Multinationals and Linkages: An Empirical Investigation
Laura Alfaro
Harvard Business School
Andrés Rodríguez-Clare
Inter-American Development Bank

Several recent papers have used plant-level data and panel econometric techniques to carefully explore
the existence of externalities associated with foreign direct investment (FDI). One conclusion that
emerges from this literature is that it is difficult to find evidence of positive externalities from
multinationals to local firms in the same sector (horizontal externalities). Many studies find evidence of
negative horizontal externalities arising from multinational activity, while confirming the existence of
positive externalities from multinationals to local firms in upstream industries (vertical externalities). In
this paper, we explore the channels through which these positive and negative externalities may
materialize, focusing on the role of backward linkages. We criticize the common usage of the domestic
sourcing coefficient as an indicator of a firm’s linkage potential and propose an alternative, theoretically
derived indicator. We then use plant-level data from several Latin American countries to compare
multinationals’ linkage potential to that of domestic firms. We find that linkage potential of
multinationals is higher than that of domestic firms in Brazil, Chile, and Venezuela. For Mexico, we
cannot reject the hypothesis that foreign and local firms have similar linkage potential. Finally, we discuss
the relationship between this finding and the conclusions that emerge from the recent empirical literature.

JEL Classification: F23, O19, O24
Keywords: Foreign Direct Investment, Multinational Firms, Linkages, Spillovers, Economic Development.