

BOOK REVIEWS

Multinational Firms, Innovation and Productivity

Daive Castellani and Antonello Zanfei
(Cheltenham and Northampton, MA, Edward Elgar, 2006),
249+xii pages

Innovation, internationalization and performance – mainly in terms of productivity – are the three interrelated dimensions that form the basis of the book’s overall framework within which there is an exploration of a variety of issues, all connected with the concept of heterogeneity of firms. In particular the book examines how the activities of transnational corporations (TNCs) interact with innovation; and also how the performance of host economies is affected by the cumulative interaction of various elements of internationalization and innovation.

The authors point out that firms’ heterogeneity has usually been studied in relation to inter-industry differences and/or differences in the country of origin of TNCs. Castellani and Zanfei’s work concentrates on a less researched aspect: intra-industry heterogeneity. The foreign TNCs differ from each other even within the same industry; their heterogeneity impacts on innovation and performance as well as on their contribution to positive spillover effects in the host economy. Similarly, firms in the host country are heterogeneous even within the same industry. They differ in a variety of characteristics that impact on their own innovation capabilities and productivity and on their absorptive capacity as receptors of spillover effects from foreign TNCs. This is the overall framework around which the book is structured; it has three parts, each comprising two chapters.

Part I deals with the changing role of TNCs. Chapter one clearly develops the two way linkages between internationalization and innovation; the latter constitutes an

advantage for the firm branching out into the international arena and, conversely, internationalization creates opportunities for innovation activities via what the authors term *double network structure*. The intra-firm network of affiliates at home and abroad interacts positively with the external networks of formalized or informal linkages that each unit of the company establishes. The positive interaction allows each unit of the firm to learn from external linkages and – via the internal network – to transmit knowledge to other units within the firm. The scope for knowledge acquisition is higher the more diverse the environments with which the various units of the firm come into contact and therefore the higher and more diverse the host countries in which a TNC operates. Thus, the authors see the TNC as a *bridging institution* between different localities and countries with their diverse economic, technological and cultural contexts.

Innovation and internationalization affect each other and co-evolve along three main features: (a) innovation activities create advantages that lead to and/or enhance internationalization; (b) the double network structure allows the TNCs to learn from diverse environments; (c) if local firms are innovative, they contribute to the innovativeness of the foreign TNC and at the same time, they will have enough absorptive capacity to benefit from the innovative activities of the foreign TNCs. The other five chapters develop the discourse around these main points; in each chapter, theoretical arguments are presented, and empirical evidence from the authors' own research and/or from other sources is brought in to strengthen the theoretical arguments.

Chapter two deals with the *double network structure*. The authors analyse the issue of geographical dispersion of innovative activities as well as the issue of embeddedness. On the latter point there is evidence that many foreign TNCs are becoming embedded into the host economies via adaptation of their technology to local conditions and/or the establishment of cooperative agreements on innovation with local firms; a relevant role in the effectiveness of the double network structure

is played by the internal organization of the TNC: specifically by the degree of autonomy that the affiliates enjoy vis-à-vis the parent company. A high degree of autonomy allows the affiliate to develop more external linkages and become more embedded into the host locality; however, a lower degree of autonomy may favour the intra-firm transfer of knowledge. One question that emerges from this chapter is the following: are internal and external networks complementary or substitutive with regard to innovation activity? There are arguments and evidence that the relationship could be either way. The authors' view is that, on balance, the evidence of complementarity is stronger. On this point, they present their own case study of the electronics and chemicals industries.

Part II deals with firms' heterogeneity in terms of innovation, internationalization and productivity. Chapter three explores heterogeneity in terms of international involvement and its relationship to innovation. TNCs differ from each other because of the differences in their country of origin or in their ability to develop their internal innovation capabilities or in terms of their chosen internationalization path. The issues are explored by reference to relevant theories of internationalization from Vernon's international product life cycle to the internalization theory to the Scandinavian School's stages in the internationalization process. We are also presented with the authors' own study of productivity and innovation of Italian firms.

Chapter four develops the theme of TNCs as *bridging institutions* in the context of their heterogeneity seen as a characteristic that applies across and within TNCs. *Across TNCs*, the heterogeneity arises from differences in the the following aspects: (a) characteristics of the country of origin; (b) characteristics of the foreign systems in which they operate; and (c) the number, diversity and quality of the different systems in which they operate as well as the type of interaction they are involved in. The analysis of *heterogeneity within the TNC* leads the authors to consider the position, behaviour, innovation activities and performance of the parent company, the foreign

affiliates and the national affiliates. The analysis addresses the following issues: organization of innovative activities with particular attention given to the dispersion of R&D activities; constraints to the transfer of knowledge and innovation and constraints to the adoption of innovation and technology. The inference on the performance of parent companies versus foreign affiliates and national affiliates is derived not only from studies by other experts but also from the authors' own work on the Italian case. The study concludes that affiliates of foreign firms perform better than purely domestic firms but not better than domestic TNCs: a conclusion with relevant policy implications highlighted in the book.

Part III analyses the indirect impact of TNCs' innovation activities through spillover effects on the host economy. Chapter five considers various spillover channels: competition; imitation and demonstration effects; workers' mobility and various forward and backward linkages. The empirical evidence of spillovers is scanty. The authors explain this lack of evidence as resulting partly from the problems in model specification of the econometric studies and partly from the negative impact of competition neutralizing any positive impact.

Chapter six goes "in search of horizontal spillovers" from TNCs and again looks at the role of heterogeneity. Positive spillovers from foreign to domestic firms can occur in the presence of: technological gap between foreign and domestic firms; and/or high absorptive capacity by the domestic firms. Thus, the characteristics of both foreign and domestic firms are relevant. In this respect, foreign firms differ in the following characteristics: (i) extent of R&D in the host economy; (ii) propensity to establish collaborative linkages for innovation activity; (iii) and time elapsed since the establishment of the affiliate in the host country. All three characteristics are relevant for the degree of embeddedness and the extent of positive spillover effects. The heterogeneity of domestic firms is analysed with regard to their being internationalized or not, which may take the form of engaging in export or direct production abroad. Internationalized firms are found to have higher absorptive

capacity and thus be better able to receive positive innovation spillover effects. A last arm of the study takes the authors to the issue of whether the difference between domestic and foreign TNCs is due to the latter being foreign or being transnational. This involves analysing transnationals (both foreign and domestic) versus non-transnationals. The authors' own study finds that the expansion of foreign firms in Italy helps domestic firms that internationalize via exports while an increase in activities at home of Italian TNCs favours other domestic firms.

This is an excellent book - results of years of research. It offers the reader a fairly coherent theoretical framework, a very large literature review for every element of the study and a great deal of empirical research by the authors themselves, which is mostly for Italy and based on the Community Innovation Survey and ELIOS databases. The literature review as well as the authors' empirical studies point to a large number of unresolved questions and therefore to the need for further research – as in the case of spillover effects of TNCs into the host economy. In other words, the book can be turned into a gold mine for doctoral students to dig in and find sources of ideas for their own research.

Given the multi-dimensionality of the theoretical framework and the richness of elements covered for each dimension, the book is necessarily dense as well as deep: not an easy bed-time reading. The readers may have to devote their full attention to gain the full benefits; however, the result is highly rewarding. Moreover, clear and concise introductions and conclusions to each chapter are a great help to the reader; so are the summary tables offered by the authors in various parts. All in all, a must on the reading list of any researcher working on innovation, internationalization and the interface between the two.

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The New Political Economy of Emerging Europe **Second edition**

László Csaba

(Budapest, Akadémiai Kiadó, 2007), 400 pages

Transition studies is a huge academic discipline these days. From a modest start – e.g. a “passionate pamphlet” published in Hungary in 1989 (Kornai, 1989)¹ – it has grown into a mass industry. Given the proliferation of studies, why would anyone read yet another book entitled *The New Political Economy of Europe*, especially 18 years and arguably millions of worthless pages after the birth of transition studies?

It is safe to bet, however, that this second (revised and extended) edition of the book by László Csaba will become a best seller against all the odds. Naturally, you have to read it in its revised version, not least because the first edition (Csaba, 2005) sold out quickly. You also have to read the second edition because the author has extended and improved the analysis in various ways. Among other additions, two new chapters have been added, entitled “Re-interpreting rules-based behaviour in Europe” (chapter 9) and “Post-crisis perspectives on the future of the EU” (chapter 10).

The remaining ten substantive chapters carry the same titles as in the first edition, although some of the data have been updated and the style has been improved. After two forewords (to the second and first editions), the first substantive chapter looks at the empirical evidence on transition (chapter 3), and then the author turns to the question of what post-communist transformation means for development (chapter 4). The prominence of development issues in the book implies that for the author, the main benchmark of success in transition is based on the pragmatic question of how people’s lives have improved. The development question is followed by examinations of the

¹ Its English version was re-baptized and given a more solemn but less exciting title of “Road to a free economy” (Kornai 1990), probably to depict transition as the reversal of the “Road to serfdom” as argued in Hayek (1944).

relationship between states and markets (chapter 5), and of the relationship between globalization and regionalization, especially in the countries that joined the EU in 2004 and 2007 (chapter 6).

The chapter on globalization and regionalization provides a logical bridge to the subsequent four chapters (including the two new ones), which all focus specifically on EU integration issues. Indeed, one of the main merits of this book is that it organically links transition with EU accession. We can largely agree with the author that accession is not the end of transition, but its logical continuation. It is again another key message of the book that EU accession brings as many new challenges to the development of new member countries as solutions to old problems. The chapter titles are self-explanatory here: “Limits to accession-driven transformation in Central Europe” and “A non-stability and anti-growth pact for Europe?”. In the latter chapter, indeed already in the first edition published in 2005, the author was not afraid of taking an unpopular position against the fashionable argument of the day that in EU accession countries macroeconomic stability would not be conducive to sustainable growth, and therefore they should aim for loose monetary and fiscal policies. Recent history indicates that he may well have been right. His own country disregarded macroeconomic discipline for a long period of time. When the inevitable correction came in late 2006 – the fiscal deficit was approaching 10% of GDP – it was accompanied by riots and other forms of social upheaval. Since then, nobody challenges any more Csaba’s adherence to macroeconomic orthodoxy.²

The last four chapters of the book return to broader issues in transition. They deal, successively, with transition in the Russian Federation (chapter 11), the mutations of market socialism (chapter 12), the issue of privatization and regulation (chapter 13) and the nexus between institutions and growth (chapter 14). In chapter 12, the author delves into the long history of market reforms (“The viable impossible?”), including the New Economic Policy of the Soviet Union in the 1920s, Tito’s

² Not all politicians, however, have stopped preaching the “virtue” of macroeconomic imbalances.

Yugoslav model from the 1960s onwards, Hungary's economic reforms after 1968 and the opening up of the Chinese economy since the introduction of reform by Deng Xiaoping. The choice of the topics in these chapters reflects the fact that Csaba is first and foremost an institutional economist. He is a particularly active member of the European Association for Comparative Economic Studies (Vice President in 1990-1994 and 1996-1998, President in 1999-2000, currently a member of the Advisory Board).

Scholars of international business and international investment will appreciate that the book pays considerable attention to the role of foreign direct investment (FDI) and transnational corporations (TNCs) in transition. This is very important because, for a long time, the majority of transition studies neglected this issue. As Csaba's compatriot, Peter Mihályi, noted: "by emphasizing de-etatization and certain aspects of corporate governance, policy makers in the East and the West (Hungary included) for many years misunderstood the *raison d'être* of privatization, and had a distorted idea of where the priorities should be. [...] In this model, FDI was not expected to play a key role in privatization." (Mihályi, 2001, pp. 61-62). In contrast, scholars of FDI noted at the beginning of the transition that due to the relative weakness of the nascent local private sector and its limited experience with the functioning of market economy, FDI and TNCs had to play a disproportionately larger role in economic transformation than in the development of other countries at a similar level of development (Dunning, 1993).

An inconvenience in the book's treatment of FDI and TNCs is that this discussion is spread over various chapters and sections of the book. In the chapter on empirical evidence (chapter 3), there is a detailed section entitled "Foreign direct investment – Do we possess a key?" (pp. 64-68), and FDI figures again prominently in the preliminary conclusions from empirical evidence (pp. 68-70). In chapter 5, the analysis of the experience of the front-runners countries deals partly with the topic (especially pp. 118-122). The chapters on the Russian Federation (chapter 11) and on market socialism (chapter 12) discuss the FDI component of transition in two large countries (p. 282 for

the Russian Federation and p. 331 for China). Finally, the chapter on institutions and growth (chapter 14) puts the spotlight on investment promotion policies (p. 377) and on the role of foreign banks on financial intermediation (p. 382). The dispersal of FDI issues over various chapters is understandable from the author's point of view, as he aims to provide a comprehensive picture of the key aspects of transition, for which FDI is only a part.

While most of the issues related to the role of FDI in transition are discussed well in the book, the role of FDI in EU accession and the impact of EU accession on FDI are treated only implicitly in the most part. A more explicit analysis could start with questions on the relationship between economic integration and FDI and the changing structure of FDI-related production, which are only partly touched upon in this book. We know already that accession to EU leads to a major shift in the composition of inward FDI, while also giving it a new impetus. The enlargement in 2004 indeed resulted in a change in the composition of inward FDI in new member countries towards higher value-added and more services-related FDI. However, at the same time, their inward FDI plummeted in 2004, to recover gradually afterwards (Hunya and Sass, 2005). Why did this happen? Was it just a temporary drop resulting from a wait and see attitude of investors with regard to the regulatory uncertainty? Or did they also anticipate a potential increase in production costs, as the full application of the rules and regulations of the *acquis communautaire* requires additional expenditure by business? Or did they think old Members would pressure accession countries to increase their taxes? And when it comes to the restructuring of industries, why is it that most of us did not foresee that new countries could not just gain but might also lose productive capacity during such rationalization? These are issues which the author might consider incorporating into future editions of the book.

A critical comment that might be added is on the FDI statistics presented in the annex of chapter 3 (p. 87). Regrettably, the data series stops at 2002. We know that one of the reasons for this is the demise of the author's main source of information, the *Economic Survey of Europe* published by the United Nations

Economic Commission for Europe (UNECE). Still, the last issue of that series (UNECE, 2005) contained data at least up till year 2003. Moreover, the on-line statistical database of UNECE offers further updates, and the FDI/TNC database of UNCTAD, the main United Nations agency on such statistics, provides even more detailed data, free of charge and on-line, which the author could have used to update his table. One of the unintended consequences of the lack of statistical updates is the author's limited attention to some new developments. For example, for many years, we all contended that FDI in the Russian Federation was relatively little because of the country's investor unfriendliness, and that the situation would not change any time soon. However, since 2003, the inflows of FDI to the Russian Federation have literally exploded – against the backdrop of increasingly restrictive rules on inward FDI. It seems that the need to access natural resources, for which global demand has increased substantially, has overridden most concerns about the business environment. Moreover, the sudden enrichment of part of the Russian population on the back of high oil and gas prices has provided an incentive for market-seeking investors, for example, in banking.

These limited critical remarks, however, do not cancel or lessen the merits of this excellent book. The author's evaluation of the development impact of FDI on countries in transition is comprehensive and even-handed. On balance, FDI has had more positive than negative impacts on transition. Going one step further, one can say that, in hindsight, it is difficult to imagine how transition could have happened at all without inflows of FDI. That does not mean, however, that FDI has been the only factor underlying success in transition. It has contributed to the transformation of countries from centrally planned to market economies in conjunction with an overhaul of the domestic business sector, a redirection of external trade and financial links with the world at large, macroeconomic stabilization and, last but not least, social transformation. Without an interaction with the latter processes, FDI would have created only an enclave with little embeddedness in its host economy. The importance of these processes is well documented in Csaba's book. He also points out that FDI is not a panacea to all problems arising from

transition; its risks and negative impacts have to be acknowledged, too. The book again does that in a reasoned manner, for example, when discussing the consequences of foreign ownership in retail banking.

All in all, this is a refreshing book. It is a comprehensive, balanced, pragmatic and non-ideologized account of both transition and what comes after. It avoids most of the problems related to the over-econometrization of the dismal science. Csaba puts all data analysis under a critical scrutiny. The fact that he is from inside the region helps. Moreover, by putting the economic analysis into the institutional and political context of the societies concerned, the author is able to evaluate the credibility of quantitative information. What follows from this is a lucid and uncompromised analysis of transition with all its complexities. However, Csaba is not a thriller writer. His sentences tend to be dense, perhaps too long. Why does the magic nevertheless work? Why is it that if you started reading the book, you do not want to stop reading it? It is the excitement about the topic and the quality of the analysis that keep you there.

You are encouraged to obtain a copy of this book and enjoy it. Whether you are a scholar, a student, a public servant, or just interested in finding out what is happening in formerly centrally planned economies, I am sure you will find the book useful. It can be used as a textbook or as reference material. We also hope that the publisher, which is member of the international Wolters Kluwer Group, has printed a larger number of copies than the first edition. However, if you do not want to take the risk of seeing it sold out, it is better to buy it now.

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* This review represents the personal opinion of the reviewer.

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