Local Content Requirements and the Boundary of Knowledge Spillovers

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Abstract

This paper investigates the reorganization of Global Value Chains (GVCs) following the removal of Local Content Requirement (LCR) policies, using the termination of Brazil's Inovar-Auto program (2013–2017) as a natural experiment. Utilizing granular, shipment-level data from the Panjiva database, we track shifts between intra-firm and arm's-length trade across geographic regions and input types. Contrary to the conventional view that protectionism is necessary to foster inward technology transfer, we find that policy liberalization significantly increased the local outsourcing of non-routine activities. This effect is most pronounced in environments with high institutional quality, where legal safeguards allow firms to externalize tacit knowledge. While routine tasks were increasingly imported intra-firm from global headquarters, the rescinding of LCR mandates dismantled the protective bubble that previously forced automakers to internalize complex work within local subsidiaries for compliance. By shifting these non-routine, less-codified tasks to independent local suppliers, the removal of LCRs effectively expanded the qualitative boundary for potential knowledge spillovers into the local ecosystem.

Keywords: Local content Requirements; Outsourcing; Knowledge Spillovers; Firm organization; Tacit knowledge; Automotive Industry
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