Strategies for Inducing Investment

One Year after Korea's Economic Crisis

Sung-Hoon Lim

Korea Trade-Investment Promotion Agency (KOTRA)

Korea Trade-Investment Promotion Agency
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300-9 Yomgok-Dong, Seocho P.O. Box 101
Seoul, Korea
Tel : (82-2) 3460-7114
Fax : (82-2) 3460-7777
http://www.kotra.or.kr

Preface

Foreign direct investment (FDI) has become a major component of the world economy. Offshore production by multinational companies far exceeds international trade. FDI is regarded as one of modes of entry necessary to gain competitiveness in the international market. In particular, inbound FDI is not only affacted by the local firms' competitiveness but also related closely with government's economic policy. Recently inbound FDI has been highlighted as a critical aspect of government policy in economies in Asia seriously affected by economic crisis -- in overcoming the foreign exchange crisis, advancing industrial structure, and creating employment.

Korea, one of countries seeking its way out of the economic crisis, also revitalized its system to promote foreign investment through the implementation of a comprehensive reform and restructuring process as well by enacting the new "Foreign Investment Promotion Act".

One year after Korea's economic crisis, therefore, it is time to evaluate the performance of the investment inducement strategies. This book analyzes both Korea's government policy and foreigners' changing perception of Korea's location attractiveness, through the general framework of transnational corporation's investment decision process, i.e, policy framework, economic determinants, and business facilitation.

I would like to thank Mr. Keun-hyung Park, for his statistical work and analysis in "Trends in International and Korea Investment Trends" and Mr. Dong-hyung Park for his wise counsel in both my professional and personal life.

Sung-Hoon Lim
Senior Researcher/ Ph. D.
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I. Introduction

Recently inbound FDI has been highlighted as a critical aspect of government policy in economies seriously affected by the Asian economic crisis: in overcoming the foreign exchange crisis, advancing the industrial structure, and in creating employment.

The foreign currency crisis in Korea at the end of 1997 was as an opportunity for the government as well as private enterprise to emphasize the significance of inducing foreign investment.

The Korea government has exerted sweeping efforts toward this goal by enacting the “Investment Promotion Act” and designating “KOTRA”(Korea Trade-Investment Promotion Agency) as a foreign investment inducement promotion body, which resulted in drawing a total of $8,852 million based on accepted cases, a 27% increase compared to the previous year, and this year the figure is expected to reach $15 billion.

Major reasons behind the positive projections for investment derive from the improvement of Korea's macro-economic environment, stabilization of foreign exchange rates, the increase of available foreign currency reserves, the upgrade of Korea's external credibility rating by renowned firms such as Moody's and S&P to “the status of being an appropriate target for investment” as well as potential investors' favorable attitudes toward the Korean market.

According to a series of surveys conducted by KOTRA querying potential foreign investors, Korea is viewed as having the fastest recovery pace compared to other Asian countries undergoing economic turbulence. In fact, most forecast that this year is the prime time to invest in Korea under the assumption that Korea's economic level will soon return completely to its pre-crisis level.

This book analyzes changes in the investment climate one year following the economic crisis in three areas: policy framework, economic determinants, and business facilitation.

II. Trends in International Foreign Direct Investment

1. 1997 Analysis

Trends in Global Investment

International foreign direct investment (FDI) in 1997 recorded $400.5 billion, based on inflow, an 18.6% increase compared to the previous year, while that based on outflow amounted to $424.4 billion, a 21% increase. (See Table II-1.)

In particular, the scale of cross-border M&As reached $236 billion, a 45.2% increase over the previous year, and the total inbound FDI increased as part of total cross-border M&As from 48% in 1996 to 59% in 1997. This trend is led by large scale M&As totaling more than $1 billion by multinational corporations in advanced countries. ($161 billion in 1997)

<Table II-1> Status of International FDI

(unit:U.S.$ billion, percent)

	1996		1997	
	Amount	Fluctuation	Amount	Fluctuation
FDI inflow	338	1.9	400	18.6
FDI outflow	333	-0.5	424	27.1
Total FDI inflow	3,065	12.2	3,456	12.7
Total FDI outflow	3,115	11.5	3,541	13.7
Cross-border M&As volume*	163	15.5	236	45.2

Source: UNCTAD, World Investment Report, 1998

Note: *The figure is based on M&As with purchases of more than 50% of shares to secure management rights.

Multinational firms in advanced countries have adopted the FDI approach of purchasing more than 50% of shares (majority share purchasing M&As), while those in developing countries prefer Green Field Investment or purchasing a small amount of shares (minority share purchasing M&As).

FDI seems to be concentrated in limited countries or regions. In case of outflow, the share of the top 10 countries accounted for 79.9% of the total, while that of the top 15 countries took up 88%. In the meantime in case of inflow, however, the share of the top 10 countries recorded 65.3%, while that of the top 15 countries accounted for 74%, showing a concentrated amount from just a few countries.

In addition, the inflow into advanced countries amounted to 58.2%, much greater than the 37.2% into developing nations, while the outflow from advanced countries reached 84.8%, a wide gap against the 14.4% from developing countries.

The economy with the largest investment inflow was the U.S., which recorded $90.7 billion, followed by China, the U.K., France, and Brazil. The country with the largest investment outflow was again the U.S., with $114.5 billion, followed by the U.K., Germany, Japan, and Hong Kong. (See Table II-2.)

The U.S. achieved a total of $90.7 billion in investment inflow, recording an increase of 18.6%, thanks to having the highest economic index. The inflow came mostly from M&A activities centered on hi-tech industries, accounting for about 90% of the total.

The EU induced $108.1 billion in 1997, a 17% increase over the previous year, showing a recovery from 1996 when the investment volume decreased. Among EU countries, the U.K. achieved the largest investment inflow with $36.9 billion, and Germany recorded a two-year decline from 1996 to 1997 due to an investment reduction resulting from withdrawal.

<Table II-2> Rank and Ratio by Inflow and Outflow

(unit:U.S.$ billion, percent)

Rank	Inflow			Outflow		
	Economy	Amount	Ratio	Economy	Amount	Ratio
1	United States	90.7	22.7%	United States	114.5	27.0%
2	China	45.3	11.3%	United Kingdom	58.2	13.7%
3	United Kingdom	36.9	9.2%	Germany	34.3	8.1%
4	France	18.3	4.6%	Japan	26.0	6.1%
5	Brazil	16.3	4.1%	Hong Kong, China	26.0	6.1%
6	Belgium & Luxem.	12.6	3.1%	France	24.6	5.8%
7	Mexico	12.1	3.0%	Netherlands	20.4	4.8%
8	Singapore	10.0	2.5%	Canada	13.0	3.1%
9	Sweden	9.7	2.4%	Switzerland	12.0	2.8%
10	Australia	9.6	2.4%	ltaly	10.2	2.4%
11	Netherlands	8.7	2.2%	Spain	10.0	2.4%
12	Canada	8.2	2.0%	Belgium & Luxem.	6.7	1.6%
13	Argentina	6.3	1.6%	Australia	6.4	1.5%
14	Russia Fed	6.2	1.5%	Singapore	5.9	1.4%
15	Spain	5.6	1.4%	Taiwan	5.2	1.2%

Source: UNCTAD, World Investment Report 1998
IMF, International Financial Statistics, No. 12, 1998
Note: These figures are based on actual investment[1] in BOP.

1) The criteria is based on the actual investment used by the central banks of each country to collect investment performance. It is the actual FDI investment reduction volume after the withdrawal is deducted from the total investment amount. Advanced countries, such as the U.S., have adopted this method, using other criteria including acceptance, approval and arrival. NIEs such as Korea employ the mixed criteria of reports, approval and actual investment. Korea operates a simple accepted cases system, and adopts the approval method in some sectors like the defense industry. Thus, there is little difference between accepted

Latin America recorded an inflow of $56.1 billion, $1.4 billion more than in 1996 -- a dramatic increase of 28%. This rise derives mainly from attempt by multinational corporations to change investment locations due to the financial crisis, absorption of international replacement capital, continuous integration of Latin America's economy, and privatization programs by public companies in the region.

Trends in the Asian Region

General Overview

Despite the instability in the foreign exchange market which has expanded from the second half of 1997, the investment inflow into the Asian region soared to $87 billion by the end of 1997, showing a 9% increase from the year previous (19% in 1996). This accounts for 58% of the inflow into developing nations. The accumulated amount increased to $596 billion, up 17% from 1996.

In particular, East Asia and Southeast Asia witnessed a $78 billion inflow despite the economic crisis, showing a 6% increase over the previous year. In the meantime, the investment inflow into Indonesia and the Philippines decreased, while that to Malaysia and Singapore maintained similar levels to those of the previous year. Investment into China and Taiwan went up, and that into Thailand and Korea increased dramatically.

This trend demonstrates that direct investment is less affected by the instability of foreign exchange market than by indirect portfolio investment, in that direct investment seeks a long-term profit.

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cases and the approval cases, and the approval cases and actual investment are used when making a comparison with other countries

Trends in Major economies

China secures the second position in the world, and the top position in Asia in terms of investment inflow, recording $45.3 billion (11% increase over the previous year), and accounting for 11% of the total world investment inflow. It is experiencing a consecutive six-year increase in FDI, and has the second position in Asia in its ratio to the total fixed capital formation (1994-1996), following Singapore.

Japan recorded $3.2 billion in net inflow, accounting for less than 1% of the world total, but the figure is still 1,000% greater than the year previous.[2)]

NIEs (Newly Industrialized Economies, i.e., Korea, Hong Kong, Singapore, and Taiwan) induced $17.3 billion, showing a 7.5% increase over the previous year. In particular, Singapore maintained the second position in Asia by attracting $10 billion, a 6% increase over the year previous. Korea and Taiwan made a sharp jump by recording $2.8 billion[3)] (a 22% increase), and $2.2 billion (a 20% increase) respectively, and Hong Kong maintained $2.5 billion (a 4% up), similar to the year previous. (See Figure II-1)

Five ASEAN nations (Thailand, Indonesia, Malaysia, the Philippines, and Vietnam) attracted $16 billion, a 7% drop from the year previous, while Thailand still recorded a 65% increase, even though it was the epicenter of Asia's foreign exchange turbulence. Malaysia maintained the previous year's level, but Vietnam experienced a sharp fall of

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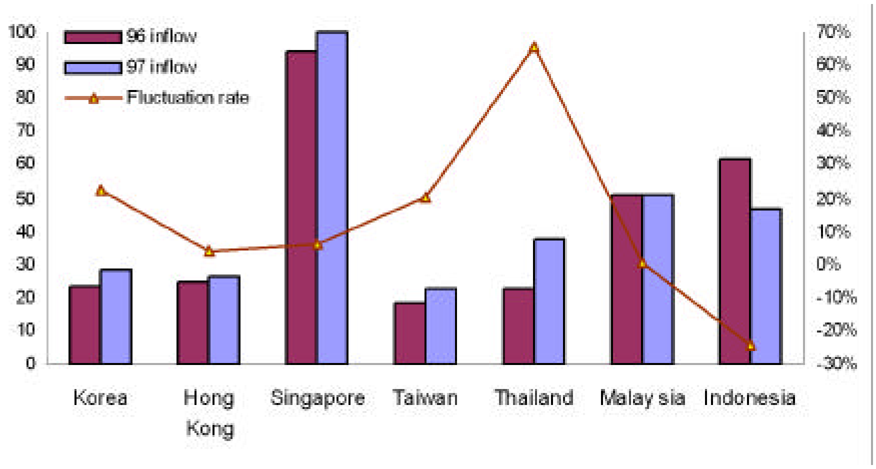
2) The reason behind the high increase derives from investment expansion by foreign companies resulting from liberalization in the distribution and financial sectors, large-scale withdrawal in 1996 along with changes in FDI statistics collection criteria. (Increased investment, taking up 10% of FDI inflow in 1997 is included.)

3) The World Investment Report 1998 published by UNCTAD (hereinafter referred to as WIR1998) shows investment inflow into Korea in 1997 reached $2.341 billion (based on the actual investment), but IMF International Financial Statistics and data from the Bank of Korea calculate the amount to be $2.844 billion in 1997.

44.3%, along with the Philippines.

<Figure II-1> Status of Investment Inflow into Major Asian Economies

(unit: U.S.$ million, percent)



Source: UNCTAD, World Investment Report, 1998, Bank of Korea
Note: This figure is based on actual investment.

In Southwest Asia, India attracted $3.3 billion in investment, accounting for 75% of the total in the region. Central Asia has shown a steady increase for five years consecutively, even though the inflow volume is meager. Most of investment went into Kazakhstan and Azerbaijan by Korea, the U.S., the U.K., and China, and the major investment sectors were focused on resource development such as petroleum and natural gas.

2. 1998 Analysis

Trends in Global Investment

Despite the persistent clouds hanging over the world economy -- the economic recession in Asia resulting from the '97 financial crisis, economic instability in China, ongoing economic doldrums in Japan, declaration of a debt moratorium by Russia, financial volatility in South America, and the bankruptcy of LTCM (Long-Term Capital Management) in the U.S. -- international investment in 1998 showed an increase over the previous year. This trend comes partly from slackening FDI into developing nations due to the fear of the current economic crisis, and at the same time from aggressive, large scale cross-border M&A activities among advanced countries, especially between the corporate sectors in the U.S. and Europe in an attempt to reinforce global market dominance by expanding their scale and network, and by securing the highest technology.

The IIF (Institute of International Finance) estimated that FDI into developing nations would decrease by 5%, from $117 billion in 1997 to $111 billion in 1998, but the ratio of FDI to private capital would climb to 70% from a 45% in 1997. This is due to a sharp decline in capital inflow, including borrowing from financial institutions vulnerable to securing credit due to a gloomy overall economic mood in developing nations, coupled with a relative rise of FDI by multinational enterprises.

The North America region recorded the highest growth in the world. U.S. showed a 112.5% increase over the previous year with an inflow of $192.9 billion, maintaining a solid top ranking in world foreign direct investment. Of the total, 61.6% was invested in the last quarter and inflows from Germany and the U.K occupied a 58.5% amount. Canada recorded $22.9 billion, increasing 132.2%. (See table II-3)

The EU countries performed a high growth of inbound FDI in 1998. Among them, the U.K. showed such an impressive 93.7% increase in inducement, recording $54.1 billion by September over the same period the previous year, climbing to the second position in inbound FDI, while China fell to third. France and Sweden showed a 52.7% and a 78.6% increase over the previous year. In particular, Germany experienced an increase of greater than $15 billion, recording an inflow of $13.3 billion in 1998. This is a significant jump from the negative figure recorded the previous year due to greater withdrawal combined by less inflow.

<Table II-3> Status of In-bound FDI into Major Countries

(unit:U.S.$ million, percent)

Country	1997	1998 (Jan-June)	Change from year previous (%)
U.S.A	90,748	192,878	112.5
U.K.	36,946	54,158 (Jan-Sep)	93.7
France	23,070	35,220	52.7
Brazil	17,085	26,134	53.0
Canada	9,876	22,936	132.2
Netherlands	9,005	21,368	137.3
Sweden	10,583	18,906	78.6
Germany	-177	13,375	-
Mexico	12,830	10,238	△20.2
Belgium	7,712	9,561	24.0
Spain	5,556	6,360	14.5
Chile	5,236	5,997	14.5
Ireland	2,727	5,116 (Jan-Sep)	61.3
Argentina	6,693	4,361 (Jan-Sep)	△5.5
Russia Fed.	6,243	1,485 (Jan-Sep)	△64.6
Italy	3,700	356 (Jan-June)	△79.6

Sources: KOTRA Trade Center Report Data
IMF, International Financial Statistics, No. 4, 1999
UNCTAD, World Investment Report

Note: These figures are based on actual investment

Russia showed a 64.6% decline over the same period the previous year, recording $1.4 billion by the third quarter, and will decrease continuously in the last quarter due to a worsening economic conditions emerging from August's declaration of a debt moratorium.

Unlike in previous years, Latin America's investment profile in 1998 varied nation to nation. Brazil, attracting the greatest amount of investment, recorded $26.1 billion, a 53% increase over the previous year. Mexico recorded $10.2 billion, a decrease of 20.2%. Argentina attracted $4.3 billion by September, 5.5% less than the same period the previous year.

Trends in the Asian Region

General Overview

Most countries, excluding Korea, China and Thailand, witnessed a sharp decline, between 12-127%, in investment inflow based on actual investment compared to the same period the previous year. Despite proactive inducement policies, most Asian countries suffered under the impact of global economic instability in the region, as well as in Russia and Latin America.

Overall investment into the region decreased due to an economic recession in Japan, the most aggressive investor, as well as the fact that many multinational firms within the region lacked investment capabilities. However, investment from outside the region, especially from Europe, has been activated by investors who view the current situation as a prime investment opportunity.

FDI is heavily focused in service industry sectors such as banking, insurance, and communication, thanks to the increasing liberalization policies of each nation.

***Trends in Major Economies*[4]**

China showed only a 0.5% increase in investment inflow compared to the year earlier, recording $45.4 billion. Investment into China by the E.U. and U.S. is on the rise, but that by culturally Chinese countries, which normally contribute to 70% of investment into the country, shrivelled greatly as the U.K. replaced China for the world's No. 2 position in investment inducement (See Table II-4)

Japan brought in $4.26 billion based on actual investment during the six months from April to September[5], showing an explosive growth of 135% compared to the same period the previous year. In particular, a great bulk of the investment came from the U.S. and Europe, an outcome of a timely match between Japanese financial institutions and corporations which seek investment from Western companies to tackle the current economic difficulties, and advanced countries' investors who seek safer investment locations than new markets with high volatility in the economic crisis.

Among NIEs (Korea, Hong Kong, Singapore, Taiwan), Korea attracted $5.1 billion based on actual investment in 1998, marking a 80.8% increase over the previous year, and based on accepted cases the figure reached $8.85 billion, a 27% increase over the previous year. Singapore recorded $5.2 billion, a reduction of 12.6% compared to the previous year. This is because the U.S., which is the No. 1 investor to Singapore, reduced its investment drastically, while Europe also cut its investment. Taiwan attracted about $3.3 billion (based on approved cases), showing a reduction of 22.8% over the previous year. The reduction comes mainly from shrivelled investment from Japan and Singapore, as even the U.S. and the U.K. slightly increased their investment.

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4) Because Asian countries have adopted mixed methods of approved cases and actual investment, the inflow is based on the criteria of both..

5) This figure records the performance as of the second quarter. Japan's fiscal year is from April to March of the following year.

<Table II-4> Status of FDI Inflow in Major Asian Economies

(unit: U.S.$ million, percent)

Economy	1997	1998	Change from year previous (%)
China	45,257	45,463	0.5
Singapore	5,964	5,214	△12.6
Korea	2,844	5,143	80.8
Thailand	3,752	4,794	27.8
Japan*	5,527	4,263 (Apr-Sep)	134.8
Malaysia	5,106	3,600**	△29.5
Taiwan*	4,267	3,295	△22.8
Indonesia	4,677	-1,300	△127.8
Australia	9,146	3,014 (Jan-Sep)	△62.6
Philippines	1,235	1,000**	△19.0

Source: KOTRA Trade Center Report Data
IMF International Financial Statistics, No. 12, 1998
UNCTAD, World Investment Report 1998

Note: These figures are based on actual investment. In the case of Singapore, the figures represent only the manufacturing sector.
* Refers to approved FDI.
** These figures are estimated by UNCTAD.

Most of ASEAN's four nations (Indonesia, Malaysia, the Philippines and Thailand) experienced a reduction of more than 19% in inflow based on actual investment. However, Thailand showed a 27.8% increase from the previous year, recording about $4.8 billion, signalling a recovery of its credibility to external investors, and pumped up by a surplus in the current account, fall in interest rates, and a stabilized economic index. Malaysia, showing a 29.5% drop from the previous year, attracted $3.6 billion due to a suspension of inflow from major investing countries such as the U.S. and Japan. This probably due to the fear of an aftermath of financial turmoil, political instability, and foreign exchange regulatory policies, despite the government's aggressive investment inducement initiatives. Indonesia witnessed the biggest drop in inflow due to both economic and political crises. The only increase in investment came from Hong Kong and the Netherlands.

III. FDI Trends in Korea

1. General Overview - '98

The total inflow based on approved FDI amounted to $8.852 billion in 1998, a 27% increase over the previous year, while that based on actual FDI reached $5.143 billion, a skyrocketing 80.8% FDI increase despite the foreign exchange crisis. However, by April, FDI was showing negative growth since at the beginning of the year most investors were reluctant to make investments due to the shrivelled buying power in the market and increased risks against returns on investment. But from May to December, the growth rate shot up to 135% thanks to aggressive investment inducement policies by the government coupled with strategic investment by multinational enterprises encouraged by reduced investment costs due to the second quarter's capital deflation. (See Table III-1.)

By industry, investment ratio to the manufacturing sector increased the most by recording a 64.8% growth, while that to the non-manufacturing sector marked a 33.2% growth. In addition, the ratio to agriculture, livestock and fishery, as well as mining also expanded to 2.0%. In the meantime, investment aimed at the domestic market in the oil refinery and non-manufacturing sectors including construction, wholesale and retail, and accommodation fell sharply while that of paper, wood and chemicals, all necessary for securing a production outpost, soared.[6] (See Figure III-1.)

6) Major examples are (1) Popco International, the largest newspaper-material manufacturer, a joint venture with ITV Consolidated of Canada, Norske Skog of Norway and Hansol Paper who plan to build Korea as a production outpost by acquiring the production plant of Shinho Paper, and (2) Dow Chemical's joint venture with LG to provide 80% of polycarbonate output to Asia by establishing the world's largest plant in Yeochon.

<Table III-1> Status of Investment Inflow by Month

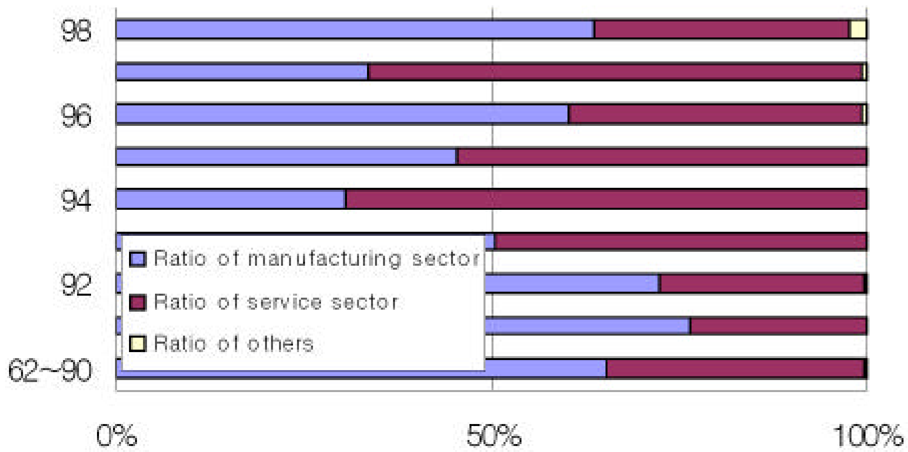
(unit: U.S.$ 100 million, %)

	97		98	
	Inflow	Percentage Change	Inflow	Percentage Change
Jan.	8.73	537.2%	1.30	-85.1%
Feb.	3.63	112.3%	1.99	-45.2%
Mar.	8.88	521.0%	2.43	-72.6%
Apr.	15.65	1,698.9%	5.67	-63.8%
May	2.44	-42.7%	6.59	170.1%
June	5.30	74.3%	6.63	25.1%
July	4.07	139.4%	12.35	203.4%
Aug.	1.78	-36.0%	4.07	128.7%
Sep.	4.33	147.4%	5.34	23.3%
Oct.	3.62	87.6%	8.94	147.0%
Nov.	0.91	-62.1%	13.78	1,414.3%
Dec.	10.37	18.0%	19.43	87.4%
Total	69.71	117.6%	88.52	27.0%

Source: Ministry of Finance and Economy
Note: These figures are based on approved amount.

Within the manufacturing sector, investment in the paper, wood, chemical engineering, medicine, machinery, electricity and electronics areas increased 739%, 222%, 538%, 254%, and 373%, respectively, showing a heavy concentration on capital-intensive industries like chemistry and electronics. In the non-manufacturing sector, investment went to finance (58%), insurance (389%) and restaurants (490%), and there was the investment in the real estate sector in 12 cases, revealing a tangible impact from opening the market to foreign investors in the finance and real estate business.

<Figure III-1> Status of Investment Inflow by Industry



Source: Ministry of Finance and Economy, Trends in International Investment and Technology Inducement

Note: These figures are based on approved inflow amount.

By region, investment from Japan and Europe increased by 89.5% and 25.3%, respectively over the year previous, while that from the U.S. decreased by 6.7%. The inflow from the U.S. and Europe marked a steep fall in the first half, but then began to recover afterwards, resulting in a steady rise in the second half. On the contrary, inflow from Japan soared in the first half, but fell in the second half. The combined ratio of investment by the U.S., Japan, and the EU recorded 71.9%, accounting for two thirds of the total. The ratio of the U.S. investment declined since April, but the U.S. still maintained the No. 1 position in investment into Korea due to a drastic increase in December. Japan took up almost half of the ratio in February, but only secured 5.7% of the ratio after significantly decreasing afterward. This is still a 4% increase from the previous year, but the figure has remained consistently lower than 10% since 1996. The ratio of the EU was meager in the beginning of the year, but due to continuous growth finished with almost one third of the ratio. (See Table III-2.)

<Table III-2> Changes in inflow from major region and ratio to total inflow in 1998

(unit: percent)

	Changes over the same time of the previous year			Ratio to the total inflow		
	U.S.A	Japan	EU	U.S.A	Japan	EU
Jan.	3.2	358.3	-97.3	24.6	42.3	7.0
Feb.	37.3	422.6	-90.1	21.3	49.2	19.1
Mar.	-79.6	293.6	-76.4	29.7	32.3	29.2
Apr.	-69.9	365.5	-80.3	42.5	22.5	24.4
May	-58.1	319.4	-68.9	39.0	16.9	25.1
June	-54.1	289.4	-51.2	38.7	14.9	29.5
July	-32.0	163.6	-11.1	38.6	10.8	38.9
Aug.	-24.7	149.4	-4.4	38.8	10.0	39.1
Sep.	-30.4	89.6	3.3	35.7	9.5	39.2
Oct.	-29.1	96.3	28.1	31.2	8.5	36.2
Nov.	-24.0	94.0	35.5	26.9	7.0	40.2
Dec.	-6.7	89.5	25.3	33.6	5.7	32.6

Source: Ministry of Finance and Economy

Note: The figure represents accumulation based on approved amount by each period. (ex: The March figure shows accumulated investment from January to March)

By nation, U.S. still maintains the No. 1 position, followed by the Netherlands, Singapore, Germany, the Cayman Islands, and Japan. Investment from Germany, France, the U.K., and Ireland, which traditionally have had a strong presence in Korea, showed a decrease, while that from the Netherlands, the greatest investing nation within Europe, continued its rise again in 1998. The inflow from the Cayman Islands through local joint ventures with the U.S. also increased dramatically as did Singapore which was relatively unaffected by the foreign exchange turmoil among the Asian nations. (See Table III-3.)

<Table III-3> Investment Ratio by Year and Country

Rank	1995		1996		1997		1998	
	Country	Ratio	Country	Ratio	Country	Ratio	Country	Ratio
1	U.S.A	33.2%	U.S.A	27.4%	U.S.A	45.8%	U.S.A	33.6%
2	Japan	21.5%	Malaysia	21.0%	Netherlands	11.9%	Netherlands	14.9%
3	Malaysia	11.2%	Ireland	12.8%	Malaysia	10.4%	Singapore	13.4%
4	Netherlands	8.8%	Japan	8.0%	France	5.9%	Germany	8.9%
5	U.K.	4.5%	Hong Kong	7.1%	Germany	5.7%	Cayman	7.1%
6	Ireland	3.8%	Netherlands	6.4%	Ireland	5.1%	Japan	5.7%
7	Singapore	3.4%	Switzerland	5.1%	Japan	3.8%	France	4.2%
8	Hong Kong	3.0%	Germany	3.0%	U.K.	3.7%	Malaysia	3.0%
9	Germany	2.3%	France	2.8%	Canada	2.6%	Sweden	2.3%
10	France	1.8%	U.K.	2.5%	Switzerland	1.5%	Ireland	1.2%
11	Others	6.6%	Others	3.9%	Others	3.6%	Others	5.7%

Source: Ministry of Finance and Economy, International Investment and Technology Inducement, all volumes, 1998

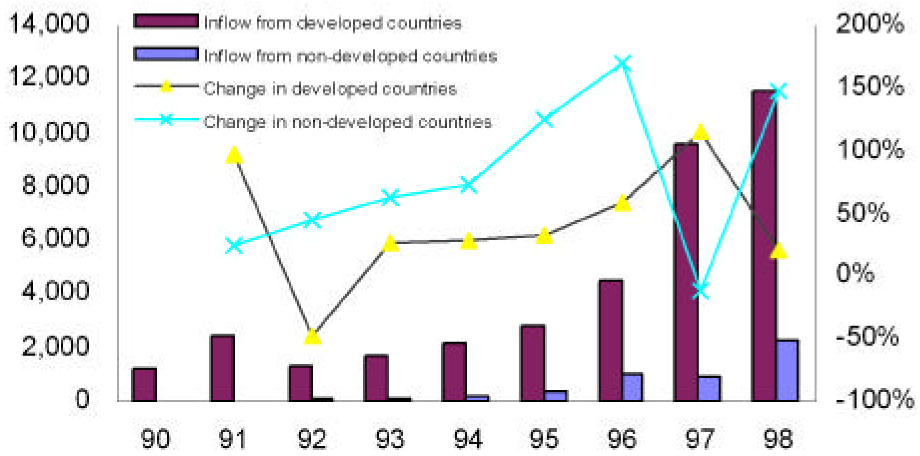
By country group,[7] the inflow from developed countries totaled \$37.2 billion from 1990 to 1998, a much larger figure than the \$4.9 billion by non-developed countries during the same period, but the

7) Divided into developed countries and NIEs, based on the criteria of membership in OECD. OECD members are categorized into developed countries, while non-members are categorized into NIEs.

increase in inflow by non-developed countries amounted to an average of 80.2%, almost double the 41.6% of developed countries. This signals a steady rise in investment ratio by non-developed countries, which are aiming at technology acquisition and market entry, even though most of the investment has traditionally come from developed countries. On top of this, the investment from these countries will take the shape of M&As, which have an edge in technology acquisition and market entry. (See Figure III-2.)

<Figure III-2> Status on Investment Inflow by Country and Changes

(unit: U.S.$ million, percent)



The inflow comes heavily from several top ranking countries, but the concentration has been diluted compared to the previous year. Inflow from the top five countries including the U.S. accounted for 77.9% of the total, showing a minor sign of diversification, still exhibiting a wide gap compared to average international investment (1997). (See Table III-4)

<Table III-4> Changes of Ratio in Investment into Korea by Top Ranking Countries

(unit: percent)

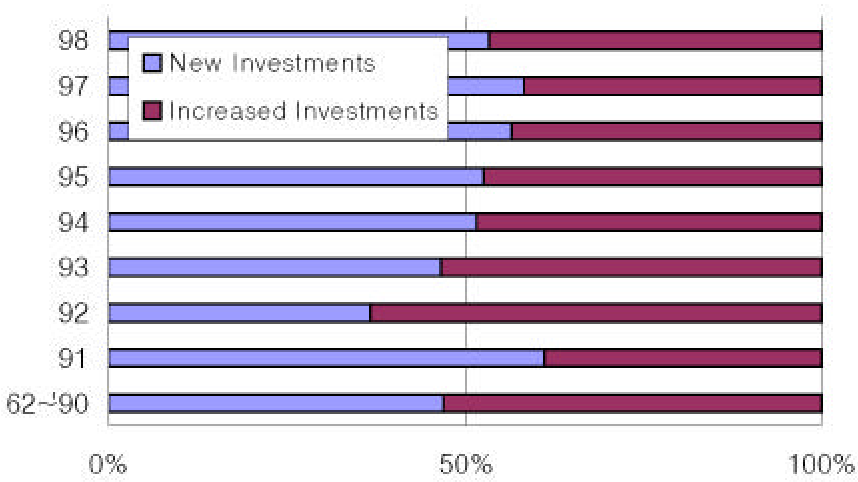
	91	92	93	94	95	96	97	98	97 World
Top 5 countries	90.6	82.2	86.5	78.6	79.2	76.2	79.6	77.9	61.1
Top 10 countries	96.5	94.2	97.0	94.2	93.4	95.9	96.4	94.3	80.1
Top 15 countries	98.7	97.0	99.1	97.6	96.7	99.2	98.7	97.3	88.1

Source: Ministry of Finance and Economy, International Investment and Technology Inducement, 1998
Note: This figure is based on approved amount.

In terms of investment type, acquisition of outstanding stocks marked a steep rise compared to the previous year. The approved amount of FDI in M&As amounted to $1.241 billion and a total of 232 cases, taking up 14% of the total inward FDI, a 10% increase over the previous year. This derives from a decrease in acquisition cost due to currency and asset value, full liberalization of M&As by foreign investors, lifting the ceiling of M&A-related investment by foreigners, and serious efforts to induce foreign investment by domestic companies under restructuring programs.

New investments recorded 53.2%, and increased amounts were up to 46.8%. There was a slight decrease in the ratio of new investments, but the figure is still higher than the increased investment. Due to economic instability and the persistent recession following the foreign exchange crisis, the ratio of new investments and increased investment remained similar with an active additional inflow by November. The average ratio of new investments went up due to an explosive growth of new investments in December, demonstrating the shifting attitude of overseas investors who had been wary of the Korean market following the economic crisis. (See Figure III-3)

<Figure III-3> Ratio of New Investments and Increased Investments



Source: Ministry of Finance and Economy, International Investment and Technology Inducement, each volume
Note: These figures are based on approved amounts.

Historically, the increased investments had always exceeded new investments but the situation reversed in 1995 when the amount of total investment skyrocketed sharply. Under these conditions, new investments seem extremely vulnerable, but when total investment plummets due to dampened domestic investment environment, there is a steeper reduction in new investments than in increased investments.

2. Instability in the Foreign Exchange Market and the Necessity of FDI

Effects of Foreign Exchange Turmoil

Accumulation of short-term foreign debts resulting from growing deficits in current accounts, along with the bankruptcies of large conglomerates with flimsy financial structures (Hanbo, Kia) led to sloppy management of financial institutions and a weakened economic base. Under this situation, the sudden outflow of foreign capital shook the very foundation of the domestic economy, triggering the foreign exchange crisis.

The government requested financial support from the IMF on November 21, 1997, to secure lacking foreign currency liquidity, and obtained an agreement to be provided with an emergency fund of $55 billion on December 2 of the same year, launching Korea into the IMF management system. As of the end of 1998, a total of $28.7 billion has been funneled into Korea from the IMF, the World Bank and the ADB.

<Table III-5> Changes in the Economic Index During the Economic Crisis

	97.12(4/4)	98.3(1/4)	98.6(2/4)	98.9(3/4)	98.12(4/4)
Foreign exchange rate (won)	1,143.84	1,605.72	1,394.57	1,326.14	1,281.83
Interest rate (%)	28.98	18.28	14.43	7.08	7.00
Available foreign currency reserves (unit: $100 million)	88.7	241.5	370.4	433.7	485.1
Economic growth (%)	5.5	-3.9	-6.8	-6.8	-4.5
CPI (%)	5.1	9.0	8.2	7.0	6.0
Unemployment rate (%)	3.1	6.5	7.0	7.3	7.9

Source: Ministry of Finance and Economy, Bank of Korea
Note: The foreign exchange rate is based on average of each quarter's rate. The economic growth and the CPI figures are compared to the same period the previous year.

With the introduction of traditional countermeasures of implementing high interest rates and belt-tightening policies requested by the IMF, along with an aggressive implementation of restructuring programs, the foreign currency liquidity situation was gradually improving. But then the country encountered other types of crises like negative economic growth and the tightening of the domestic capital market. This resulted in serial corporate bankruptcies, massive lay-offs, and a shrinkage in consumption and investment as well as domestic demand. Due to this, the IMF and the government adopted new approaches of lowering interest rates to increase domestic demand, and implementing active boosting measures through a flexible currency operation from May 1998. The above graph displays the changes in Korea's economic index during the economic crisis. <See Table III-5>

Necessity of FDI Inducement to Overcome the Foreign Exchange Crisis

Stable securement of foreign currency liquidity: Inducement of FDI is a suitable approach for overcoming the foreign exchange crisis and preventing its recurrence by securing foreign currency on a stable basis, since it is a way of bringing in foreign capital without any interest and expanding national wealth, unlike portfolio investment which allows free movement of capital and high elasticity, and short-term borrowing which creates the burden of high interest rates.

Expansion of national wealth and employment creation: Inducement of FDI is needed to correct the unfortunate effects of the economic recession and restructuring programs, such as reduced income and the high unemployment rate. It will also bring about an early resolution to the unemployment problem, and household income will increase by creating more jobs, which will in turn trigger rising consumption, then greater production, then employment, thus creating a continuous cycle for reinforcing national wealth.

Advancing industrial structure and enhancing corporate competitiveness: FDI will contribute to enhancing competitiveness and recovering credibility from overseas investors by improving industrial structures, introducing new management approaches, and obtaining state-of-the-art technology.

IV. Determinants in FDI and Profile of Korea's Investment Environment

1. Determinants in FDI and Location Advantage

According to Dunning's eclectic paradigm,[8] the most well-known FDI theory, the basic motivation behind multinational enterprises' international production include ownership advantage, internalization, and location advantage. This means that for enterprises to promote profits through international production, they, above all, have to secure an exclusive competitive edge[9] over other enterprises. So they seek FDI as a way to achieve internalization, as establishing production facilities in local areas is more advantageous than either licensing or selling. At the same time, to tap the above-mentioned advantages, choosing a location with low production costs such as cheap labor, makes the situation even more attractive. Determinants of Dunning's location selection are shown below (See Figure IV-I).

Ownership advantage, internalization, and location advantage are major factors influencing FDI.

In the meantime, direct investment motives by multinational enterprises entering into the overseas market can be roughly divided into four categories: market-seeking, resource-seeking, efficiency-seeking and strategic asset or capability-seeking.[10] Among them, the

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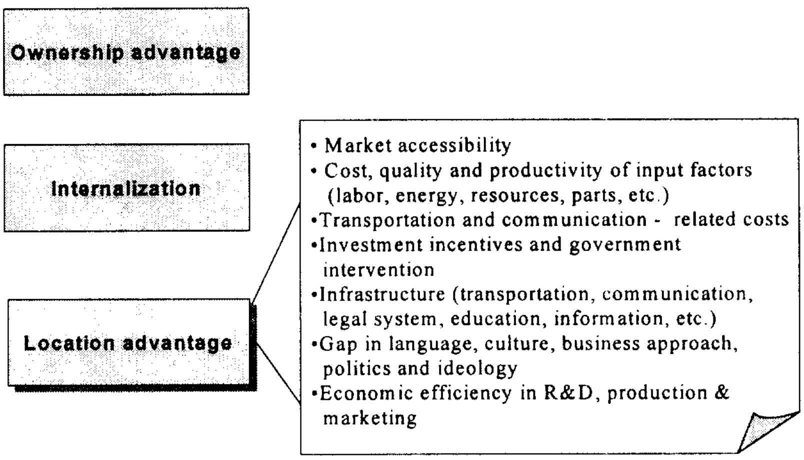
8) Dunning, J.H., 1980, "Toward an Eclectic Theory of International Production", *Journal of International Business Studies*, Vol. 11, No.1, Spring/Summer 1980, pp.9-32
Dunning, J.H., 1981, International Production and the Multinational Enterprise, Allen and Unwin, London

9) Stephen Hymer argued that foreign firms should secure specific capabilities (a monopolistic edge) which can sufficiently offset the disadvantages foreign firms face compared to domestic firms, and allows them to successfully operate business activities in local areas. (Hymer, S.H. 1976, The International Operations of National Firms: A Study of Direct Foreign Investment, Cambridge, Mass., MIT Press)

market-seekers are looking to prepare production facilities for direct operation in local markets to evade export barriers such as consumers' buying power, tariffs and quotas, while the efficiency-seekers are geared toward making an entry into local markets to secure price competitiveness in the international market by reducing production cost by tapping into low production elements. The resource-seekers aim to make an entry into local markets to establish stable and efficient production systems by obtaining natural resources, while the strategic asset or capability-seekers prefer to make an entry into overseas markets to secure the state-of-the-art technology of developed countries or the core competence of advanced enterprises.

<Figure IV-1> Determinants in Location Advantage in Dunning's Eclectic Theory



Dunning, J. H., 1981, International production and the Multinational Enterprises, George Allen and Unwin, London, Chapter 2, pp. 80-81

10) Behman, J.N., 1972, The Role of International Companies in Latin America: Autos and Petro-Chemicals, Lexington, MA: Lexington Books

Other than the four economic determinants mentioned above, policy framework and business facilitation on overseas investment by local countries also affect selection of investment location.[11)]

The local government's policy framework on foreign investment refers to its treatment toward foreign enterprises - fair and non-discriminatory practices (access to specific industries by foreign investors, approval on M&As, etc.), its privatization policies, and membership within international agreements on FDI. Business facilitation includes providing conveniences in carrying out investment procedures and in living facilities and conditions, such as the local government's foreign investment inducement promotion activities (image promotion activities), investment incentives, administrative support, post-investment service for overseas investment, and arranging schooling for expatriates.

Economic factors such as production costs and market conditions in local countries serve as the most significant criteria for foreign investors, and also increase location attractiveness.[12)] In addition, developing a policy framework for foreign investment by local countries is another significant factor in terms of developing location advantage to overseas investors.[13)]

Other economic factors such as availability of skilled workers at a cheap cost, market size of local countries, existence of consumers with significant buying power, and accumulation of technical know-how are not the kind of determinants that can be easily adjusted on a short-term basis, but incentives and simplification of investment procedures can be adjusted,

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11) United Nations, 1998, World Investment Report (ch 4, pp 89-133)

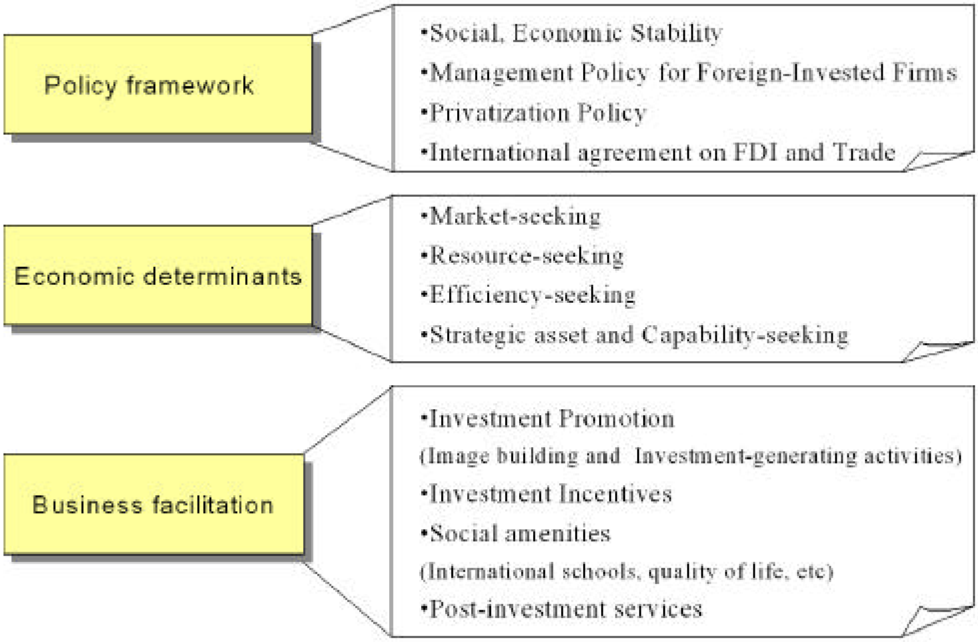
12) Guisinger, 1992, "Rhetoric and reality in international business: a note on the effectiveness of incentives", *Transnational Corporations*, 1, 2 (August), pp. 111-123
Guisinger, 1989, "Total production: a new measure of the impact of government intervention on investment profitability", *Journal of International Business Studies*, 20, pp. 280-295

13) Dunning, J., 1998 "Location and the multinational enterprise: a neglected factor?", *Journal of International Business Studies*, 29, 1, pp. 45-66

which can positively affect location advantage.

Thus, determinants of investment considered by foreign-invested firms include economic aspects, policy framework and business facilitation.

<Figure IV-2> Foreign Direct Investment Determinants



United Nations, 1998, World Investment Report, Chapter 4, pp 91

2. Korea's Investment Profile According to each FDI Determinant

Policy Framework

Socio-Political Factors

The risk rating of each country published in the September 1998 edition of Euromoney shows an overall decline in Asian countries due to the foreign exchange market instability. Among them, Indonesia and Malaysia recorded the 91st (42 spots lower) and 56th (21 spots lower) positions respectively, while Singapore, which had long maintained the No. 1 position in Asia, also dropped down to the 21st spot, leaving no Asian countries in the top 20 positions (Japan - 23rd). Korea slipped to 34th from its previous 30th position, a relatively minor fall compared to other Asian countries affected by the economic crisis. Korea's risk level stands at 64.47, ranking fifth, following Singapore, Japan, Taiwan and Hong Kong. (See Table IV-1)

<Table IV-1> Status of Risk Level and Trends in Major Countries

	'98 Overall Ranking	'97 Overall Ranking	Change from year previous (%)	Index Total (100)	Political Risk Level (25)	Economic Achievement Level (25)
China	45	39	-6	47.97	17.08	16.32
Hong Kong	30	25	-5	75.75	19.32	16.20
Indonesia	91	49	-42	27.20	8.89	8.49
Malaysia	56	35	-21	41.89	15.25	12.47
Philippines	60	57	-3	40.35	13.10	14.04
Singapore	21	16	-5	89.17	23.29	19.24
Taiwan	24	23	-1	86.49	22.28	19.52
Thailand	58	51	-7	41.15	14.00	12.26
Korea	34	30	-4	64.47	15.11	14.06

Source: Euromoney 1998, Sep.

Note: The total index is based on a scale of 100 including factor such as debt ratio, credibility, and giving a weight of 25% to both to political risk level and economic achievement level.

Financial Environment

Korea's international financial economic status shows that the won-dollar exchange rate stood at 965 won to the U.S. dollar in October 1997 right before the economic crisis skyrocketed it to 1,960 won to the dollar in November. At the end of 1998, however, just one year later, it had stabilized in the 1,200 won to the dollar range. In addition, the available foreign currency reserves which had amounted to only $4 billion in December 1997, exceeded $50 billion in January 1999, and reached $52.22 billion as of February 15, 1999. The ratio of the short-term foreign currency borrowing fell drastically to 20% from 40% thanks to the extended ratio of the short-term foreign currency maturity period from 26% at the end of 1997 to 90%. (See Table IV-2)

<Table IV-2> Trends in Foreign Currency Reserves

(unit: U.S.$100 million)

	'97.12	'98.3	6	9	10	11	12	'99.1	'99.2
Foreign currency reserves(A)	204.1	297.5	409.0	469.8	488.3	500.2	520.4	536.0	557.8
Deposits at overseas branches (B)	113.3	54.0	36.6	34.0	33.7	33.5	33.3	33.0	33.6
Others(C)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Available foreign currency reserves (A-(B+C))	88.7	241.5	370.4	433.7	452.7	464.7	485.1	500.9	522.2

Source: Ministry of Finance and Economy

Standard and Poor's (S&P) upgraded Korea's credibility (long-term foreign currency bond level) by three steps from B+, (inappropriate for investment) in December 1997 to BB+, (appropriate for investment) in January 1999. It has also kept the credibility forecast positive, hinting at a possible additional upgrade. It has also upgraded the short-term foreign currency bond (B->A3), as well as the long-term and short-term won denominated bond (BBB+/A3->A-/A2). Along with this, it upgraded the ranking of the Korea Development Bank and the Export and Import Bank to the "appropriate for investment" level. Another credit-rating firm, Moody's, also announced that it would readjust Korea's national credibility level to "appropriate for investment". Thus, the foreign currency denominated national bond level went up from Ba1 to Baa3 (two positions), while the foreign currency bank-deposit level from Caa to Ba2 (five steps), but the won-denominated national bond level showed no change, still remaining at Baa1. (See Table IV-3)

<Table IV-3> Trends in National Credibility Level (Foreign Currency Long-Term Bonds)

S&P	Moody's	Fitch IBCA
Previous : AA- '97.10.24 : A+(1step↓) 11.25 : A-(2step↓) 12.11 : BBB-(3step↓) 12.23 : B+(4step) ‘98. 2.17 : BB+(3step↑) '99. 1.25 : BBB-(1step↑)	Previous : A1 '97.11.28 : A3(2step↓) 12.11 : Baa2(2step↓) 12.21 : Ba1(2step↓) '99. 2.12 : Baa3(1step↑)	Previous : AA- '97.11.18 : A+(1step↓) 11.26 : A(1step↓) 12.11 : BBB-(4step↓) 12.23 : B-(6step) ‘98. 2.b2 : BB+(5step↑) '99. 1.19 : BBB-(1step↑)

In the domestic finance sector, the call interest rate stabilized at 6.1% in Jan. 1999, from 6.7% in Dec. 1998, and from 30.1% at the end of 1997 when the government maintained the high interest rate and low growth policy framework. The average bank lending rate which soared to 16.6% at the end of May in 1998 from 12.1% in Nov. 1997, declined to the 11.9% level as of the end of Jan. 1999. (See Table IV-4.). The dishonored-bill rate in Seoul which once marked 0.46% in 1997, fell to 0.13% in Dec. 1998, and has now returned to the pre-crisis level. In the meantime, the ratio of newly established/bankrupt corporations is continuously rising. (See Table IV-5)

<Table IV-4> Status and Trends in Interest Rates

(unit: percent, numbers)

	End of '97	End of May '98	End of Sep	End of Nov.	End of Dec.	End of Jan. '99
Call interest rate (1 day. %)	30.1	16.8	8.2	7.1	6.7	6.1
Corporate debenture (3 yr. %)	29.0	16.7	12.7	9.3	8.0	8.1
Bank deposit rate*	-	16.2	11.4	9.2	9.0	8.9
Bank lending rate**	-	16.6	14.8	12.4	12.0	11.9

Source: Ministry of Finance and Economy

Note: * represents the interest rate of a one-year time deposit, while
** represents the interest rate for small companies and the ordinary lending rate.

<Table IV-5> Status and Trends in Default Rates

(unit: percent, numbers)

	'97	'98.6	Sep	Oct	Nov	Dec	99.1
Bill dishonor rate (Seoul)	0.46	0.47	0.35	0.18	0.20	0.13	0.13
No. of bankrupt firms (Seoul)	557	664	403	349	338	335	204
No. of bankrupt firms (nationwide)	1,431	1,825	1,085	1,036	903	862	643
Newly established /bankrupt corporations (7 major cities)	3.4	2.5	4.2	4.2	5.6	7.0	-

Source: Ministry of Finance and Economy

Economic Determinants

Market Factors

Korea's GDP recorded negative growth in 1998 which stayed in the

-5% range (estimate) in 1998 due to the economic crisis, but it is expected to go up this year by about 2%, a clear sign of recovery in domestic demand. This puts Korea in a much better situation than that of its major competition in Asia: including Thailand, Hong Kong, Indonesia, the Philippines, Malaysia, and Singapore. (See Table IV-6 & IV-7)

<Table IV-6> Korea's GDP and Economic Growth Rate

(unit: trillion won)

	1994	1995	1996	1997	1998
GDP	305,970	351,975	389,813	420,987	-
Economic growth rate	8.6%	8.9%	7.1%	5.5%	-5.8% (estimate)

Source: Bank of Korea

<Table IV-7> GDP Growth in Major Asian Nations

(unit: percent)

	ING Baring				World Bank			J.P. Morgan	
	1997	1998	1999	2000	1998	1999	2000	1998	1999
China	8.8	7.5	7.0	7.2	-	-	-	7.0	5.5
Hong Kong	5.3	-4.8	-2.9	0.8	-	-	-	-5.0	-1.5
Indonesia	4.5	-14.7	-6.3	1.5	-15.3	-2.8	2.3	-14.0	13.5
Malaysia	7.8	-5.7	1.4	2.0	-5.1	0.5	4.2	-5.0	0.5
Philippines	5.2	-0.7	-0.6	3.7	-0.5	2.5	4.4	-0.5	2.5
Singapore	7.8	-0.2	-0.3	3.6	-	-	-	0.0	-2.0
Taiwan	6.8	4.8	3.9	4.7	-	-	-	4.0	2.0
Thailand	-0.4	-8.5	1.5	1.8	-7.0	0.3	2.6	-6.0	2.5
Korea	5.5	-6.6	1.7	2.1	-6.5	1.0	3.5	-6.0	2.0

Source: ING Baring, Global Economics 4Q 1998 / World Bank, Global Economic Prospects / J.P.Morgan, Asian Financial Market 4Q

Resource Factors

According to M. Porter, a Havard economist, a nation's competitiveness is decided by four conditions: factor conditions, demand conditions, related and supporting industries, firm strategy, and structure and rivalry.[14) Here, factor conditions include not only basic resources such as energy and minerals, but also technical manpower and advanced conditions. The ranking of Korea's infrastructure went up slightly from 34th place in 1997 to 31st in 1998. In particular, it has secured an edge in technical infrastructure as well as in the environmental sector, compared to its major competitors in Asia, but its self-sufficiency level in the energy sector remain low. (See Table IV-8)

<Table IV-8> Comparison of Infrastructure Level among Major Asian Countries

(unit: world ranking)

	1998 basic infrastructure ('97)	1998 technical infrastructure ('97)	1998 energy self-sufficiency level ('97)	1998 environment ('97)	1998 total ('97)
China	31 (37)	43 (46)	38 (15)	18 (20)	40 (40)
Hong Kong	16 (16)	15 (14)	27 (34)	26 (27)	19 (19)
Indonesia	41 (41)	41(44)	32 (12)	13 (14)	38 (39)
Malaysia	28 (24)	28 (28)	17 (37)	20 (21)	24 (27)
Philippines	44 (44)	45 (42)	44 (36)	27 (28)	44 (44)
Singapore	2 (2)	9 (10)	45 (35)	34 (35)	15 (11)
Taiwan	29 (28)	25 (23)	26 (30)	32 (32)	26 (28)
Thailand	40 (38)	42 (43)	41 (41)	19 (22)	41 (42)
Korea	37 (34)	26 (27)	40 (44)	15 (13)	31 (34)

14) Porter, M. 1990, The Competitiveness Advantage of Nations, Ch.10, New York: Free Press.

Source: IMD, The World Competitiveness Yearbook 1997
IMD, The World Competitiveness Yearbook 1998

Note: IMD measured basic infrastructure based on infrastructure management and development, distribution systems and transportation systems including air, roads, and railways, while it measured technical infrastructure based on investment levels in information and communication, computer availability, and communication facilities and service. In the meantime, energy self-sufficiency is based on energy production and level of use, while the environment sector is based on environmental protection levels such as waste disposal facilities and recycling.

Production Efficiency Factors[15)]

Korea's capital cost ranked 45th both in 1996 and in 1997, the lowest ranking among its major competitors. However, labor cost was 34th in 1996 with an 11% increase from the previous year, but in 1997 it was down to 17th with an increase of only 1%. However, it is noteworthy that Korea ranked higher with a relatively small wage increase rate compared to other major Asian countries. In addition, the average monthly wage in Korea fell to 1,315,362 won in 1998 from 1,326,241 won in 1997, keeping Korea "Top 10 list on the worlds" for average monthly wage. (See Table IV-9 & IV-10)

Labor productivity is steadily rising, while the wage increase rate is gradually declining, giving Korea an edge over other countries,

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15) Traditionally the capital and labor costs are what are considered the production cost in conomics. Multinational enterprises with outstanding technical and managerial capabilities will tap these comparative edges efficiently for the production, thus low capital and labor cost directly affect the investment inducement. However, basically capital cost has significant weight in location selection by multinational enterprises wishing to utilize local financing, but given the fact that, in most cases, multinational enterprises are equipped with large capitals and make investments by utilizing them, and that the borrowing and lending are conducted in an efficient manner under the global financial market opening, the significance becomes relatively minor.

especially for foreign investment. IMD's report on international competitiveness in 1998 ranks Korea 7th in the world, and First in Asia in terms of manufacturing sector productivity (which reflects purchasing the power index) followed by Israel, Norway, Belgium, Finland, the U.S., and France. (See Table IV-9)

<Table IV-9> Comparison of Capital and Labor Cost Fluctuation in Major Asian Countries

	Capital cost		Labor cost fluctuation (manufacturing sector)	
	1997	1996	1997	1996
China	4.43 (27)	3.55 (32)	-	-
Hong Kong	6.66 (18)	8.13 (5)	4.50% (28)	4.50% (25)
Indonesia	2.67 (41)	2.34 (39)	13.30% (38)	13.30 (35)
Malaysia	5.92 (21)	7.44 (14)	5.10% (29)	5.10% (21)
Philippines	3.05 (34)	4.83 (26)	-	-
Singapore	7.48 (9)	7.49 (11)	-3.04% (4)	-3.04% (2)
Taiwan	6.66 (17)	5.50 (23)	-0.67% (11)	-0.67% (5)
Thailand	2.70 (40)	4.46 (27)	-	-
Korea	1.90 (45)	2.05 (45)	1.30% (17)	10.80% (34)

Source: IMD, The World Competitiveness Yearbook 1997
IMD, The World Competitiveness Yearbook 1998

Note: Capital cost is based on the IMD figure, while labor cost represents the fluctuation against the previous year. The figure in the parenthesis shows the world ranking.

The frequency of labor-management disputes accelerated due to forced lay-offs resulting from restructuring programs in 1998, but the rate of newly organized labor unions shows a gradual decline. The number of employees who joined labor unions in 1998 amounted to

1.4 million, only 11% of the total, a meager level compared to 32.1% who joined in 1998 in the U.K., 28.9% in Germany, 23.2% of Japan, and 13.9% in the U.S. (See Table IV-10)

<Table IV-10> Trends in Wage and Labor Productivity in Korea

(unit: won, frequency)

	1995	1996	1997	1998
Labor productivity	100	112.9	128.0	132.0
Average monthly wage (won)	1,123,895	1,261,168	1,326,241	1,315,362
Labor-management disputes (frequency)	88	85	79	129
Labor union organization rate (%)	13.8	13.3	12.2	11.0

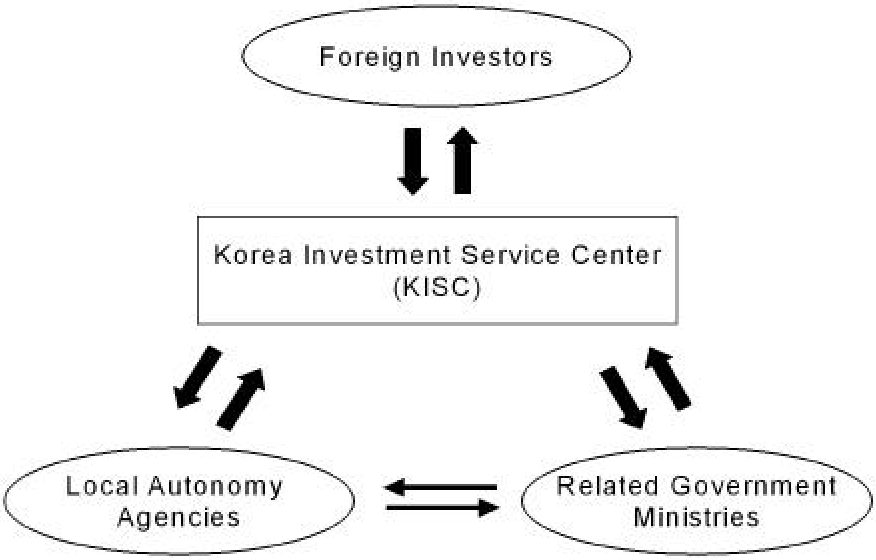
Source: Ministry of Labor, Wage Study by Korea Labor Institute, all volumes
Note: Labor productivity bases the year 1995 on 100.

Business Facilitation Factors

Investment Promotion Factors

The government of each country provides various supports for investment by setting up an investment inducement body directly under the government or as a separate body. Major investment inducement bodies in foreign countries include IBB (Invest in Britain Bureau) in the U.K., MIDA (Malaysian Industrial Development Authority) in Malaysia, and the EDB (Economic Development Board) in Singapore. Korea has developed KISC (Korea Investment Service Center) within KOTRA as an exclusive arm for facilitating foreign investment.[16)]

<Figure IV-3> Flow of Foreign Investment



Investment promotion activities by these bodies encompass image-building activities to create a favorable image for investors its own country's investment environment, investment-generating service activities for matching foreign investors with domestic companies, and investment-service activities offering a wide-range of support such as administrative and consulting services to foreign-invested firms.[17)]

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16) At the economic ministerial meeting in April 1998, KOTRA was designated as an exclusive body for investment inducement, and in an attempt to establish a one-stop service system for investment support, KISC was established, and was staffed by KOTRA personnel who have extensive expertise in the field of international investment as well as incorporating three departments from KOTRA's head office, 10 trade offices within the country, 38 exclusive investment inducement bodies, and officials from relevant government ministries and specialists. KISC was restructured in July 1998 to handle various investment-related matters such as civil petitions related to licensing and approval of foreign investors, investment-related consulting, trouble-shooting, receipts of and replies to investment inquiries, investment-related planning and survey and promotions.

Image-Building Activities

“Image-building activities” refers to a series of promotional activities such as production and distribution of promotion materials through the media, and participation in various investment-promotion exhibition fairs. The following outlines information on KOTRA's promotional activities over the last year.

Promotion activities

KOTRA published a number of investment-inducing periodicals including *Korea Trade & Investment,* the only English magazine offering up-to-date trade, investment and industrial information within the country. As well, KOTRA produces various English-language investment inducement promotion materials to distribute to foreign agencies and prospective investors. It has also carried out intensive promotion efforts to key corporations, organizations and individuals including prospective domestic and international investors, existing investors, specialized investment consulting firms, and opinion leaders from around the world. KOTRA has also looked to expand and diversify the target audience to publicize within official foreign agencies in Korea, major in-flight magazines, and investment related bodies within hotels.

KOTRA has also set up a KISC homepage to publicize and provide more comprehensive information on every aspect of Korea's investment environment: its investment system, trade, finance, labor, industry and local autonomy system, etc.

* KISC's homepage address: www.kisc.org

KOTRA has installed and operated its “Korea Investment Promotion Center' in international exhibitions and fairs in major developed

17) Well, L.T. and A.G. Wint, 1990, Marketing a Country, MIGA Ch. 2; pp.9-22

countries including the U.S., Japan, and in Europe.

KOTRA has diversified its promotion methods using CD-Rom, video, and billboard advertising at the Kimpo International Airport, as well as major overseas media. KOTRA has also manufactured and distributed specialized promotion materials regarding Korea's economic policies, investment systems, regions and industries.

Investment-Generating Service Activities

"Investment-generating service activities" refers to exploring investment sources, processing inquiries on investment, organizing and participating in trade fairs, dispatching investment inducing missions to specific regions for investment, and arranging various seminars related to dispensing investment information.

KISC recorded $2.17 billion in investment-inducing performance, with 129 cases in 1998, accounting for 9.2% of total foreign investment within the country, and 24.5% of total investment volume. The performance after the opening KISC reached 10.1% of total cases, and 28.1% in terms of volume, showing a monthly average of 11 cases, and $180 million.

Partner search, and support for investment inquiries and visiting investors to Korea

KISC has designated 38 trade centers in 20 foreign countries as exclusive centers for inducing investment. They help in searching for prospective partners by visiting firms with investment potential, explaining about Korea's investment climate, and distributing promotion materials (currently KISCs database holds 2,418 firms). KISC processes investment-related inquiries, and operates the "Comprehensive Counseling Center' as a domestic contact point to assist with increased investment by Korean partners of foreign investors, and as well as providing support to existing foreign-invested firms.

KOTRA works directly with visiting foreign companies for negotiations on investment conditions, or for site surveys such as the “Target Company for Intensive Support” and accompanies the team during its entire schedule to provide diverse services such as greetings at the airport, arranging meetings with related agencies, translations, and industrial tours to partner companies and plant sites.

* There were a total of 227 cases of this special assistance in 1998 (Monthly average: 19 cases).

KOTRA also provides information on Korea's investment climate, arranges visits to related agencies, and engages in "match-making" activities -- setting up negotiations -- for visiting trade missions from major developed countries such as Japan, Europe, and Canada. Last year KOTRA assisted in this way 12 times, representing 273 firms and 351 persons.

Organizing and participating in trade and investment fairs

KOTRA organized and hosted the “Korea Technomart '98” in 1998 to reinforce the technical competitiveness of domestic firms by introducing state-of-the-art technology and promoting investment. In June 1999, it will organize the “APEC Investment Mart 1999” in Seoul. (See Table IV-11.)

Dispatch of investment inducement missions

Investment inducement mission teams comprised of government members, local autonomy agencies, related bodies and firms. Seminars on Korea's investment environment and match-making meetings were held in foreign countries. KISC set up a “Post-Investment Service Team' for each investment inducement mission to offer continuous support until investment process is concluded. (See Table IV-12.)

<Table IV-11> Trade and Investment Fairs

	Korea Technomart 1998	APEC Investment Mart 1999
Location & date	Nov. 6-10, 1998 COEX	June 2-5, 1999 COEX
Schedule	Technical Exhibition and Consulting, Technical Presentation, Presentation on Investment Climate, Industrial Tours	Investment Exhibition: Country Booths for 21 Member Countries, Presentation on Investment Environment, Lectures by International Experts: Economists, Entrepreneurs, heads of international organizations
Outcome or Expected Impact	Conducted 1,800 business meetings with 177 participating firms highlighting advanced technology from 16 countries Outcome of business meetings: $1.5996 billion in 194 cases Registered $1.25 billion (6.7% of the total) in proposals for joint ventures Final total: 16 cases of exchanging MOUs or LOIs	Provides opportunity to draw bringing foreign direct investment to Korea by arranging a forum for investment inducement to APEC member countries Highlights leadership role and reputation of Korea as a key player in the upcoming Asia-Pacific era in the 21st centry, as it has overcome its financial turmoil, and facilitates new awareness of the Asia-Pacific region and economic activities focused on Korea

<Table IV-12> Outcome of Investment Inducement Missions Dispatched in 1998

Mission Team	Location	Outcome upon completion of meeting	Final Status
Korea-U.S. Forum (June 7-13)	New York, L.A.	Investment Agreement: 19 cases, $2.16 billion Negotiated: 82 cases, $10.637 billion	Agreement confirmed for investment: 17 cases, $2.614 billion Under negotiation: 74 cases, $8.33 billion
Investment Trade Mission to Europe (June 27-July 4)	Oslo, Rome, Frankfurt	Investment Agreement: 11 cases, $703 million Negotiated: 39 cases, $2.67 billion	Agreement confirmed for investment: 6 cases, $1.481 billion Under negotiation: 21 cases, $899 million
Investment Inducement Team to Japan (Oct. 6-10)	Tokyo, Osaka	Investment Agreement: 9 cases, $893 million Negotiated: 88 cases, $1.782 billion	Agreement confirmed for investment: 13 cases, $2.4 million Under negotiation: 22 cases, $3.072 billion

Investment Support Services

Investment support services include consulting services, support services for notification and applications, and post-investment service for investors. KOTRA provides these services from the Investment Consulting Office within KISC.

Investment consulting services

Foreign investment business meetings totaled 8,839 cases with a monthly average of 1,105 cases. Among these, personal visits amounted to 2,719 cases (domestic: 1,173 cases, foreign: 1,546 cases), while phone consultations amounted to 6,120 cases.

Investment notification and applications

In accordance with the Article 40 of the Implementation Ordinance of the "Foreign Investment Promotion Act", KISC and trade centers at home and abroad can process foreign investment notification and applications directly as well as post-investment service. From Nov. 17 to Dec. 31 of 1998, the investment notification applied to KISC amounted to 42 cases, equivalent to three months' volume in ordinary banks dealing with foreign currency.

Various administrative services regarding licensing and approval for factory establishment by foreign investors can be taken care of by the One-Stop Service personnel on behalf of investors. Among these, seven civil petitions regarding business registration, and qualification for sojourn are handled directly on site (1,819 cases in 1998), while 103 cases in five categories -- such as factory establishment approval under the "Foreign Investment Promotion Act"-- are handled by agents. Meanwhile, the receipt and processing of civil petition-related documents are directly handled by KISC through links to local autonomous agencies.

Post-investment service

The Ombudsman Team operates within KISC to address the grievances and difficulties of foreign investors, and to improve the overall investment climate by reporting to the government any areas that need to be addressed improvement. This team provides administrative support related to investment, business operations, and settlement -- including schooling, housing, health care and obtaining a driver's license. The Ombudsman Team assisted in a total of 25 cases in 1998.

Set-up of an integrated system (cyber KISC) for investment inducement

A web site for investment inducement is under way to generate investment information, locate potential partners, handle receipt and application of foreign investment notification and registration, to settle civil petitions, and to provide post-investment service (construction period: Sep. 1998 - May 1999)

Investment System, Liberalization, and Incentives

Basic System and Foreign Investment Procedures

In an attempt to promote foreign investment, the system was revised from "regulation and management-oriented" into "promotion and support-oriented" in November 1998, and now includes the "Foreign Investment Promotion Act", "Implementation Ordinance of the Act", "Implementation Rules", and "Regulations on Foreign Investment (Notice by the Ministry of Finance and Economy)" as basic regulations.

Investment procedures were reshaped into a "demand (foreign investors)-oriented" style to simplify management, licensing and approval systems and provide one-stop service by establishing KISC under KOTRA. Foreign investors now only have to notify to head offices or branches of banks, or head office and branches of KOTRA to proceed with investment. The system of obligatory notification to the Ministry of Finance and Economy one month prior to the introduction of foreign capital no longer exists, nor the obligatory designation of a domestic agent upon investment notification. In addition, the batch handling system was introduced. An example of this was automatic processing of 26 civil petitions including approval on conversion of farming land once the approval on factory establishment was granted. Also, the automatic approval system -- to recognize licensing and approval once the processing period is over -- was also adopted. However, the registration system still exists for various support and post-investment services.

Status on Liberalization and Market Opening

With the launch of liberalization of cross-border M&As, all Korean firms are open to cross-border M&As except for firms in the defense industry. Restrictions on hostile cross-border M&As were also lifted by abolishing the obligatory transfer resolution by the company's board of directors.

<Table IV-13> First Phase of Business Sector Liberalization in 1998 (10 sectors)

April 1, 1998

Full opening (seven sectors)	Residential building leasing, non-residential building leasing, residential building assignment and supply, non-residential building assignment and supply, stock exchange, golf course operations, cereal grain pounding
Partial opening (one sector)	Futures transactions (granted only when investment is made up of less than 50% of shares; when a foreign investor doesn't become the primary shareholder)
Expansion in opening (two sectors)	Cable broadcasting (program provider and less than 30% of general cable broadcasting), investment co-op (more than 80% of foreign capital should be invested in the form of new shares, warrant bonds, and venture businesses registered in KOSDAQ within one year.)

In 1998, foreign investment was liberalized in almost all business sectors in two phases, and now only 31 restricted sectors remain out of a total of 1,148. Of the 31, only 13 are completely closed, 18 are partially open, resulting in a 98.9% opening for foreign investment. Along with this, restrictions on usage, the ceiling on long-term credit, and the necessity of an application of import source diversification system on production facilities and parts imported by foreign-invested firms were also eliminated. In addition, the real estate market was liberalized, and restrictions on land acquisition were also lessened. (See Table IV-13 & Table IV-14)

<Table IV-14> Second Phase of Business Sector Liberalization in 1998 (20 sectors)

May 6, 1998

Full opening (eleven sectors)	Product exchanges (future transactions), investment firms (short-term financing, general financing, investment co-ops, holding companies) gas stations, real estate leasing, land development and supply, other coastal water transport, other loan financing, other finance-related services, water supply, credit investigation (July 1, 1998), crude oil refinery (Aug.1, 1998)
Partial opening (two sectors)	Tobacco product manufacturing (July 1, 1998), gambling operations (confined to casino, May 1 1999) - Monopoly of tobacco product manufacturing shall be maintained by Tobacco & Ginseng Corp., but in case of privatization of the Tobacco & Ginseng Corp., foreign investment can take up to 25% of total (7% per capita).
Expansion in opening (seven sectors)	Power generation (less than 50% for government-sponsored bodies such as KEPCO, Water Resource Corp., full opening for other private power generation), trust companies (full opening of securities investment trust) newspaper publications (Jan.1, 1999, less than 33%), publication of periodicals (less than 50%), wired telegraphs and telephone, wireless telegraphs and telephones, other electronic communications

The opening of the capital and financial markets has also expanded to include securities and bond markets, as well as foreign currency transactions. The investment ceiling for foreigners on securities and bonds has been lifted completely,[18] and so has the 25% obligatory

18) The limit for investment into public corporations (KEPCO, POSCO) has been

public purchase system. (See Table IV-15)

<Table IV-15> Liberalization of Short-Term Financial Products

Division	First-phase (Feb.16 '98)	Second-phase (May 25 '98)
Products liberalized	- Corporate products *Commercial paper *Commercial bills *Trade bills	- Financial Institution Transactions *CDs *RPs *Self-issued bills, bill notes

*No ceiling on foreign investment

Foreign currency transactions have also been liberalized, allowing the borrowing of foreign currency for more than one year by corporations and banks dealing with foreign currency, and allows issuance of overseas securities with a maturity period of more than one year. The buying and selling of foreign currency bonds among residents has also been liberalized. Other than these, the establishment of local branches of foreign banks and security firms has been allowed earlier than scheduled.

Investment Incentives

Reduction and exemption of leasing fees

The criteria for reduction and exemption of leasing fees within the exclusive industrial complex for foreign firms (Chonan, Kwangju Pyungdong, Daebul) has been readjusted downward. An exemption of 100% is granted for hi-tech industries with capital of more than $1 million while a 75% reduction is granted to ordinary manufacturing companies with capital of more than $10 million.

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expanded to 30% of the total and 3% per capita.

The target for reduction and exemption of leasing fees for foreign-invested firms was expanded into the industrial complex sites owned by the government, and the period was also extended to 50 years with a no-time-limit renewal possible.

Tax reductions and exemptions

The range of advanced technologies under the target of tax reduction and exemption was expanded from the existing 265 items from seven sectors to 446 items from eight sectors, and the target for tax benefits was also expanded from hi-tech businesses and those within free-export zones to include industrial support service, and firms occupied within foreign-invested zones. The existing free export zones are granted the same tax reduction and exemption advantages as the foreign investment zones (FIZs.). The period for tax benefits has been extended from eight to 10 years (100% for seven years, and 50% for three years) for the national tax (corporate tax, income tax), while that for the local tax is 8-15 years depending on the discretion of local governing bodies.

Establishment of foreign investment zones (FIZs)

If it is necessary to induce foreign investment, the local government can designate specific areas attractive to foreign investors as "foreign investment zones" after undergoing a review by the Foreign Investment Committee. The criteria to designate the FIZ will include 1) the inclusion of foreign-invested firms with more than $100 million in capital, operating in the manufacturing, industrial support service sectors or hi-tech industries, 2) those with more than a 50% foreign investment ratio, creating more than 1,000 full-time jobs, or 3) those with more than $50 million capital, creating more than 500 full-time jobs. In case of designating part or all of a national industrial complex or a local industrial complex whose development has already been completed, the criteria must also include foreign-invested firms with more than $30 million in capital, creating more than 300 full-time jobs.

The FIZ can also be set up for tourist accommodation, the international conference sectors as well as for comprehensive leisure resorts on Cheju Island or within regions designated by ordinance from the Ministry of Finance and Economy. For tourist accommodation and international conference facility sectors, the capital should exceed $30 million, while for the general leisure business either on Cheju Island or within the regions designated by the ordinance from the Ministry of Finance and Economy (Bomun Tourist Complex, Joongmun Tourist Complex, Sungsanpo Tourist Complex, Haenam Flower Tourist Complex, Gampo Tourist Complex, Wonju Wolsong Tourist Complex, Hwachon Paroho Tourist Complex, Kimchon Hot Spring Tourist Complex, Pyungchang Bongpyung Tourist Complex), the capital should be over $50 million.

Support for FIZs

Tax benefits are granted to firms moving into the zone, and other on construction cost and infrastructure assistance can be provided to execute development projects in case the firms are occupied in the national industrial complex. Up to 50% of infrastructure installation costs for road, water, sewage and land acquisition is supported, and various social infrastructure facilities are provided. In the meantime, diverse taxes including the capital gains tax for development project executors, as well as seven levies, such as the forest and mountain conversion levy and the farming land development levy, are exempted. In addition, firms within the FIZ are not subject to restrictions on business sectors operated by small and medium enterprises, and are free from obligatory outsourcing of designated items to small and medium companies. In addition, they are not subject to obligatory hiring of National Persons of Merit (e.g., war veterans and their family), and other export and import restrictions including import source diversification system until the end of 2003.

V. Evaluation on Korea's Investment Environment by Foreign Investors

The sweeping efforts by the government and related investment inducement bodies are bearing fruit in an improved investment climate. KOTRA conducted a survey of foreign-invested firms operating in Korea and prospective overseas investors on the domestic corporate environment as well as on their future investment plans, and the major findings are as follows.

1. Perception on Korea's Investment Environment by Foreign-Invested Firms Operating Within the Country

During the period of Aug. 14 - Sep. 28, 1998,[19] 4717 foreign-invested firms operating in Korea were targeted for survey (Based on firms who reported to the Ministry of Finance and Economy as of July 31, 1998). Among the 405 firms who responded, 244 are from the manufacturing sector, taking up 60%, while 161 are from the non-manufacturing sector, accounting for 40%. By each country, 133 are from the U.S. (33%), 80 are from Europe (20%), 143 from Japan (35%), and 49 from other countries (12%).

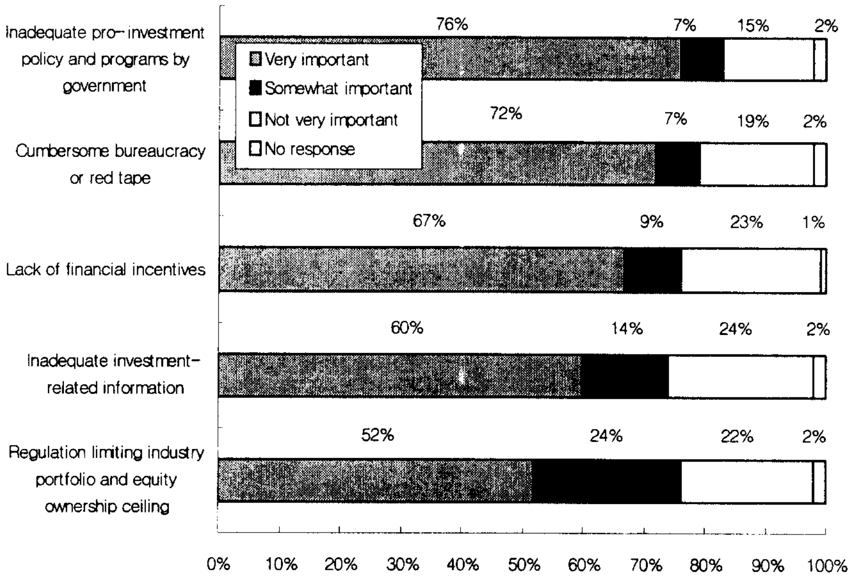
Bottlenecks Adversely Influencing Investment Decisions

Major impediments influencing investment by foreign-invested firms include “inadequate pro-investment policy and programs by the government”(76%), “cumbersome bureaucracy or red tape”(72%), “lack of financial incentives for new foreign investments”(67%), “inadequate investment-related information such as plant location and licensing procedures”(60%), and “regulations limiting industry

19) The Foreign Investment Promotion Act which was enacted to promote foreign investment took effect Nov. 17, 1998 after being passed at the National Assembly on Sep. 2, 98. In this regard, the study doesn't reflect the content of the Act since it was targeting foreign-invested firms already operating within the country.

portfolio and equity ownership ceiling by foreign investors " (52%).

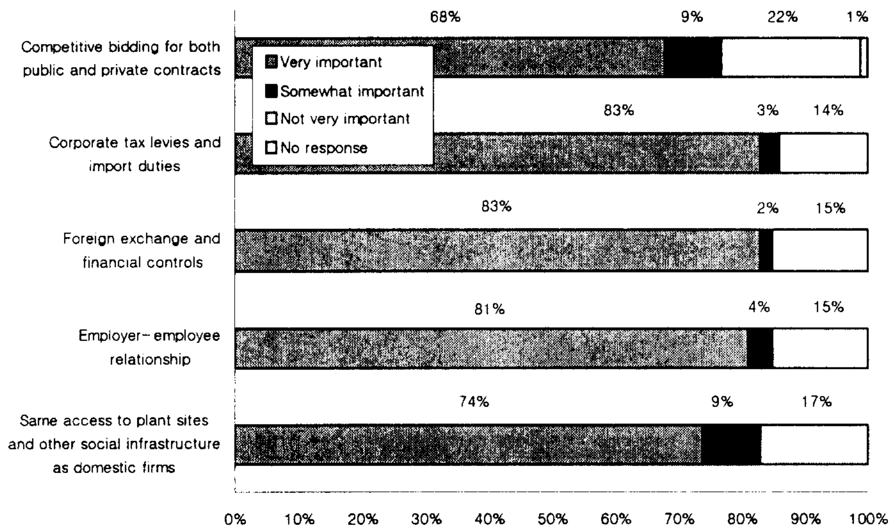
<Figure V-1> Bottlenecks Adversely Influencing Investment Decisions



Fair and Non-Discriminatory Practices by Area

Perception on fair and non-discriminatory practices by each area showed " foreign exchange and financial controls " (83%), " corporate tax levies and import duties " (83%), " employer-employee relationships " (81%), " having the same access to plant sites and other social infrastructure as domestic firms " (74%), " competitive bidding for both public and private contracts " (68%), demonstrating high concerns for " fair and non-discriminatory practices " as significant factors to the respondents. Factors deemed less significant for were " competitive bidding for both public and private contracts " (9%), " having equal access to plant sites and other social infrastructure such as domestic firms ” (9%), “ employer-employee relationships ” (4%), “ corporate tax levies and import duties ” (3%), and “ foreign exchange and financial controls ” .

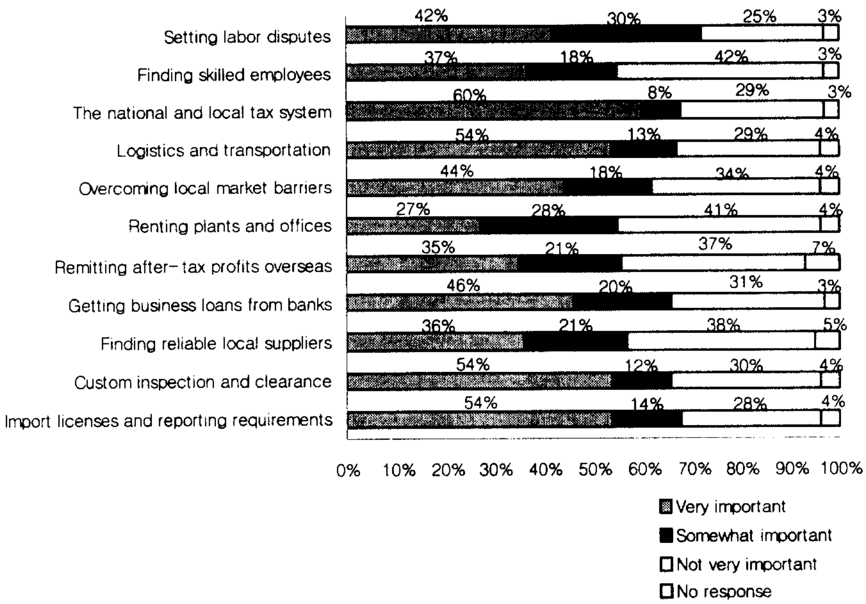
<Figure V-2> Fair and Non-Discriminatory Practices by Area



Difficulties in Everyday Business Operations

More than half of the respondents mentioned “ the national and local tax systems ” (60%), “ logistics and transportation ” (54%), “ custom inspection and clearance ” (54%), and “ import licenses and reporting requirements ” (54%) as major difficulties, and especially, “ the national and local tax system ” was cited as the toughest element. In the meantime, “ getting business loans from banks ” (46%), “ overcoming local market barriers ” (44%), “ settling labor disputes ” (42%), “ finding skilled employees ” (37%), “ finding reliable local suppliers ” (36%), and remitting after-tax profits overseas (35%) were mentioned as less difficult elements, and only 27% of the respondents mentioned "renting plants and offices" as a major difficulty, showing the lowest figure among the 11 items.

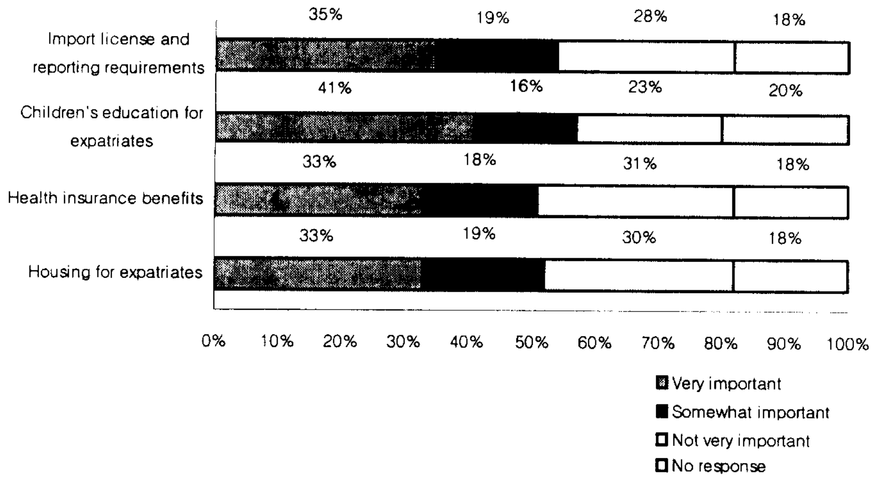
<Figure V-3> Difficulties in Everyday Business Operations



Difficulties in daily life

Cited as difficulties in daily life among respondents "children's education for expatriates" (41%), "getting resident visas for expatriates" (35%), "providing health insurance benefits" (33%), and "providing housing for expatriates" (35%), showing that more than one-third of the respondents experienced difficulties in these areas. In particular, children's education emerged as the single most serious difficulty for expatriates in daily life, registering 41% on the "very important" scale.

<Figure V-4> Difficulties in Daily Life



2. Perception of Foreign Investors on the Investment Climate of Korea

KOTRA conducted a survey on the perception of Korea's investment climate against 178 firms -- including these major multinational companies, Heritage Capital (U.S.), Unilever (Netherlands), Mie Electronics (Japan) -- from Nov. 11 to Dec. 30, 1998 through 38 trade offices for investment inducement in 20 countries including the U.S., the U.K, and Japan. Among 178 respondents, 46 were from Asia, 52 from North America and 79 were from Europe. Of them, 101 were in the manufacturing sector, while 45 were in the service sector.

The foreign investors surveyed think mainly of market potential, human resources and a technology base as the most favorable elements for an investment climate. Of the respondents, 74% evaluated Korea as being an "attractive target for investment", and 53% of them expressed intent to invest within 2-3 years.

Countries considered to be Korea's primary competition for inducing foreign investment, according to survey respondents, are China (32%), followed by Taiwan (19%), Japan (13%), Malaysia (9%), Singapore (7%), and Thailand (5%).

As for the government's recent investment promotion measures, about 43% responded them to be effective, and already yielding fruits from massive efforts to improve the investment climate, however, they felt still there remains room for improvement.

Economic and Political Conditions

Of the respondents, 58% evaluated the economic growth potential in Korea to be very high, while only 7% of the respondents mentioned financial factors, such as interest and exchange rates to be high.

<Table V-1> Domestic Economic and Political Conditions

	Highly stable	Stable	So so	Not very stable	Very unstable	No response
Economic growth potential	6.15%	51.40%	33.52%	6.70%	0.00%	2.23%
Financial stability (interest rate, exchange rate, etc.)	0.00%	7.26%	33.52%	50.84%	6.70%	1.68%
Political stability	2.79%	26.26%	40.78%	26.82%	1.68%	1.68%
North Korea's impact on Korean economy.	6.15%	18.99%	33.52%	30.17%	8.38%	2.79%

Social and Cultural Conditions

Foreign investors singled out the “labor unions attitude toward foreign companies” as the most negative factor in social and cultural conditions (46%).

<Table V-2> Social and Cultural Conditions

	Very favorable	Favorable	So so	Slightly unfavorable	Extremely unfavorable	No response
Koreans' general attitude toward foreigners	9.50%	33.52%	33.52%	18.99%	3.35%	1.12%
Consumers' attitude toward foreign products	4.47%	29.61%	37.99%	20.11%	4.47%	3.35%
Labor unions' attitude toward foreign companies	0.00%	3.91%	38.55%	34.08%	11.73%	11.73%
Cultural compatibility	2.23%	10.61%	27.37%	43.58%	15.08%	1.12%
Strengths and weaknesses of Korean culture from foreign investors' point of view	Strengths: High-quality, diligent labor force, loyalty to the organization and cohesion Weaknesses: Adherence to hierarchy, hostility to M&As, inflexibility, preoccupation with short-term interests, xenophobia, aggressive and militant labor union					

Incentives for Foreign Investors

More than 30% of foreign invested firms showed favorable reaction to tax-related incentives, and foreign investment and special economic zones, but in terms of financing and R&D support, the figure stayed at 10% and 13% respectively, showing the meager appeal of these incentives. (See Table V-3)

<Table V-3> Incentives for Foreign Investors

	Very favorable	Favorable	So so	Somewhat unfavorable	Very unfavorable	No response
Tax incentives	6.15%	27.93%	31.84%	17.88%	2.79%	13.41%
Capital grants Rent subsidies	1.68%	20.11%	39.11%	18.44%	2.23%	18.44%
Employment Training grants	1.12%	20.11%	37.99%	19.55%	1.12%	20.11%
R&D grants	1.12%	11.73%	45.25%	19.55%	1.12%	21.23%
Support for financing	2.23%	7.26%	41.90%	27.37%	1.68%	19.55%
Special economic zones for foreign investors	5.59%	26.82%	35.20%	14.53%	1.12%	16.76%

Business Practices and Management Systems of Korean Companies

Of the respondents, 49% perceived that restructuring programs contributed to the improvement of the investment climate, and only 11% showed a negative response to restructuring programs.

<Table V-4> Perception of Restructuring

	Agree strongly	Agree	So so	Disagree	Disagree strongly	No response
Restructuring efforts enhance attractiveness of business partnerships with Korean companies	12.85%	35.75%	35.20%	10.06%	0.00%	6.15%

Regarding transparency of accounting, more than 65% of foreign firms showed dissatisfaction, and 36% of them responded negatively to the corporate governance structure.

<Table V-5> Business Characteristics and Management System of Korean Firms

	Very satisfied	Satisfied	So so	Unsatisfied	Very unsatisfied	No response
Corporate governance structure	0.56%	15.64%	43.02%	27.37%	8.38%	5.03%
Corporate competencies	2.79%	25.14%	40.22%	24.02%	2.23%	5.59%
Efficiency Productivity	2.79%	29.61%	35.20%	26.82%	0.56%	5.03%
Corporate culture	5.03%	20.11%	40.78%	23.46%	6.15%	4.47%
Accounting transparency	0.56%	6.70%	21.23%	33.52%	31.84%	6.15%

Survey Results

Nationality, investment type, and level of experience in Korea seems to affect foreign investors' perception on Korea's future investment climate.

Among the direct foreign investment target countries, Japanese investors show the highest reservation, and regard political, economic, social and cultural conditions as the most important elements affecting investment, while U.S. investors are more concerned about government policies and regulations. In the meantime, European investors perceive regulations and administrative services as major investment barriers, thus leading to the necessity of more intensive promotion in these areas.

U.S. investors are concerned about the North Korean threat and its link to the investment climate, while Japanese respondents regarded it of little relevance, showing a wide gap in perception between the two countries.

VI. Future Prospects

Eleven KOTRA trade offices, located in the top eight countries which make significant investments in Korea, including the U.S., the U.K., the Netherlands and Japan, conducted a survey of 21 companies including Schroder of the U.S. The results of the study forecast the Korean economy to completely recover from the Asian economic crisis within three years, the fastest recovery among the Asian countries affected.

In particular, multinational corporations located in Europe, especially in Germany and France, predict a bright future for Korea's economy, expecting a full recovery by the end of 1999, while Japanese firms view the recovery to come after 2000, arguing that the recovery is more affected by changes in the Asian and global economy than by Korea's efforts alone.

In addition, respondents mentioned the years 1998 and 1999 to be ripe for investment into Korea, thus bringing high hopes for active foreign investment this year.

Survey respondents view Korea's market potential as very high and that full-fledged investment will come when restructuring programs are completed, and the management environment, including flexibility in the labor market, is improved.

Korea's pull as an investment location includes its strong industrial base, human resources, and high market potential. In particular, European countries such as Germany, the Netherlands, France and Switzerland evaluate market potential as the biggest draw, and also predict expansion of domestic demand through inroads into North Korea. In the meantime, Japanese firms view the market potential, human resources and governments' commitment to liberalize the market for investment as the most appealing aspect of investing in Korea.

Another solid reason for more foreign investment in 1999 is the increasing direct investment globally, and Korea's enhanced profile as a preferred investment location.

Investment inflow into Korea has been on a continuous rise for the past seven years, even despite the Asian economic crisis of 1997. An increase of greater than 19% has been witnessed over the past three years.

Factors contributing to drawing investment include economic aspects such as market demand, production cost, and natural resources, as well as government policy aspects such as social and political stability, management policies for foreign-invested firms, and business facilitation aspects such as investment promotion activities, investment incentive systems, social conveniences, and post-investment services for investment management. Recently, more investment incentives following the enactment of the “Foreign Investment Promotion Act” are expected to bring about an increase of foreign investment to pre-crisis levels. (In the three years before the economic crisis, there was an average of 80% per year)

Given Korea's upgraded international credit-ratings in the first half of this year and continuous restructuring efforts, foreign investment centered on M&As will almost certainly accelerate in the second half as investors' attitudes rapidly turn favorable, and when sell-offs of domestic firms have been settled.

Until now, Korea's investment inducement support system has been uniformly applied regardless of business types or investment methods. However, the findings of the survey conducted by KOTRA reveal varing inclinations and motivating factors.[20]

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20) Shown in the survey on the perception of investment environment into Korea and report on current trends for investors by overseas trade offices of KOTRA.

This means that the firms in the service sector prefer M&A-type investments, while those in the manufacturing sector prefer partial equity participation and strategic alliances.

The investors' own experience is also reflected in investment inclination. Firms with previous experience in direct investment in Asia or transactions with Korean companies put more significance on factors such as location, and political and economic stability, and they prefer M&A-type investments over equity participation or alliances.

According to a survey by KOTRA regarding future business operations of foreign-invested firms in Korea, 44% of the respondents said they plan additional investment in the future, four times more than the 11% who intend to reduce their investments.

In this regard, aggressive promotion of recently improved investment systems and investment climate should be launched, and investment inducement strategies should also be mapped out considering the investment type and inclination of investors.

In particular, foreign-invested firms operating in the domestic market have a more positive view on additional investment, and given that the additional investment volume accounts for almost half of total foreign investment, and as that is increasing steadily, keener attention should be focused on inducing additional investment from foreign-invested firms already operating in Korea.

Data provided by the Ministry of Finance and Economy shows that additional investment reached $15.35 billion from 1962 to 1998, which accounts for 46% of the total accumulated investment volume during that time, narrowing the gap between additional and new investment which totaled $17.039 billion.

Even in terms of investment inflow, additional investment shows stable growth compared to new investment, based on last year's monthly trends, relatively unchanged in Korea's investment climate following the economic crisis.

In general, existing investors have more accurate judgement on investment risks and future profits by being able to secure more information compared to new investors. The current trend of increased additional investment shows promise of a favorable investment climate in Korea despite challenging conditions such as the ongoing foreign exchange rate turmoil and restructuring programs. Therefore is greater priority should be given to inducing re-investment and additional investment from overseas investors, and implementing proactive measures to expand the trend.

Along with this, products should be developed which are appropriate to the domestic investment environment by analyzing investment motivations and patterns of foreign investors. KOTRA's survey on foreigners' perceptions of Korea's investment climate this year shows that major motivating factors among investors here range from “market exploration”(86.6%), followed by “to seek production efficiency”(27.6%), and “to secure advanced technologies”(11.2%).

Korea's market growth potential (GDP growth rate), which is more stable than other Asian countries such as Thailand, Hong Kong, Indonesia, Philippines and Malaysia, these positive factor serves as another positive motivator for investment.

Direct investment can be divided into “upstream foreign direct investment” and “downstream foreign direct investment” when analyzing the direction of investing countries. Recently, the trend in foreign direct investment is moving away from traditional “downstream” foreign direct investment into the “upstream”[21], and investment from

21) Downstream foreign direct investment refers to the advancement of enterprises in developing countries into developed countries, while upstream foreign direct investment refers to typical direct investment, where enterprises of developed countries make advancement into developing countries. (Lim and Moon, "Effect

developing countries is rising faster than that from developed countries.[22) However, since most investment still comes from developed countries on a short-term basis, investment from countries with advanced technologies and expertise should be more aggressively pursued, while on a long-term basis, the corporation's level of technology, which is the basic requirement and key element driving upstream direct investment, should be upgraded to attract investors from developing countries. Equal attention should also be given to activating the M&A market.

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of outward foreign direct investment on home country export : the case of Korean firms”, Presented at AIB Conference 1998, Vienna)

22) Refers to “Status of investment inflow by each country group and changes” in <Figure III-2>.