset structure poses problems for the region ... (Bartels, 2004: 86).

Some sense of this thinness or lack of industrial diversity is also identified by Felker.

More specifically still, then,

FDI clustering in Southeast Asia did not correspond to Porter's (1990) competitive "diamond", with a full set of vertical links to supplier and user industries, or to the collections of complementary assemblers, designers and component makers that define innovative SME clusters in the literature on Europe. Rather they were horizontal groupings of foreign manufacturers performing similar production functions, lured by suitable cost and infrastructure factors and, significantly, by the externalities (skills, knowledge, logistics infrastructure) generated by each other's presence (Felker, 2004: 88).

As such,

The key dynamic in Southeast Asia's MNE-based industrialisation ... might be termed "contingent clustering", in that there were relatively few territorially *generated* assets that could explain the dynamism of the foreign production establishment. Rather it was the co-ordination economies arising from MNCs investment decisions which gave rise to localised externalities among firms whose origins and primary linkages were non-local. ... What is distinct about this pattern is that it is "local" only in a very abstract sense (Felker, 2003: 267).

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4 Whilst some localised labour-market and even knowledge externalities are produced, due  
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6 to the lack of a viable domestic industrial base, these are produced by and shared almost  
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8 exclusively among the foreign-owned sector in these clusters (as depicted in the  
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10 exclusively overseas MNE presence in the contingent cluster in figure 1). Moreover,  
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12 following Aitken and Harrison (1999) the possibility that the positive externalities  
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14 generated by FDI in host economies can be offset to a greater or lesser extent by negative  
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16 externality effects associated with the crowding-out of indigenous industry has been  
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18 recognised. The interesting point here is that these production-complex type clusters are  
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20 potentially mobile in their entirety. Even Singapore, the exception among Southeast  
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22 Asian experiences of industrialisation, has cycled through several such contingent  
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24 clusters (Mirza, 1986) – the implication being that such ostensibly FDI-only clusters are  
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26 only weakly embedded and capable of being migrated as and when conditions become  
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28 propitious as has been the case over the past decade with re-location to China.  
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36 The second tier of triangular processes of industrialisation in the likes of Southeast Asia  
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38 and mainland China has often been directly or indirectly orchestrated (Ernst, 2001) by the  
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40 states or leading firms of first tier developing countries through the development of  
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42 overseas enclave industrial parks (Pereira, 2003; Perry and Yeoh, 1999 and Yeung, 1999  
43  
44 on the case of Singapore). The simplest forms of clustering involving Export Processing  
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46 Zones and the industrial parks that constitute elements of the triangulation of production  
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48 in Southeast Asia generate few backward linkages and minimal externalities through  
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50 labour market interactions. Labour market mechanisms are perhaps the main way in  
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52 which there is technology transfer from MNEs in clusters (Thompson, 2002: 886). Yet  
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3 the self-contained nature of many industrial enclaves including their labour markets  
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5 precludes wider processes of technology transfer (Phelps, 2004b). In the most extreme  
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7 cases, the major use of migrant labour is a positive hindrance to the development of  
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9 labour skills and the diffusion of technology to the local environment. A major weakness  
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11 of clusters dominated by MNEs therefore centres on the low degree of technological  
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13 spillovers involved (Altenburg and Meyer-Stamer, 1999: 1706). Some of the major  
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15 indirect economic benefits produced from these clusters are restricted to induced  
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17 multiplier effects – the circulation of disposable income in the local economy and the  
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19 build up of consumer services.  
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27 Despite the renewed interest in the role of FDI in industry clusters noted above, one of  
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29 the major reviews of recent years was able to suggest that ‘within Europe there seem to  
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31 be rather few examples of successful growth centres in which MNEs play a leading or  
32  
33 active role’ (Young, Hood and Peters, 1994: 662). Thus, concerns over the vulnerability  
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35 of clusters of FDI have been evident in the UK. Scotland’s ‘Silicon Glen’ has failed to  
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37 mature into a robust and sustainable cluster of activity. Similarly the sorts of growth-pole  
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39 production complexes that have formed around major FDI projects such as Nissan in the  
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41 North East of England have prompted concern over an extension of the so-called branch  
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43 plant syndrome from single plants to a collection of plants (Amin and Robbins, 1990).  
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45 The potential vulnerability of these production complex-type agglomerations with limited  
46  
47 wider linkages to domestic industry stands in contrast to the occasional example of more  
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49 dynamic clustering effects associated with major MNEs (Glasmeier, 1988).  
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3 Ireland repeatedly is cited as an example of successful FDI-led industrialisation and has  
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5 been the subject of policy initiative informed by notions of industrial clustering. MNEs  
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7 have a considerable presence in the electronics industry and in particular the  
8  
9 microcomputer industry. However, despite the substantial employment in such sectors,  
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11 even here the possibilities for the development of clusters around leading MNEs appears  
12  
13 limited. In light of global conditions and in the context of the current logistical  
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15 arrangements preferred by MNEs ‘the suitability of a strategy of building integrated  
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17 clusters around subsidiaries of MNEs in the microcomputer assembly industry may well  
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19 become of theoretical interest only’ (van Egeraat and Jacobson, 2005: 300). What van  
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21 Egeraat and Jacobson demonstrate successfully here is that variations on ‘just-in-time’  
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23 logistical practices said to promote agglomeration in some instances (Mair, 1993) have  
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25 evolved in other instances to promote only, what Felker terms, abstract forms of  
26  
27 localisation. Such abstract forms of localisation resemble not the pure agglomeration or  
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29 social networks model but variations on the production complex model of clustering  
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31 distinguished by Gordon and McCann (2000).  
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### 41 3. MNE POLITICAL BEHAVIOUR AND CAPTURE

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46 The political behaviour of MNEs has been analysed in terms not dissimilar to the “black  
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48 box” of neoclassical economics (Encarnation and Wells, 1985) – a black box that could  
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50 usefully be opened if we are to fully explore critically the possibilities for economic  
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52 development from MNEs (Phelps and Fuller, 2000). Yet, if anything, an interest in the  
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54 political behaviour of MNEs has waned somewhat recently. ‘The topics of political risk  
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3 and external environment analysis were significant ones in the 1970s and 1980s;  
4 understandable at a time when general attitudes to MNCs were antagonistic, and controls  
5 over FDI and MNC behaviour were widespread' (Young, 2000: 17). In analytical terms  
6 – though hardly of less salience in policy terms – an analysis of the political behaviour of  
7 MNEs and their subsidiaries is just as important at a time when there is little serious  
8 questioning of the behaviour MNEs by host governments. In fact, the shifting boundaries  
9 of the firm make externalities a potentially elusive benefit to local and regional  
10 economies while 'frequently too little attention is given to the motives that firms have to  
11 capture agglomeration benefits internally' (Perry, 2005: 75).  
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27 Political behaviour adds an element of strategy or opportunism to an already powerful  
28 economic logic to internalisation as MNEs seek to augment or generate ownership  
29 advantages. The 'rules of the economic game are not simple "givens" but are often  
30 "takens", with significant implications for the nature of ownership advantages and  
31 internalization of external agents' (Boddewyn, 1988: 344). Two further observations  
32 should be made regarding the potential for capture. First, complete internalization or  
33 capture of state functions and expenditures by MNEs is rare. Semi- or quasi-  
34 internalisation is the norm regarding instances of capture (Boddewyn, 1988: 356).  
35 Second, the organisation and nature of MNE-state relations vary according to the issue-  
36 area (Brewer, 1992) in question, with distributional issues (such as incentives) being  
37 those most open to 'capture' since these are a matter for negotiation between individual  
38 MNEs and host states. (10)  
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### **Information asymmetries and governmental failures to coordinate externalisation**

We saw earlier the asymmetrical bargaining position between MNEs and states as an ingredient in the potentially reduced impact of FDI. These information asymmetries and coordination failures on the part of governments have become most obvious with respect to the largest discrete FDI projects but may be magnified in the case of attempts to develop industry clusters.

Some of the most salutary lessons regarding the vicious circle of policy disengagement and failure of FDI to generate presumed benefits come from western nations – especially the ‘competition states’ of the UK and USA - which illustrate the problems caused by an absence of state coordination. Since the 1920s, the UK government has consistently had a relatively liberal open policy toward inward and outward FDI (Bailey, Harte and Sugden, 1994). This has coexisted with a long-standing desire to diversify those regional economies subject to structural decline since the industrial revolution through the dispersal of mobile investment – ostensibly FDI in recent decades. However, UK regional policy was oriented towards the symptoms of regional decline not the causes (Morgan, 1997 cited in De Propis and Driffield, 2006: 278). Indeed, from its inception, UK regional policy was explicitly designed to ameliorate the agglomeration effects that had begun to operate in reverse with the structural decline of the UK’s older industries. However, in doing so it also precluded the build-up of the positive effects associated with the creation of newer agglomerations. The UK government has not engaged in any serious monitoring of the effects of FDI and has intervened only modestly and, crucially,

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3 in an inconsistent manner since this time (Bailey, Harte and Sugden, 1994; Hodges,  
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5 1974). More recently, UK governments have concentrated on creating a favourable  
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7 macroeconomic environment to encourage FDI as a modernising force while neglecting  
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9 microeconomic or industrial policy interventions that might have secured longer-term  
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11 development (Young and Hood, 2001). Ironically then,  
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18 UK industrial policy is based upon the ad hoc attraction of large scale, job-  
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20 creating inward investment to create short-term jobs in declining regions. There is  
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22 no coherent strategy integrating sector targeting and economic development, at  
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24 least at the central level, and government policy has artificially dispersed foreign  
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26 companies, missing out on any clustering benefits (Loewendahl, 2001: 219).  
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29 Hence the failure of viable clusters of industry to develop as depicted the bottom left  
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31 portion of figure 1. The emphasis has been on minimising the transaction costs facing  
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33 prospective investors with the UK being an easy point of entry but, by the same token,  
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35 also an easy point of *exit*, for FDI within the European Union (Amoore, 1999). As a  
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37 result, and with a very few industry exceptions, there has been little incentive for MNEs  
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39 to locate their most technology-intensive FDI in the UK or for such FDI to become  
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41 embedded in virtuous circles of agglomerative tendencies (Cantwell, 1988).  
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45 This lack of coordination manifests itself in the likes of: wasteful competition among  
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47 'regions' within the UK for FDI projects (Tewdwr-Jones and Phelps, 2001); conflicting  
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49 objectives or interests of different state and quasi-state bodies within regions over a  
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51 single FDI project (MacKinnon and Phelps, 2001); and even the complicity of national  
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53 governments in eluding the European Commission's attempts to coordinate the likes of  
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55 investment incentives rules and reporting (Thomas, 2000). More fundamentally,  
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3 however, it is borne of a lack of consistent, concerted and credible national and local  
4 policy geared toward producing conditions conducive to garnering the important  
5 externalities associated with FDI as part of wider strategies to develop industry clusters  
6 (depicted as an absence of coordinative links between the state and industry in figure 1).  
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12 A number of recent studies have highlighted the implications of the ad hoc attraction of  
13 FDI for local economic development and the potential for capture in the case of large  
14 discrete FDI projects. The information asymmetries between MNEs and governments are  
15 most apparent with respect to these sought-after investments since, whilst the  
16 requirements and financing of the investments are a closely guarded secret, the sorts of  
17 government assistance is invariably open to public scrutiny (Phelps, Lovering and  
18 Morgan, 1998; Phelps and Tewdwr-Jones, 1998). Drawing on a study of the Nissan and  
19 Siemens investments in the Northeast of England, Loewendahl (2000) concluded that the  
20 UK central government has rarely deployed the full power of its position when  
21 bargaining with MNEs at the time of initial entry. As a consequence, despite greater  
22 targeting of the financial incentives operated under UK regional policy since the 1960s, it  
23 has now become synonymous with the attraction and dispersal of FDI (Driffield, 2004).  
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25 A recent National Audit Office (NAO, 2003) report spoke of the 'grants culture' among  
26 the MNEs which now absorb the majority of regional policy incentives. Such a 'blanket  
27 approach to attracting manufacturing inward investment ... could be connected with the  
28 development of clusters of foreign activity which underperform' (Munday, Peel and  
29 Taylor, 2003: 519-520) and create few positive impacts beyond direct employment  
30 (Driffield, 2004: 592).  
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3 The sorts of information asymmetries and coordination failures that exist on a case-by-  
4 case basis for discrete FDI projects are likely to be magnified when we examine the  
5 prospects for broader based policy interventions to stimulate industry clusters from FDI.  
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8 Drawing on the sometimes chastening experiences with cluster development in Scotland,  
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10 Peters and Hood make explicit the difficulties policy makers face: 'any local policy  
11 maker would require a very detailed understanding of all the key interrelationships in a  
12 cluster ... imperfections. This is rarely feasible. And, even if it were the public sector is  
13 seldom best placed to meet the need that key cluster stakeholders have for rich, industry  
14 specific information of an advanced and specialized nature' (Peters and Hood, 2000: 76).  
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27 In the USA, the degree of central (Federal) government co-ordination in the form of FDI  
28 policy is even less than in the EU (Graham, 2003). New 'entrepreneurial' state policies  
29 have not displaced old policies based on reducing factor costs to mobile capital while  
30 there is also a 'disjunction between sub-national and national economic strategy'  
31 (Eisinger, 1988: 5). Thus, Federal macroeconomic policy has served at times to weaken  
32 the bargaining positions of city and state governments, with anti-inflationary policies  
33 exacerbating local unemployment and hence the scramble for FDI - as was the case with  
34 new flows Japanese FDI into the United States during the 1980s (Lowery, 1990). At this  
35 time, any 'efforts by states to develop independent industrial policy have been less than  
36 entirely successful, or at least not as successful as they might have been. And ... the roots  
37 of this at least partial failure are to be found at the national level of government'  
38 (Lowery, 1990: 193). Reid and Gattrell's (2003) study highlights the information  
39 asymmetries that exist between one MNE and state and local governments in the  
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3 bargaining process over the level of financial and other incentives necessary to keep  
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5 Jeep's investment in-situ in Toledo. Wood (2003) has highlighted that information  
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7 asymmetries have also contributed to the lack of clustering of related inward investments  
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9 at an intra-metropolitan scale.  
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15 Again, the experiences of Southeast Asian states can prove instructive as to the  
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17 magnitude of the policy effort required to successfully harness FDI to wider clusters in  
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19 which there are significant and cumulative external economies operating. As we saw  
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21 earlier, FDI-led production-complex type clusters have developed in Southeast Asian  
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23 states. Although some instances of clustering such as Penang's concentration of high  
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25 technology industries have been regarded as models of industrialisation (including in this  
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27 case the development of localised linkages) (UNCTAD, 2002), the need for government  
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29 coordination of industrial policy is also clear. Whilst not completely unsuccessful, state  
30  
31 industrial policy has contributed to the particular character of these 'contingent' clusters.  
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33 'Compared to Singapore's disciplined and highly detailed efforts to foster specific FDI  
34  
35 clusters, most of the region's policies suffered from haphazard implementation and poor  
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37 bureaucratic coordination' (Felker, 2004: 91). As such, 'Southeast Asian host economies  
38  
39 can rely less than before on the internal technological dynamism of foreign-dominated  
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41 sectors to bring structural change. Instead cluster-building efforts depend more than ever  
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43 on local factors, including the policy capacities of state investment and industrial  
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45 extension agencies' (Felker, 2004: 95).  
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### 55 **MNEs and internalisation: two examples of capture**

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6 In a context of hostile state-firm relations that existed through the 1950s to 1980s, MNE  
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8 political behaviour was common place and focused on managing the political and  
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10 economic risk of engaging in many host country regulatory environments (Vernon,  
11  
12 1971). In today's more liberalised environment, arguably MNE political behaviour may  
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14 be just as pervasive although the objectives may have changed toward opportunistic  
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16 strategies centred on capturing or internalising those externalities available in host  
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18 countries (Phelps, 2000; Phelps and Fuller, 2000). In the remainder of this section I  
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20 highlight the possibilities for MNE subsidiaries to partially capture collective  
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22 consumption expenditures and local externalities associated with local land/property and  
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24 labour markets.  
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### 32 (i) The land nexus 33 34 35

36 In the western competition states of the UK and USA at least, land, property and physical  
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38 infrastructure (such as roads and power generation) have become an important ingredient  
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40 in the capture of local institutions by major corporations (Monbiot, 2001) including  
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42 MNEs. Using the case of Nissan in the Northeast of England, Peck (1996) describes a  
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44 longer term shift in the planned collective provision of infrastructure for inward investors  
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46 in the UK toward an increasingly customised provision for individual inward investors by  
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48 the 1980s. Since this time, the pattern of customised provision of infrastructure with its  
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50 associated opportunity costs has been repeated with major FDI projects such as Toyota,  
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52 LG, and Siemens in the UK (Phelps and Tewdwr-Jones, 2000). In the United States too,  
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3 such land deals and their financing as part of broader incentives packages have proved  
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5 controversial (Yanarella and Green, 1990).  
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10 The customised assembly of land and provision of property and infrastructure raises  
11  
12 many important questions. For a start there are questions regarding democratic  
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14 accountability and due process since land-use and planning policy can and has been  
15  
16 ignored on the basis of the economic arguments in favour of developments. Critically, the  
17  
18 environmental impacts of FDI typically receive less of an airing than economic  
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20 development issues (Yanarella and Green, 1990). The sustainability of, and opportunity  
21  
22 costs associated with, the use of often large tracts of prime green or even industrial land  
23  
24 for investments that have a dwindling life expectancy is also of significance. The ill-fated  
25  
26 LG investment in Wales, for example, took up a golden strategic site and effectively  
27  
28 curtailed key planning and land use options locally (Phelps and Tewdwr-Jones, 1998)  
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30 despite never being more than half realised as a project and closing within 6 years.  
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32 Moreover, the 'planning gain' that local governments are commonly allowed to bargain  
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34 for with major developments has rarely been obtained in the case of FDI projects. Not  
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36 one of the largest ten FDI projects into Wales during the 1980s and 1990s had generated  
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38 planning gain for the municipalities involved (Alden, 1999). If anything the opposite has  
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40 tended to occur, with improvements to road access or power supply being paid for by the  
41  
42 municipal or decentralised arm of central government as part of an incentives package.  
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44 The customisation of space can also extend to the land and infrastructure requirements  
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46 associated with assembling the limited, 'abstract' production complex externalities in the  
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48 form of supplier-parks for major FDI projects (Phelps and Fuller, 2001).  
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6 In the East Asian developmental states the participation of overseas companies in land  
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8 and property market speculation and the distortion of planning priorities may be less  
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10 prevalent due to widespread state ownership of land and various restrictions on land  
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12 ownership and usage.(11) Indeed, in the least developed country settings it is private  
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14 enterprise including FDI that sometimes individually or collectively provides important  
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16 elements of infrastructure such as roads and power generation or telecommunications in  
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18 the absence of state capacity to fund such collective consumption expenditures (Fisiman  
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20 and Khanna, 2004).  
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#### 27 **(ii) The labour-market nexus**

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32 Conceivably, those externalities bound up with the labour market are those that MNEs  
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34 have the most difficulty in preventing leaking into the local economy even in developing  
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36 nations. In the competition states of the UK and the USA where they can, MNEs have  
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38 preferred not to cluster their major FDI projects alongside other major investors but to  
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40 locate away from each other so as to exercise a degree of domination over local labour  
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42 markets and avoid competition for labour. In the context of skills shortages in advanced  
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44 economies there may be a further twist in a quite familiar story.  
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51 The impact of manufacturing FDI in generating externalities via the local labour markets  
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53 may not be as strong as presumed. First, the training of workers often now constitutes  
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55 part of the customised package of incentives offered to a new major FDI project. Second,  
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3 there is a case for arguing that high technology FDI, regardless of its longevity, can exert  
4 a positive effect on local labour force skills (Charles and Benneworth, 1999). However,  
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8 Dawley's (2007) work on the labour market 'imprints' of major FDI semiconductor  
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10 projects in the northeast of England highlights how the pressure for fast 'ramp-up' of  
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12 production can translate into 'off-the-shelf' labour forces, a significant proportion of  
13  
14 which have been recruited from existing employers outside the locality. Third, in light of  
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16 increased personal mobility and as a result of the first two developments noted above, an  
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18 important proportion of new skills added to the local workforce are lost at or before  
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20 closure. The potentially positive role of FDI and associated skills within new rounds of  
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22 investment – in Massey's (1984) terms - may be less than was the case in the past. The  
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24 combination of these effects means that an important element of the sunk costs associated  
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26 with the set-up of an operation – the sort of private investments that might keep an MNE  
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28 establishment rooted to a particular place are off-set by public expenditures. The net  
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30 effect of this may be to further shorten the lives of MNE subsidiary operations and  
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32 increase the turnover of FDI in the local economy.  
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41 At local level, skills agendas are now routinely distorted by major FDI projects at their  
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43 arrival. Where there is a lack of wider business community involvement in education and  
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45 training agendas in localities whose economies are dominated by FDI, major MNEs can  
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47 exert disproportionate influence. In some contexts – notably the smaller national or  
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49 regional economies of the UK dominated by FDI - it has been a near permanent feature of  
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51 the policy environment with both established investors, such as Ford, Sony and BAe  
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53 Systems (Phelps, Valler and Wood, 2005), and new investors, such as LG (Phelps,  
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3 Loving and Morgan 1998), able to tilt local education and training strategies towards  
4 their specific needs.  
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11 In actual fact, one ought not to press the case for capture too far in the case of education  
12 and training agendas. MNEs have been important agents in the modernisation of labour  
13 market skills in places like Wales (Rees and Thomas, 1994). Moreover, Phelps and Fuller  
14 (2001) and Phelps, Valler and Wood (2005) illustrate that whilst there is customisation in  
15 the training and education policy sphere in a nation such as Wales, this has been  
16 associated with a countermovement by which policy-makers have been relatively  
17 successful in broadening these developments to the wider population of foreign and  
18 indigenous companies.  
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32 Whilst at international and national scales there is evidence to suggest that MNEs have  
33 become sensitised to the possibilities for tapping into sources of highly skilled labour and  
34 created assets (Cantwell, 1995; Dunning, 1997) it is incorrect to assume that the  
35 presumed benefits will accrue at the subnational scale in the form of the clustering of  
36 research and development and design activities of MNEs. As McCann and Mudambi  
37 (2005: 1871) argue instead, 'many of the largest firms do not co-locate their knowledge-  
38 creation activities with those of their competitive rivals ... Moreover, in situations in  
39 which they do so, the organisational aspects of the firms are designed specifically to  
40 avoid the sharing of knowledge'. Rather, there are concerns over the so-called 'reverse  
41 spillovers' responsible for the undermining of host economy technological capacities as a  
42 result of such technology sourcing by MNEs (De Propis and Driffield, 2006: 279).  
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#### 4. CONCLUSION

In the title of this paper I have opposed two scenarios of industrial clustering and capture. Binary oppositions have proved extremely hard to transcend in the literature on FDI and economic development, and the intention here is not to add a further binary to our lexicon. Instead, the title is intended to be rhetorical only – a device to draw attention to the role for government intervention in the extraction of economic development impacts from MNEs and their FDI in ways that over time may come to constitute what we regard as (Marshallian) clustering proper.

It is ironic that those policy and academic discourses most critical of the economic impacts of FDI appeared at a time when, by and large, benefits could be assumed to flow ‘automatically’ from FDI as a result of openness to trade and investment flows without government intervention. A further irony here is that it seems likely that instances of inappropriate government interventions both in developed nations such as the UK and certain groups of developing nations such as those in Latin America, actually prevented the fuller realisation of these ‘automatic’ benefits of FDI. Yet, at a time after qualitative changes in the MNE-orchestrated organisation of production, widespread liberalisation and the hollowing-out of many nation states (such that these benefits can no longer be assumed to flow), both academic and policy discourses have, to a significant extent, retreated from a critical interrogation of the precise contribution of FDI to clustering processes and economic development. Whilst new clusters of FDI dominated activity

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3 have become visible in developing countries they also serve as a potent reminder to  
4 developed nations of the value of intervention in capturing the now relatively modest and  
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have become visible in developing countries they also serve as a potent reminder to developed nations of the value of intervention in capturing the now relatively modest and 'contingent' economic impacts that are on offer in any one location in the form of clustering. More broadly then, 'removing obstacles to operations by foreign investors without going overboard in favouring them is the challenge that faces those who regulate FDI today' (Mody, 2004: 1210).

However, inward investment policy is not enough since 'only by concentrating resources sectorally, technologically and spatially would it be possible to come close to creating conducive conditions for cluster generation' (Young, Hood and Peters, 1994: 671). Turning to the UK specifically, part of the problem here is that regional policy which attempts to steer and stimulate investment to particular places has, from the outset, not been designed to foster the sorts of external economies associated with agglomeration proper. Whilst recently regional policy has become synonymous with cluster policy (De Propis and Driffield, 2006: 288) *in rhetorical terms*, if anything, *in its operation* since its inception regional policy has become synonymous with the attraction and dispersal of FDI. One key ingredient in the formation of sustainable agglomerations of industry in the UK - in which FDI makes a contribution in terms of positive localised externalities - must be a further targeting of assistance. Here the evidence suggests that the incentives associated with regional policy could usefully be concentrated on supporting indigenous enterprise given that: (i) the bulk of regional policy incentives are absorbed by FDI and given that; (ii) FDI contributes its most significant positive external economy effects within existing clusters in which indigenous companies are significant. Correspondingly

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3 assistance should be steered away from the support for new FDI-led clusters in which  
4 such positive contributions are minimal. Beyond this, as Young, Hood and Peters (1994)  
5 indicated is the need also to ensure that national-level education and training and funding  
6 for science and technology development reflect and reinforce these choices. Certainly the  
7 sort of concentration and concertation of policy and incentives appears to be one of the  
8 lessons to be drawn from the experience of the new industry agglomerations that have  
9 arisen in developmental states of Northeast Asia.  
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22 Alongside the general need for a joined-up approach to coordinating different elements of  
23 policy, there remains a need for a greater analytical understanding of the potential points  
24 of leverage on MNEs with a view to drawing down benefits is needed. Again, the limited  
25 local externalities that attend contingent clustering in industrialising Southeast Asia are  
26 all the more sobering given the often quite creative policies of states have not been an  
27 unalloyed success. Barely acknowledged, though just as sobering, the powerful economic  
28 logic of internalisation that underpins MNE strategy is augmented by an element of  
29 complementary political behaviour that, in the western 'competition state' setting has  
30 seen MNEs quasi-internalise or capture local externalities – in the form of collective  
31 consumption expenditures - where possible. The asymmetrical economic logic toward  
32 internalisation over externalisation centred on MNEs' economic activities therefore  
33 presents an on-going challenge for local and national governmental bodies to broaden  
34 firm-specific concessions to wider business communities.  
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3 Finally, one indirect product of this paper is to highlight the value of integrating insights  
4 from debates regarding FDI and clustering that have tended to remain rather separate  
5 within different academic disciplines. It should be clear that critical academic  
6 understandings and policy interventions in this sphere can benefit from an  
7 interdisciplinary perspective. The asymmetrical bargaining position of MNEs over states  
8 can draw on insights from politics and sociology as much as economics. A critical  
9 appreciation of the precise benefits to local economies can draw upon the geography and  
10 development studies literature as much as the economics and business studies literature.  
11 Recent work in economic geography has begun to question not only the extent to which  
12 external economies are territorially constrained but also the 'relational' sources of  
13 competitive advantage including the international transmission of knowledge and  
14 external economies via MNE corporate networks.  
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43 their generous hospitality.  
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#### 55 NOTES

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6 (1) Although FDI is essential to the formation of MNEs, the latter cannot be reduced to the  
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8 former since the MNE is an organising principle for a series of on-going international  
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10 connections rather than the one-off transaction that is FDI (Jones, 2005; Wilkins, 2000).  
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12 MNEs can have considerable economic development impacts on host economies without  
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14 engaging in FDI through the likes of their relations with suppliers and customers etc. It is  
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16 precisely these indirect influences that are at play in host economies with the 'triangular  
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18 trade' associated with global production networks which are examined later in the paper.  
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24 (2) Moran, Graham and Blomstrom (2005) number this as one of three 'conventional  
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26 wisdoms' regarding FDI and economic development.  
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31 (3) The coherence, especially that of Michael Porter's (1990) version, of the concept of  
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33 clustering – including that of its geographic scale - is itself open to question (Martin and  
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35 Sunley, 2003). It is not the intention of this paper to delve into these issues directly. The  
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37 purpose instead is to question the type and significance of localised externalities  
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39 associated with the clustering of FDI.  
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45 (4) Here several terminological variations exist. Gereffi (1999) refers to global  
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47 commodity chains, Dicken et al (2001) use the term global production networks, while  
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49 Felker (2003, 2004) uses the term international production networks.  
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4 (5) This may be less likely in the case of some ‘buyer-driven’ global production  
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6 networks.

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10 (6) This is not to say that such business strategies are infallible, merely that they are  
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12 rarely matched by creative or opportunistic strategies on the part of states to fully capture  
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14 the available externalities. Indeed, as McCann and Mudambi (2005: 1863) note,  
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16 ‘subsidiaries embedded in leading technological centres of competence ... may be  
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18 sources of potential competitive advantage that actually remain unrealized because of the  
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20 internal political structure of the MNE’. This, however, is another story and beyond the  
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22 scope of this paper.  
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29 (7) There is a problem of circularity analogous to that regarding the phenomenon of  
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31 agglomeration and the concept of external economies; does the unequal distribution of  
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33 FDI, at least in part, account for uneven patterns of economic development globally, or is  
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35 FDI simply attracted to economically developed areas independent of any economic  
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37 development contribution.  
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42 (8) The concerns of Nunnenkamp and Wade primary are for the prospects of developing  
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44 countries, though the fundamental insight might also be heeded in the most complacent of  
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46 ‘competition state’ nations (Cerny, 1997).  
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52 (9) The detailed argument of this paper may be most applicable to ‘producer-driven’  
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54 global production networks and manufacturing-oriented MNEs than to ‘buyer-driven’  
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3 global production networks and retail MNEs. However, the general concern of the paper -  
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5 to question the nature and significance of local externalities associated with MNEs - still  
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7 applies in the case of the latter. Indeed, the problems may be just as intractable though  
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9 different in nature when one considers the anti-competitive effects of retail MNEs in  
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11 crowding-out (rather than demonstrating to) rival indigenous firms.  
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17 (10) With regard to 'regulatory' issues, MNEs tend to act in industry coalitions.  
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19 However, to the extent that regulatory issues now constitute part of the package of  
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21 incentives granted to investors, or have been used directly in 'rules-based' competition  
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23 among governments, policies in this issue-area arguably have become more susceptible to  
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25 capture.  
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31 (11) Given the dwindling life of FDI projects, the relatively short land use leases granted  
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33 to overseas investors in the likes of Singapore may actually be a more rational means of  
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35 effecting both land-use and economic planning objectives than the free land and property  
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37 markets of western competition states.  
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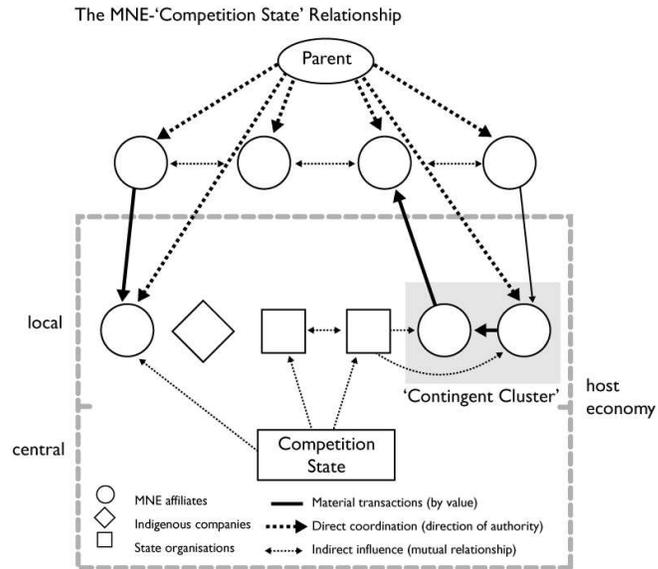
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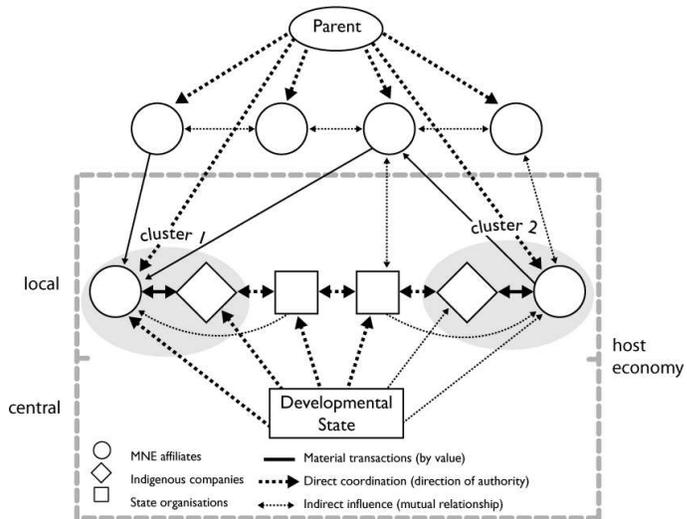
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The MNE-Competition state relationship  
205x154mm (150 x 150 DPI)

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The MNE-'Developmental State' Relationship



The MNE-developmental state relationship  
210x154mm (150 x 150 DPI)