Foreign Direct Investments and Economic Growth: Evidence of Firm-Level Productivity Spillovers in the Philippines

Rainier Ric B. de la Cruz
University of the Philippines Baguio
rbdelacruz1@up.edu.ph

Abstract

Can developing countries really benefit from foreign direct investment? This study provides empirical evidence on the FDI – growth nexus at the microeconomic level by assessing the impact of foreign investments on the productivity of local manufacturing firms in the Philippines. While existing literature on spillover effects generally rely on case studies of specific FDI projects and country cases or industry level analyses, this research examines the existence of different spillover mechanisms using firm level data from the 2015 World Bank Enterprise Surveys which cover several aspects of business environment along with measures of firm performance.

Empirical estimates indicate that horizontal linkages, which capture the extent of foreign presence in one sector, are strongest in the electronics, precision instruments, and furniture subsectors, while forward linkages, which proxy for the potential forward spillover effect from foreign presence in a producer industry's suppliers, are strongest in transport machines and machinery and equipment. Finally, the strongest backward linkages are found in the basic metals and refined petroleum products subsectors. Regression results show that the level of firm equity owned by foreign investors (foreign share) has a positive and significant impact on local firm productivity while all proxies for spillover effects are insignificant in all model specifications. This may indicate that spillovers remain limited in the country because of the presence of economic and regulatory constraints: local firms may lack the necessary absorptive capacity to capitalize on beneficial knowledge transfers even as constitutional and other legal restrictions on foreign participation in certain key sectors continue to hamper foreign investment inflows.

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