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Foreign Direct Investment Affluences in Iskandar Malaysia

Patmawati Ibrahim

Senior lecturer, Faculty of Technology Management and Business, Universiti Tun Hussein Onn Malaysia (UTHM), 86400 Batu Pahat, Johor, Malaysia
Email: patmawati@uthm.edu.my;

Maimunah Ali

Senior lecturer, Faculty of Technology Management and Business, Universiti Tun Hussein Onn Malaysia (UTHM), 86400 Batu Pahat, Johor, Malaysia
Email: maimunah@uthm.edu.my

Abstract

Iskandar Malaysia is one of the regional economic growth areas that have been identified by the government of Malaysia to spearhead economic transformation programmes as stipulated in the Tenth Malaysia Plan. The aims of the economic transformation programmes are to address the declining trend in foreign investment and outflow of human capital, as well as to spur the next stage of economic development. Thus, Iskandar Malaysia serves as the platform to highlight Malaysia's structural shift to broader macro objectives that aims to transform Malaysia into a developed nation by a knowledge-based economy. Since its inception in 2006, Iskandar Malaysia has attracted foreign investments of about RM111.4 billion as of the first quarter of 2013 and 40% of the investments has already been realised. The entry of heavyweights foreign investors such as Temasek, Ascendas, CapitaLand, China's Country Garden and Australia' Walker Corp have propelled foreign direct investment (FDI) flows into Iskandar Malaysia, making it highly dependent on foreign funds for development. Although FDI is the key catalytic agent of economic growth and development, it is not without pitfalls and setbacks, especially on local community and average households in Johore. The aim of this paper therefore, is to examine the affluences and setbacks of FDI in Iskandar Malaysia on average local households across the five flagship zones of Iskandar. The study would include analysing the impact of FDI on culture and social-economic environments as well as on natural surroundings in the Iskandar area, and subsequently, attempts to touch on the sustainability of FDI in maintaining rapid economic progress of Iskandar Malaysia.

Key words: Malaysia, Iskandar region, FDI, economy, transformation, Johore.

JEL Classification : O11, E22, R58

1. Introduction

The idea of Iskandar Malaysia starts with a strategic partnership between Malaysia, Singapore and Riau (Indonesia) to develop the SIJORI (Singapore, Johore, Riau) growth triangle in 1989. The strategic partnership aims to combine the strength of the three areas focusing on enhancing the attractiveness of the region to foreign investment. The partnership however, failed to take off despite the strong political support and sound economic reason. When Iskandar Malaysia was first initiated in 2006, the perception was 'why should it be different'. However, Iskandar Malaysia is an ambitious and comprehensive project compared to SIJORI. Its scope includes far beyond the manufacturing sector, venturing into tourism, healthcare, education and property sectors (IRDA, 2012). Iskandar has taken on a new dynamism with the greater involvement of Singapore. The enhanced connection between Iskandar Malaysia and Singapore allows Singapore's keen interest in Iskandar being built on pragmatic and strategic reasons. Apart from Singapore's Temasek Holding, heavy involvement of other international foreign investors is a testament of the region's booming prospects. They are CapitaLand, China' Country Garden and Walker Corp (IRDA, 2012). Heavy involvements of foreign investment are not without risks. Among the risks are long gestation period of catalytic developments, the possibility of a waning diplomatic and bilateral relations between Malaysia and Singapore as well as lack of critical mass in the commercial and properties activities in Iskandar Malaysia. The aim of this paper therefore, is to examine the affluences and setbacks of foreign direct investment (FDI) in Iskandar Malaysia on average local households across the five flagship zones of Iskandar. The study would include analyzing the impact of FDI on culture and social-economic environments as well as on natural surroundings in the Iskandar area, and subsequently, attempts to touch on the sustainability of FDI in maintaining rapid economic progress of Iskandar Malaysia.

2. Literature Review

Cross border investment in the form of FDI is one of the most potent drivers of globalization. The widely held assumption is that FDI brings new investment which boosts national income (Holger and David, 2003), expected to bring additional externalities and spillovers to the host country (Moran, 2001) as well as increasing productivity or export growth (Holger and David, 2003). Based on this assumption, the FDI policy of many countries have been liberalised through regulatory changes (UN, 1999), government intervention (Head, 1998; Girma, Greenway and Wakelin, 2001) and tax incentives (Holger and Davis, 2003). FDI does have its importance. Moran (2001) provided supported evidence of the FDI benefits to domestic firms and Larrain et al. (2000) conclude that MNCs have positive effects on the local economy. Literatures have identified four channels through which a host country benefits from FDI and they are imitation, skills acquisition, competition and exports (Holger and David, 2003).

The debates on FDI continue on aspects of how FDI affects human welfare. There are huge literatures on FDI's effects on economic growth (Roy and Van den Berg, 2006) and literatures suggest that there is a broad consensus that FDI is good for economic growth (Edwards, 1998; Baldwin, 2003; Lewer and Van den Berg, 2003). Economic theory proposes that FDI results in a more efficient allocation of world savings and lowering of risks through asset diversification and has also been linked to international technology transfers. Researchers have found that FDI is the most likely form of cross-border investment that drives international technology diffusion (Caves, 1996; Balasubramanyam, Salisu and Sapsford, 1996). Romer (1993) stress the positive role FDI played in technology transfer and its relationship to economic growth. In addition, Easterly and Levine (2001) and Caselli's (2004) provided empirical evidence that shows long-term economic growth is the effect of technological progress apart from factor accumulation. Hajeazi and Safarian (1999) conclude that FDI accounts for the bigger segment of technology flows between OECD countries compared to trade.

However, there are studies that found FDI may have failed to contribute to the technology spillovers as suggested before. Haddad and Harrison (1993) using the Moroccon data, Aitken and Harrison (1999) on Venezuela and Djankov and Hoekman (2000) analysing Czech Republic and Bulgaria found that these countries have not benefitted from the FDI's technology spillovers. Others have found that the expected technology progress from FDI tend to concentrates in certain geographical areas (Evenson and Singh, 1997) and move between countries at a sluggish pace (Borensztein et al., 1998; Branstetter, 2000; Mayer, 2001). Interestingly, literatures have found that FDI is not the only medium through which technology flows between countries. Technology transfer happens due to a variety of reasons. Balasubramanyam, Salisu and Sapsford (1996) found that the technology spillovers from FDI critically depends on the extent that the domestic firms are protected from import competition. Smarzynska (2000) concludes that foreign ownership shares affect technology transfer when evidence suggests that firms with leading technology prefer wholly-owned subsidiaries to joint ventures. Despite all these studies, there is uncertainty and a lack of consensus on the role of FDI in the process of economic growth making the relationship between FDI and economic growth a complexity (Roy and Van den Berg, 2006).

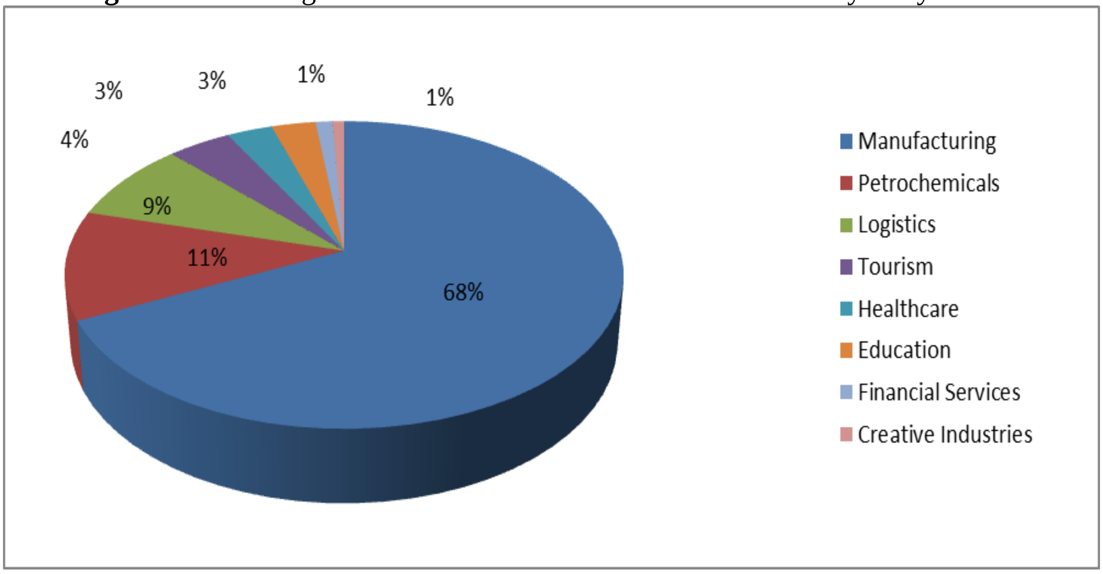
FDI is not without risks. To most economists, the infusion of foreign capital is beneficial to the economy, providing jobs, venture capital, new management techniques and higher productivity (Vrountas, 1990). FDI also brings the fear that foreign control comes with foreign money, foreign speculation will bring about rising property prices, and dependency on foreign money could affect policies and decision-making. On top of that, foreign control of industries affects the national interest of the host country. As the global economy becomes more complex, the distrust of FDI is well founded as countries have become subjugated to the will of another through the power of FDI (Vrountas, 1990). Barriers to FDI however, do not protect a host country from the risk of dependency, resentment and malaise associated with FDI. A broad and pragmatic approach to FDI and understanding its far reaching effects should be the better way in dealing with FDI.

FDI if monitored and manage properly can provide economic growth, new technology and prosperity. Countries have learned through experience, ways to manage FDI and understanding the significant effects that the FDI bring could bring about a win-win situation between both the host country and foreign investors. Foreign investment need not mean foreign domination.

3. Current FDI Situation In Iskandar Malaysia

When it was first announced in 2006, Iskandar Malaysia's committed investment was RM11 billion. As of March 2013, a total of RM111.37 billion in investment has been committed to Iskandar; with 42% (RM44.82 bil) of the investments have already been realised. Between January to March 2013 alone, Iskandar Malaysia recorded RM5.06 billion in new investments and it continues to receive strong support from both local and foreign investors (IRDA, 2013). The biggest investments are in manufacturing (RM35.3bil), petrochemicals and oleo-chemicals (RM5.95bil), logistics (RM4.43bil), tourism (RM2.23bil), healthcare (RM1.6bil), education (RM1.55bil), financial services (RM600mil) and creative industries (RM400mil). The allocation of investments according to sectors is illustrated in Figure 1.

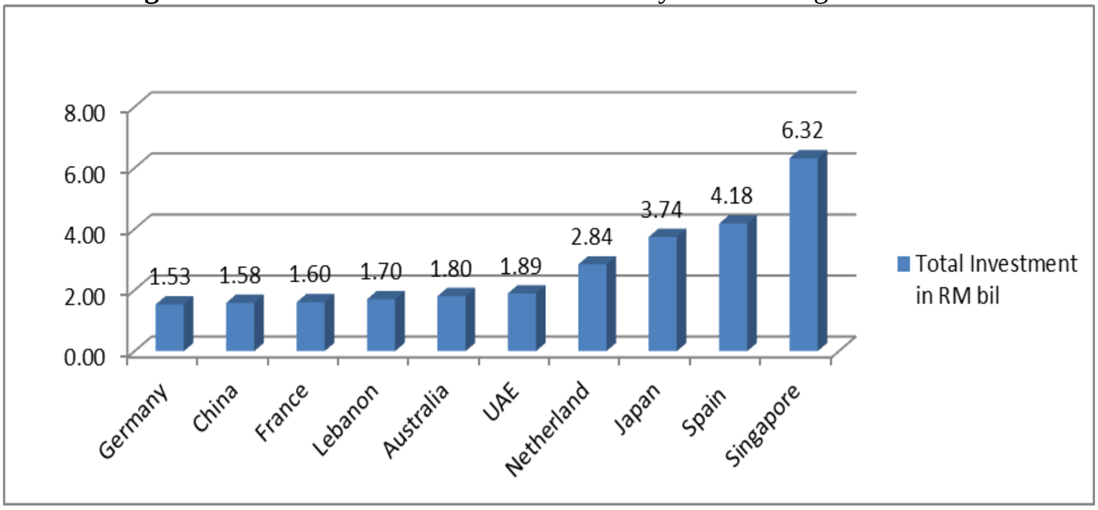
Figure-1. Percentages of Investment Allocation in Iskandar Malaysia by Sectors



Source: IRDA, 2013

Singapore's active involvement in Iskandar is marked by the entry of Temasek Holding as the first large scale investment by Singapore. Apart from Temasek, Fastrack Autosports and Singapore government-linked Ascendas have also formed a joint venture with UEM Land to develop a motorsport city and commercial properties development respectively (DBS, 2013). As at December 2012, Singapore remains the largest investor in Iskandar Malaysia. Figure 2 shows the number of investors in Iskandar Malaysia as at December 2012.

Figure-2. Total Investments in Iskandar Malaysia according to Countries



Source: IRDA, Khazanah, IIB , MIDA,2012

4. Future Direction of Fdi in Iskandar Malaysia

To attract investors to Iskandar Malaysia, various agencies have offered incentives for promoted activities in Iskandar. The agencies come under the purview of various government ministries and they are the Malaysian Industrial Development Authority (MIDA), the Multimedia Development Corporation (MDEC), the Ministry of Agriculture (MOA), the Malaysia Islamic Financial Centre (MIFC), the Malaysian Biotechnology Corporation (Biotech Corp) and Halal Industry Development Corporation (HDC). The related agencies and their respective incentives are shown in Table 1 – Table 6.

Table-1. Tax Incentives for Promoted Activities in Iskandar Malaysia by MIDA

- Electrical and Electronics
- Petrochemicals and oleochemicals
- Food and Agro-processing
- Biotechnology

	Pioneer Status	Investment Tax Allowance
General	5 years Pioneer Status and tax exemption at 70% of statutory income	60% ITA on qualifying capital expenditure incurred within 5 years and can be set off against 70% of statutory income
High Technology Projects	5 years Pioneer Status and tax exemption at 100% of statutory income	60% ITA for 5 years and can be set off against 100% of statutory income
Strategic/ Prepackaged incentive Projects	10 years Pioneer Status and tax exemption at 100% of statutory	100% ITA for 5 – 10 years and can be set off against 100% of statutory income

	income
	. Exemption on import duty and/or sales tax on plant and equipment directly used in the manufacturing process . Exemption from import duty and/or sales tax on raw materials and components used in the manufacturing process
. Logistics i. Integrated logistic services providers ('ILS') ii. International procurement centres ('IPCs')/ regional distribution centres ('RDCs')	. 5 years Pioneer Status and tax exemption at 70% of statutory income, or . 60% ITA for 5 years and can be set off against 70% of statutory income . For IPCs and RDCs, full tax exemption for 10 years
. Tourism i. Establishment of hotels (up to 3 stars) ii. Expansion/modernization of existing hotels iii. Establishment and expansion of tourist projects iv. Establishment of recreational camps v. Establishment of convention centres	. 5 years Pioneer Status and tax exemption at 70% of statutory income, or . 60% ITA for 5 years and can be set off against 70% of statutory income . Exemption from import duty and/or sales tax on selected equipment used in the hotel/tourism industry
. Education i. Technical or vocational training ii. Private Higher Education Institutions ('PHEIs") providing selected courses in Science (new set up) or existing PHEIs in the selected fields of Science undertaking additional investments for upgrading or expansion capacity	. 100% ITA on qualifying capital expenditure incurred within 10 years to be set off against 70% of statutory income . Special building allowance of 10% per year . Exemption on import duty and/or sales tax on educational equipment including laboratory equipment . Exemption on withholding tax on royalties paid to non-resident franchisors . Incentives for Private Higher Education Institutions ('PHEIs) providing courses relating to multimedia and which have their own multimedia faculties are also available through MDeC.
. Creative Industries i. Film and video production	. 5 years Pioneer Status and tax exemption at 70% of statutory income, or . 60% ITA for 5 years and can be set off against 70% of statutory income . For other incentives, please refer to incentives provided through MDeC for multimedia development and applications.
. Financial services, advisory services and consulting services i. Provision of regional headquarters services under business process outsourcing/ offshoring	. 10 years tax exemption on the provision of regional headquarters services to related companies including certain types of business process outsourcing/ offshoring . See part IV below for incentives for selected services under Islamic Financial Services

Source: www.mida.gov.my

Table-2. Incentives through MDEC

Economic Drivers	Incentives
. Education i. Private Higher Education Institutions ('PHEIs") providing courses related to IT and which have their own multimedia faculties . Creative Industries May include: i. Film and television (pre and post production, production) ii. Games and animation (content creation, production, post-production) iii. Online and mobile content generation iv. Online and mobile content aggregation and enablers . Financial services, advisory services and consulting services i. Business process outsourcing/offshoring	. 5 years Pioneer Status (extendable by another 5 years) and tax exemption at 100% of statutory income; or . 100% ITA on qualifying capital expenditure incurred within 5 years to be set off against 100% of statutory income . Exemption on import duty and/or sales tax on multimedia equipment used in the MSC operations . Exemption on withholding tax on payments to non-residents for technical services, licensing fees and interest on loans for technology development . Owners of buildings in Cyberjaya whose buildings are rented out to MSC status companies are eligible for Industrial Building Allowance of 10% to be claimed over a period of ten years

Source : www.mscmalaysia.com

Table-3. Incestives by MOA

Economic Drivers	Incentives
1. Food and agro-processing	. Approved Food Production company i. 100% tax exemption on statutory income for 10 years . 1. Company which invests in Approved Food Production company i. The investor company is entitled to a tax deduction equivalent to the amount invested in the subsidiary (must be at least 70% owned) which undertakes the food production project; or ii. The investor company will be given group relief for the losses incurred by the subsidiary company . Exemption on import duty and/or sales tax on plant and equipment directly used in the operations

Source: http://agrolink.moa.my/moa

Table-4. Incentives through MIFC

Agencies	Incentives
MIFC	Tax exemption for Islamic Financial Institutions on transactions in international currencies
	Tax exemption for Special Purpose Vehicles issuing Islamic securities
	Tax deduction for expenditure on the issuance of Islamic securities
	Tax exemption for Islamic fund management companies
	Tax deduction for the establishment of an Islamic stockbroking firm

Table-5. Incentives through Malaysian Biotechnology Corporation

Agencies	**Incentives**
Biotech Corp	100% income tax exemption for ten years commencing from the first year the company derives profits; or
	Investment Tax Allowance of 100% on the qualifying capital expenditure incurred within a period of five years.
	Upon the expiry of the tax exemption period, a BioNexus status company will be given a concessionary tax rate of 20% for ten years on income from qualifying activities.
	A company which invests in its subsidiary (at least 70%), which is a BioNexus Status company is granted tax deduction equivalent to the amount of investment made in that subsidiary;
	A company or individual investing in a BioNexus status company is given a tax deduction equivalent to the total investment made in seed capital and early stage financing;
	Exemption of import duty and sales tax on raw materials/components and machinery and equipment;
	Double deduction on expenditure incurred for R&D;
	Double deduction on expenditure incurred for the promotion of exports; and
	Buildings used for biotechnology activities will be eligible for Industrial Building Allowance to be claimed over a period of 10 years.

Source: www.biotechcorp.com

Table-6. incentives by HDC

Activities	**Incentives**
Halal Park Operator . - Development of halal parks	. 10 years Pioneer Status with tax exemption at 100% of statutory income; or . 100% ITA on qualifying capital expenditure incurred within 5 years to be set off against 100% of statutory income . Exemption from import duty on equipment directly used in the Cold Room Operations
Halal Logistic Operator . Services provided must be integrated similar to services provided by an “integrated logistic services provider” which had been approved with tax incentives	. 5 years Pioneer Status with tax exemption at 100% of statutory income; or . 100% ITA on qualifying capital expenditure incurred within 5 years to be set off against 100% of statutory income . Exemption from import duty on equipment directly used in the Cold Room Operations
Halal Industry Players Activities must be in four industry sectors . Specialty Processed Food . Cosmetic and Personal Care / Pharmaceutical . Halal Ingredients . Livestock and Meat Product	. Exemption on statutory income from export sales for 5 years; or . 100% ITA on qualifying capital expenditure incurred within 10 years to be set off against 100% of statutory income . Exemption from import duty on raw materials used for the development and production of halal promoted products . Double deduction on expenses incurred in obtaining international quality standards such as HACCP, GMP, Codex Allimentarious (food standard guidelines of FAO and WHO) , Sanitation Standard Operating Procedures and regulations for compliance for export markets such as Food and Traceability from farm to fork.

Source: www.hdcglobal.com

Of the economic sectors highlighted earlier on, the emphasis is on the service sectors with high economic multiplier effects such as financial, logistics, healthcare, education, tourism and creative (IRDA, 2012).

5. Impact of FDI on socio-economic environments and natural surroundings in Iskandar Malaysia

Robust investments in Iskandar Malaysia especially from FDI have seen the changes in socio-economic environment and natural surroundings. Among the changes are rising tourist arrivals, rapid expansion of property market in Johor and further connectivity between Johor and Singapore. Iskandar Malaysia is becoming a tourist hotspot with tourist arrivals from Singapore alone grew at 18% (DBS, 2013). The increase in the arrival of tourists is due to the new attractions such as Johor Premium Outlets, Puteri Harbour Family Theme Park, Austin Heights Water Theme Park and Legoland Malaysia. The number of tourist arrivals in Iskandar Malaysia from Singapore is shown in Table 7.

Table-7. Number of Tourist Arrival in Johor from 2009 - 2011

Year	Number of Tourist Arrival
2005	9.3 million
2006	9.4 million
2007	10.3 million
2008	10.5 million
2009	12.4 million
2010	12.9 million
2011	13.0 million
2013	12.2 million

Source: Tourism Malaysia

As a result of investment boost from both the foreign and local investors, the Johor property market especially the areas near Iskandar Malaysia has been booming. Residential and property prices rose about 8% and 9% respectively with most developers concentrate on the upper market properties (DBS, 2013). Future and upcoming launches are expected to enjoy continuous strong interest spurred by news on new infrastructure improvements and strong FDI. The proposed high speed rail from Iskandar Malaysia to Kuala Lumpur by 2020 and the extension of the Singapore's MRT system into Johor Bahru by 2018 together with cross border taxi and bus services have been projected into the overwhelming response from prospective investors (DBS, 2013).

However, despite a strong and positive feedback from both locals and foreigners, Iskandar Malaysia does have a negative impact especially on locals who are left out of the mainstream development. Iskandar Malaysia is estimated to have 1.35 million people or 43% of Johor's population of 3.17 million by 2025. The population increase is mostly through migration and 66% of the population is of working age. Malays comprise 48.2%; Chinese 35.8%; Indians 9.4% & foreigners 6.6%. One third of the population is estimated at below 15 years old (IRDA, 2013). Most of the development projects in Iskandar Malaysia have long term gestation period which will see that no contribution of positive earnings for their early years. Furthermore, high rise and upper market development trend especially of residential properties with launching prices that are above average, will be beyond the reach of the poor and average households in Johor (DBS, 2013). The expected trickle down and economic spillovers from Iskandar Malaysia to the local Johorean may not happen.

5. Sustainability of FDI in Iskandar

IRDA has taken few initiatives to ensure the sustainability of FDI in Iskandar Malaysia. These include building up strategic enablers to sustain development, nurturing investments through incentives, improvement in relationship between government agencies and investors to facilitate greater prosperity (IRDA, 2013). These initiatives have prompted the government to invest about RM8.31 billion in Iskandar Malaysia (IRDA, 2013) to ensure better safety, connectivity and physical facilities that creates comfortable surroundings and environments. Apart from that, the government of

Malaysia has also taken care to smooth the visa and immigration processes, explore transportation linkages, share expertise in environmental preservation as well as involved in industrial cooperation to enhance the relationship between the authorities and investors.

The authors would like to suggest that the harmonisation of custom clearance procedures to ensure smooth transition of people, goods and services should also taken into consideration. Furthermore, a mutual recognition of standards in terms of products, qualifications, professional practices should also be part of future sustainability programmes. Legal means should also be used to provide a comprehensive agreement that will protect investment and intellectual property that will safeguard the interests of intended stakeholders. The success of Iskandar Malaysia is important to both Malaysia and its foreign counterparts. Thus, the sustainability of the progress will depend on how the synergies and economic growth from Iskandar's partnership is generated to benefit all those who are involved.

6. Conclusion

A broad and pragmatic view of FDI and the understanding of its effects should be taken in planning and projecting the progress of Iskandar Malaysia. FDI does have benefits that are substantial in the long-run to both the host country and foreign investors. However, the long term benefits from FDI in Iskandar Malaysia still lack of critical mass involvement of the locals in the mainstream development. Time will tell whether foreign investment will also lead to foreign values and control in Iskandar Malaysia.

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