

Notes

Introduction

1. In general, foreign resource inflows can be viewed as an income transfer that can be either consumed or invested. In Obstfeld's (Obstfeld, 1994) model, for instance, a foreign resource inflow is no different from any other increase in income. Unless the rate of inter-temporal substitution is very high, the representative agent will respond to a permanent resource inflow with an increase in consumption. As the inflow affects income as well as consumption, saving may rise or fall. If the resource transfer is temporary or takes the form of a loan that must be repaid, the consumption effect is somewhat damped, but it is still likely to exceed the effect on investment. Thus, resource inflows may raise utility by allowing households to smooth consumption rather than by leading to a rise in investment and growth. However, it should be noted that this type of utility-based models miss some essential features of foreign capital inflows. In particular, the assumption of a single representative agent assumes a degree of capital market development – equalization of lending and borrowing rates – that does not exist in most developing countries, see Agenor (2001).

2 FDI: Global Trends and Assessments

1. Amiti and Wei (2004) made an interesting comment on job losses due to outsourcing in the context of the USA. To quote:
... outsourcing does not lead to net job losses. ... For example, when disaggregating the US economy to 450 industries, there is a small negative effect on employment. But aggregating up to 100 sectors, there were no job losses associated with service outsourcing. This implies that a worker could lose her job due to outsourcing but then she, or an unemployed worker, may find a job in another form within the broader industry classification. Hence aggregate data would indicate that there are no net job losses when there is sufficient job creation in another sector, which indeed seems to be the case. (p. 39)

4 Foreign Investment: China

1. SEZ means 'special economic zone'. An authority of the country to practise a special administration system and implement special policies to achieve particular economic goals in its domestic and foreign activities establishes it. China's first economic zones, viz. Shenzhen, Zhuhai, Shantou, and Ximen were established in the early 1980s. Later in 1988 Hainan Island was also designated as the fifth special economic zone. The establishment of these zones aims at opening the four windows, namely, technology, knowledge,

management and foreign economic policy and also to the economic expansion in and outside China so as to promote the development of the export-oriented economy in the hinterland. The special economic zones are the signs of the opening of China's hinterland to the outside world. The special economic zones have been established as experimental zones for the economic reform in this country. Whenever a new policy is formulated, an experiment is first made in the SEZs before the new reform is carried out elsewhere.

2. However, China is obliged to open up its financial market for international competition since it has become a member of World Trade Organization (WTO). Hence the number of foreign banks and financial institutions in China is expected to increase and China may allow them to conduct Yuan business as well. Likewise, as China builds up its trade-related infrastructure, trade between China and other countries will be increasingly direct and will bypass Hong Kong. Hence, the demand for Hong Kong's entrepôt as well as transshipment services is expected to decline. Furthermore, some of the comparative advantages of Hong Kong's trade-related services are more artificial than real. For example, the intermediate role of Hong Kong in China-Taiwan as well as China-South Korea trade is mainly due to the restriction of direct trade between China and the two trading partners. With the improvement in diplomatic relation and direct shipping links between these trading partners, Hong Kong's comparative advantage in servicing indirect trade between them is again likely to be eroded (see Chai and Kwong, *ibid.*).
3. China's official figures of FDI may be an exaggeration. A large amount of China's FDI has been earned in mainland China but then booked to accounts in Hong Kong for tax purposes and subsequently comes back to the mainland as FDI, in a process of 'round-tripping'.
4. The coastal open cities are coastal port cities where special open policies are followed. In May 1984, the State Council decided 14 more coastal port cities, that is Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhejiang and Beihai. The sole purpose of opening these coastal port cities was to achieve better industrial foundations, high level of technology, transport facilities, quick access to information, good network of economic cooperation at home and the channels for foreign trade so as to attract overseas investments. These open cities offer preferential policies to the investors. On technology-intensive and knowledge-intensive ventures or on energy and transport projects, the enterprise income tax will be collected at a rate of 15 per cent. On industrial and agricultural projects, the income tax will be collected at the rate of 24 per cent. No duties will be collected on equipment and machinery imported as overseas investments, the raw and processed materials imported for the production of export goods, means of transportation for their own use and office accommodation.
5. Recent research reveals that FIEs located in Guangdong performed better than those located in the SEZs, see Cheng and Wu (2000) and Fung *et al.* (2000).
6. Pudong is one of the Economic and Technological Development Zones (EDTZ). It has the characteristics of the other SEZs, but it goes farther in allowing foreign firms to import and export goods for use within the zone duty free (entrepôt free trade). A similar free trade zone has been established in Tianjin and Guangzhou. The choice of Pudong as an EDTZ applied the

special economic zone concept to a location up the coast, to a city renowned in generations past for its business and financial acumen. Unlike Shenzhen and the other SEZs which are literally fenced off from their surroundings, planners view the development as not only integral to the economic and social progress of Shanghai, but also as a way to boost the economics of the six provinces that comprise the greater Yangtze River area, home of 34 per cent of China's population (see Keijzer, 1995). In 2001, of the total 395 investment projects launched in Pudong, 26 registered an investment of over US\$10 million each, with total investment coming to US\$1.639 billion, up 249 per cent year-on-year. Furthermore, foreign investors, accounting for 85.8 per cent of the total, wholly own 339 out of the 395 projects. As on December 2001, there were 7,030 foreign funded enterprises (FfEs) in the area, and they were expected to invest a total of US\$36.6 billion of foreign capital and that includes US\$15.5 billion of contractual capital. In order to use foreign capital more efficiently, the Pudong SEZ is expanding its area with the area of software park to increase from the current 30,000 sq. km to 90,000 sq. km; the customs area of the Waigaoqiao Bonded Zone will expand from 6.4 sq. km to 7.52 sq. km; the microelectronic industrial belt will expand to neighbouring townships; and the urban area of Pudong will expand from 100 sq. km to 130 sq. km. One of the ensuing effects of the expanding is that foreign companies have seized the opportunity to increase investment. Official figures show that Hong Kong leads the way by launching 2,677 projects with US\$3.4 billion of contractual foreign capital. It is followed by the United States, which has launched 987 projects with US\$2.97 billion of contractual foreign capital; and Japan the third by launching 883 projects with US\$1.62 billion of contractual foreign capital. Of the world's top 500 enterprises, 112 have shown presence in Pudong, launching 198 projects. In addition, there are other projects in this area such as a micro-electronic project (US\$300 million), a semiconductor project (US\$400 million) and an Intel expansion project (US\$300 million).

7. See *The Economist*, 15 Jan. 2004, p. 3.
8. See *China Economic News* (No. 21), 4 June 2001, pp. 11–13.
9. The future demographic pattern may be unfavourable for China. The one-child policy adopted by China in the last two or three decades will exact penalties after the next two or three decades when the ratio of working population to non-working population will be unfavourable for China. In fact the size of the population which will define the talent pool will be less for China at that stage.
10. On close examination, it reveals that China's 'high-tech' exports turn out to be not truly 'high-tech' according to international standard. The Chinese version of high-tech exports is defined by finished information technology products, DVD players and laser printers (Table 4.16). Interestingly, the high value-added brains of these products – integrated circuits – dominate the top high-tech imports into China.
11. According to the 'crowding-out' hypothesis, inward FDI might have a negative effect on domestic R&D activity, because purchasing technologies from abroad (by setting up joint ventures with foreign investors, for example) is a substitute for innovating on one's own. This substitute is more attractive

when conducting one's R&D is risky, or when the technology concerned is of high standard (such as invention).

5 Foreign Investment: India

1. See Lall and Streeten (1977).
2. For a recent comprehensive survey of the issues, see Kathuria (1995).
3. For detailed discussion see Sengupta *et al.* (1996).
4. UNCTC, 1994.
5. For a discussion of FERA and its implications see Martinussen (1988).
6. See Bhagwati and Srinivasan (1993).
7. See Kumar (1994).
8. Previous research rationalizes the low actual to approval ratio as due to:
 - (a) concentration of investment in a few large size projects,
 - (b) sizeable investment flows in infrastructure industries where gestation period high,
 - (c) large projects in organic chemicals, fertilizers and steel are being dropped or reviewed.
9. See US Embassy (2001).
10. The availability of information on them depends on their legal status. Limited information is available about their legal status. For example, very little information about the companies those registered outside the country, and in tax shelters, like Mauritius. Another case is the Enron's Dabhol Power Company – the largest foreign project yet – is incorporated in India as an unlimited liability company. But it is shell company that Enron controls through at least six holding companies registered in various offshore locations (see Mehta, 1999, Nagraj, 2003).
11. In his case data has been extracted from the Prowess package of the Centre for Monitoring Indian Economy (CMIE). Prowess covers all the firms listed in the Bombay Stock Exchange (BSE) with data from their annual reports. While extracting the data, two truncation rules were followed: (a) continuous data for a firm for all the years of the study period (that is the panel should be balanced); (b) the firm should not belong to any sector, which is reserved exclusively for small firms, such as match-sticks, leather products, and so on. After accounting for these two criteria, the initial data set consisted of 519 firms with data for eight years from 1989/90 to 1996/97 for 24 three-digit industries. Of these 519 firms, 32 firms had to be dropped, as they either had negative value added for more than three years of study period or were government owned or the Prowess reported zero fixed assets for the firms. Thus, the final analysis involved use of data for 487 firms belonging to 24 three-digit manufacturing industries. The selection of these industries is based on the matching of the Prowess industrial classification to that of SIA. The matching is necessary to facilitate an estimation of the impact of entry of foreign firms and FDI after liberalization. This is because SIA is the only source that gives industry-wise data on the collaborations and FDI after the liberalization and its classification is

different from that of the Annual Survey of Industries (ASI) or Prowess classification.

Of the 487 firms, 116 firms (that is nearly 24%) have a foreign equity participation of 25% or more (designated as FDI firm) during the study period. The distribution shows that the foreign firms' presence varies from zero to nearly 50% in different sectors with three sectors pulp and paper, vegetable oils, and industrial and scientific instruments having no foreign firm. The share of foreign firms varied from a little over 2% in sugar to over 63% in LCVs and the passenger cars sector for the year 1990 (Kathuria, 2002).

12. The HMI makes 120,000 cars annually in India and it is Hyundai Motor's largest production base outside Korea. India is the second largest overseas market for the company after the USA where it sells 500,000 cars a year. Unlike most multinational car companies in India, HMI invested in an aluminium foundry and also a transmission line so that it could increase indigenisation levels and cut costs. As a result, HMI has achieved indigenization levels over 85 per cent (see Park, 2004).
13. HMI was the first self-sufficient manufacturing unit and greenfield investment of an overseas automobile company in the Indian car industry. A greenfield investment is a start-up investment in new facilities. Such an investment can be wholly owned or a joint venture. It had invested Rs2,900 crore by 2001. HMI formed the industrial cluster with a strong subcontracting linkage between vendors. In 1997, the core companies (vendors) came from Korea with HMI. Most of the companies' headquarters are located in the Ulsan automobile cluster near Hyundai Motors, Korea (parent firm HMI). Under the umbrella of HMI, they had invested in joint ventures with Indian companies or in greenfield investment in the automobile industry.
14. The 'flying geese' pattern was originally conceptualised as a general theory of economic development. It explained the development of an industry from its introduction of its products to an economy through imports through the establishment of local production facilities to the emergence of growth in exports.
15. India is targeting one per cent share of world exports by 2007, see 'No Comparison', *Times of India* (2002).

7 Technology Transfer: Case Studies

1. This case is based on an article published in *Asian Business and Management*. For details see Chen and Ku (2002).
2. For details see Banik and Subbaymma (2000).
3. This case is based on company Annual Reports and write-ups in *Dataquest* (30 Sept. 2002), *Business India* (14–27 Oct. 2002b), *Business Standard* (26 Aug. 2003), *Economic Times* (14 Jan. and 28 Apr. 2004).
4. This case is based on company web sites and Annual Reports and write-ups in: *Deccan Herald* (7 Sept. 2004), *Financial Express* (18 Aug. 1998) and *Economic Times* (29 Oct. and 23 Nov. 2004).
5. This case is based on an author's visit to the Lenstec plant and discussions with its MD, Ian Hickling.
6. In a personal communication to one of the authors.

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