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Huang's Response

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Beamish and Delios write an eminently reasonable review. I agree that the environment for private sector has improved. *Selling China* describes some of these developments (pp. 202–204) and predicts that the overall role of FDI will decline, which is exactly what happened. The FDI/domestic private investment ratio has fallen. This decline is the other side of the mirror as the rising ratio: suppressing the domestic private sector, everything else being equal, can raise this ratio; supporting it can reduce this ratio. There are no logical or empirical inconsistencies. I believe that I overstated the ideological rigidity of the Chinese state and that I was vague in specifying the ideological constraints. In the 1990s, the ideology was of an industrial policy kind, rather than Communism.

This critique is based on interesting data and falsifiable interpretations of Chinese reforms. I may offer different hypotheses. For example, competition among MNCs can also lead to lower profitability of Japanese firms and SOE reforms have not changed the control structure of these firms. But these differences can be resolved through further research.

The blunt criticisms by Shenkar and Overholt have a different flavour altogether. *Selling China* can be completely wrong, but the right way to critique it is to question the evidentiary and analytical bases of my conclusions. They do not even *attempt* to do so. Not a hint of an effort is made to address questions such as sample selection, generalizeability of case-study evidence or theoretical specifications. Their criticisms boil down to the following: you are wrong because I am right.

I cannot tell what is Shenkar's overriding theme, except that I have done many things wrong. I have, apparently, ignored both macro and micro perspectives. I could have omitted one or the other, but I do not understand how I could have managed to ignore both. Evidently unfazed by the fact that *MOR* commissioned this symposium, Shenkar says that *MOR* readers will be disappointed with the book's failure to address managerial issues. I never claimed to address managerial issues. His criticism would make sense if he could show why this failure detracted

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from the issues I did address, which he never did. So he is expressing an opinion about his taste.

Shenkar says that my understanding of institutions is narrow and I fail to adopt 'a more rigorous sociological interpretation' of institutions. Fine, but please tell readers (1) what part of my analysis is wrong due to this narrow usage; (2) what institutions I am talking about, and (3) what exactly is a sociological definition. Let me spell out the institutional contexts in my book and readers can judge whether they are broad or narrow: (1) state ownership, (2) the orientation of financial and legal institutions, and (3) fragmentation of capital markets. I am prepared to embrace another definition of institutions but I cannot do so – nor can I identify what is wrong with my own usage of institutions – if I do not even know what the alternative definition is.

On top of the criticism that my account is narrow, there is also the criticism that I ignore the 1979 and 1986 FDI regulations. Almost all FDI studies invoke FDI legislation as an explanation. *Selling China* argues that factors beyond FDI legislation also affect FDI. Is something amiss here? My account is narrow because I went beyond the narrowest and the most conventional account of FDI?

Shenkar's commentary is fraught with conceptual and empirical inaccuracies. The contractual inflows are not cooperative ventures governed by the 1986 law. The former is non-equity, while the latter is an equity form of investment classified in the same way as joint ventures. This mistake is otherwise innocent except for the fact that Shenkar wants to explain why contractual flows were greater than equity flows in the earlier years. But here he becomes entangled in a trap. By his logic, equity investments should have surged ahead of contractual inflows because the equity investment law was passed earlier – in 1979 – than the legislation governing what he views as contractual inflows (in 1986). The contradiction between his logic and the data he tries to explain is glaring.

Shenkar's choice of Honduras and Israel is truly unfortunate. He confidently asserts that an uncompetitive Honduras would not attract much FDI whereas a competitive Israel would. According to UNCTAD, in 2000 the FDI stock/GDP ratio was 25.1% in Honduras but only 19.1% in Israel. It is a good habit to check the facts. (Shenkar uses FDI per capita as a measure of FDI attractiveness. By this measure, the war-torn Angola is far more attractive than China.)

Shenkar criticizes me for adhering to an economic paradigm *and* for ignoring the technology transfer benefits of FDI. He either does not understand economics or he does not understand technology transfer (or both). Economists are *obsessed* with technology transfer of FDI. The whole idea of this book is that this economic paradigm is narrow when it comes to China and that FDI performs broader functions, such as providing venture capital to private entrepreneurs, *de facto* privatization, and integrating assets in a fragmented market. I just do not get his criticism here. The departures from the standard economics are clear, not just in the message but also in methodologies – case studies, interviews, and field research.

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His point about SAIC's acquisitions shows how fragmented knowledge about China can lead to the wrong conclusions. Industry insiders in China will tell you that SAIC is desperately frustrated that Volkswagen and GM did not bring sufficient technology and it has now shifted its tactic toward acquisition. As for Shenkar's admonition to remember FDI and technology transfer when sitting in a future SAIC-made car in the United States, let me just say that we do not have to wait. I sit in a Toyota every day (and periodically in a Hyundai) to know that he is wrong.

The criticism by Overholt – and Shenkar – about technology transfer muddles the distinction between positive and normative analyses. I *document* that much of FDI is in low-tech industries originating from low-tech economies. From this, Overholt jumps to the conclusion that I am normatively opposed to FDI. This criticism is not merely inaccurate but it is directly contrary to what I argued explicitly. In numerous places (pp. 95–96, 202–203, and 317–319), I praise low-tech FDI for bringing capital to credit-constrained entrepreneurs and for effecting institutional transformation. I simply point out that the reason why FDI played this institutional role is because China's inefficient institutions prevented domestic private firms from doing the same. Overholt seems unaware of the distinction between a cause and an effect: the bulk of the book is not about the effects of FDI but about its causes.

His most egregious distortion is that *Selling China* argues that FDI displaces the domestic private sector. He quotes from the two-page synopsis of the book, while ignoring the rest of the book. A whole chapter explains how China's institutions, not FDI, depressed the competitiveness of the domestic private sector. I devoted three pages (pp. 92–94) to specifically debunking the 'crowding-out' hypothesis. Let me quote: 'there is no compelling reason to believe that the entry of foreign firms on its own would necessarily crowd out private firms. Foreign firms may spur the development of private firms, for example, by creating buyer and supplier linkages with efficient private firms'.

The next sentence then provides the punchline: 'The ability of a private firm to become a supplier to a foreign firm would *critically depend on its access to financing and on its legal status, that is, those dynamics that are dependent on the institutional factors analyzed in this book*' (emphasis added). About 190 pages out of 380 pages in the book document exactly how poor financial and legal treatments undermined the competitiveness of Chinese private firms on the one hand and created incentives for accessing financing and legal protection from foreign firms on the other. I challenge anyone to locate one sentence where I write that FDI undermined the competitiveness of domestic private firms. It is distressing that a reviewer does not get the basic point of my book.

There are at least three ways in which his point that the contractual flows were due to poor legal institutions is wrong: (1) by his logic, contractual flows – equivalent to outsourcing – should be absent in a country like the USA and everything

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should be produced in-house; (2) the logical implication of better legal protection is not the disappearance of contractual inflows, but longer-term contracts replacing shorter-term contracts, and (3) a hugely inconvenient fact for his story is that contractual inflows increased in the late 1990s when the legal environment for foreign firms became better (as a result of WTO).

I documented the latter fact in my book (pp. 203–204) and argued that this change coincided perfectly with an improving environment for domestic private firms. And here is a methodological point. My view on contractual flows is based on empirical evidence – cross-country, case study, and field research – and on the logic of contract production (pp. 156–162). For sure, there is room for different views, but Overholt simply asserts the superiority of his views without so much as a hint as to why my logic and evidence are wrong.

I categorically reject the characterization that my work is 'emotionally loaded' and is a 'political filter'. Apart from its deep offensiveness, the basis of his characterization is just absurd. My use of the phrase 'FDI-dependent' invited his scathing criticism, but this is a standard term in the FDI literature, referring to the ratio of FDI divided by either GDP or domestic capital formation (defined precisely and specifically on p. 7). If a country has an FDI/GDP ratio of 0.00001, we say that this country's FDI dependency ratio is 0.00001. (The term, 'dependency ratio', is also used in the pension and insurance literature). He prefers his own coinage, FDI-welcoming. (Webster's dictionary: Welcoming = to accept with pleasure.) I leave the readers to judge who is being subjective.

His other criticisms go after some invented targets. Yes, I did express a more positive view of India in this book (p. 332) and in later works. Let me repeat this view: India's financial and legal systems are less biased against the private sector compared with China's. Overholt extrapolates from this clearly bounded statement that I ignored India's poor education and lack of infrastructures, and that I praised India's lack of FDI. The exact opposite is the case. Because I recognize India's massive shortcomings, I am more impressed with the ability of its financial and legal institutions to offset these disadvantages and with the fact that its growth is more efficient, despite the fact that it does not have much FDI.

Then there is the random criticism that I somehow endorse debt over equity. Apparently, Table 1.2 motivated this criticism. The idea of Table 1.2 is to show that FDI/investment ratios are not driven only by the openness of FDI policies. Some countries have more open FDI policies and yet have lower ratios. The table has no information on FDI/debt ratios for the simple reason that it is not the subject of the book. In fact, I specifically argued that the book is not about financing, because China is a net capital exporter. It may be quasi-plausible to label me as an FDI sceptic because I attribute some FDI inflows to inefficiencies, but I have no idea how I became an advocate of debt by writing a book about the effect of suppressing the private sector.

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In his eagerness to criticize my book, Overholt makes some erroneous observations. I would advise him to check China's debt/GDP ratio before concluding that the Chinese economy is not debt driven. (Hint: China has one of the highest ratios in the world.) He lumps Latin America, Philippines, Korea, and Japan together as countries that pursued bad strategies. Korea and Japan? They may have troubles but they both *became rich countries!!!* Let's get real here.

I believe that *Selling China* can be improved in many ways. After reading the last two reviews, my opinion has not changed in either direction.

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