

NEED TO IMPROVE THE ENVIRONMENT FOR FOREIGN DIRECT INVESTMENT

Kwang-Cheol Shin
(kcshin@hri.co.kr)

Sharp Increase of FDI Since Financial Crisis

Foreign investment invigorates the economy and expands growth potential by promoting economic growth and employment, expanding exports, and transferring technology. FDI also raises economic efficiency by promoting industrial restructuring. Therefore, FDI has been used as a driving force in the economic growth of many countries. Especially since Korea's financial crisis in 1997, FDI has been one of the tools of economic recovery by helping resolve foreign currency shortages and aiding corporate restructuring.

Since Korea's financial crisis in 1997, FDI has been one of the tools of economic recovery by helping resolve foreign currency shortages and aiding corporate restructuring.

FDI in Korea has been growing since 1997. By UNCTAD statistics, Korea ranks third in Asia in FDI inflow. China ranked first with \$40.4 billion in 1999, accounting for 10.7% of total FDI to Asia.

By UNCTAD statistics, Korea ranks third in Asia in FDI inflow.

According to statistics from the Ministry of Commerce, Industry and Energy, FDI to Korea amounted to \$15.5 and \$15.7 billion in 1999 and 2000 respectively. There were 4140 reported FDI cases in 2000, about four times the number in 1997. This shows the rapid increase of FDI to Korea.

There have been some worries about the escape of national wealth through FDI. But the positive effects outweigh the negative, as Korea's foreign currency holdings are increased and advanced management methods are learned.

Table 1. Yearly FDI Performance

(units : \$ million, cases, %)

	1994	1995	1996	1997	1998	1999	2000	2001.1-2
Amount	1,317	1,941	3,203	6,971	8,852	15,541	15,690	3,706
(Increase)	(26.1)	(47.8)	(64.5)	(117.6)	(27.0)	(75.6)	(1.0)	(111.8)
Cases	646	873	967	1,055	1,400	2,102	4,140	508
(Increase)	(41.0)	(35.1)	(10.8)	(9.1)	(32.7)	(50.1)	(97.0)	(-9.1)

Source: Ministry of Commerce, Industry and Energy

Stable inflow of foreign currency and employment creation effect

FDI accounted for about 20% of Korea's usable foreign currency reserve during 1998-1999.

FDI accounted for about 20% of Korea's usable foreign currency reserve during 1998-1999. In addition, while the production growth rate of Korean companies decreased by 2.3%, that of foreign companies increased by 9.4% in 1998. This shows that foreign companies played a substitute role in production. Also important is the employment creation effect of FDI. According to a study by the Korea Institute of Economics and Trade on FDI policy in the global economy in 2000, FDI created 1,400 jobs per \$100 million. Foreign companies have also contributed to the national economy through R&D activity. The Korea Industrial Technology Association stated that in 1999, the share of foreign-owned research institutes out of the 4,810 research institutes in Korea was 9.9%. Also, R&D expenditure by foreign companies amounted to 2.5 trillion won in 1999, or 24.7% of total R&D expenditure in Korea.

From quantitative growth to higher investment quality

The rapid growth of FDI in Korea was due to a policy to promote FDI after the IMF financial crisis.

The rapid growth of FDI in Korea was due to a policy to promote FDI after the IMF financial crisis. The Foreign Investment Promotion Act, which was passed in September 1998, created the infrastructure for FDI. The launch of the Korea Investment Service Center at the Korea Trade-Investment Promotion Agency in April 1998 supported foreign investors doing business in Korea.

FDI policy showed a shift in 2000. It focused on improving the software aspect of investment promotion institutions by enhancing industrial competitiveness and the living environment. The new policies focused on core strategic industries, venture companies, and customer satisfaction, as well as enhanced living conditions for foreigners through better residences, education and healthcare.

Table 2. Shift in FDI Policy

<After the Financial Crisis>	<21st Century>
<ul style="list-style-type: none"> · Increasing foreign currency holdings, promoting restructuring · Hardware side(providing buildings, incentives) · Centralized authority · Focusing on Korean Operation 	<ul style="list-style-type: none"> · Improving competitiveness, Globalizing the economy · Software side(enhancing management, living conditions) · Central and local collaboration · Promoting role as east-Asia hub

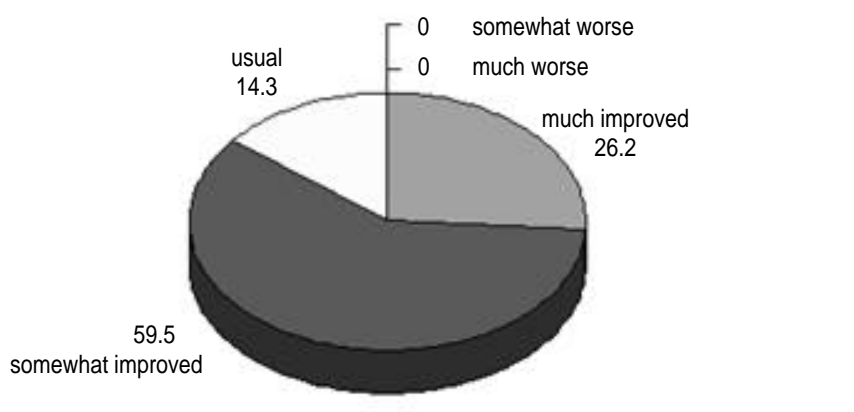
Improved investment conditions, but competition is also strong

In a survey of foreign companies' attitudes, foreign firms pointed out that investment and management conditions have been improved, but the labor sector needs continuous restructuring.

85.7% of foreign companies in Korea said that investment and management conditions have improved. And they have positive views about the Korean government's measures to recover from the financial crisis. However, some bottlenecks include labor and management relations (mentioned by 40.5% of respondents) and irrational business practices (23.8%).

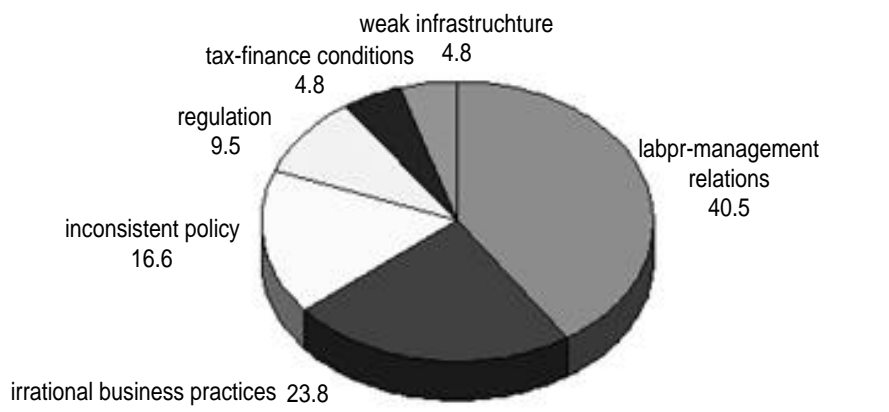
85.7% of foreign companies in Korea said that investment and management conditions have improved.

Figure 1. Change in Investment Conditions for Foreigners (unit: %)



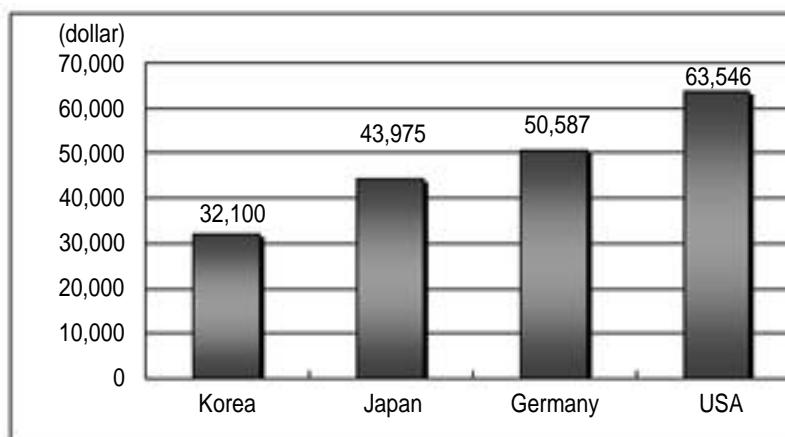
Source: Korea Chamber of Commerce & Industry, Survey of Attitudes of Foreign Investing Companies, February 2001.

Figure 2. Bottlenecks for Business in Korea (unit: %)



Source: Korea Chamber of Commerce & Industry, Survey of Attitudes of Foreign Investing Companies, February 2001.

— Figure 3. International Comparisons of Labor Productivity (1998) —



Source: Korea Productivity Center, The International Comparisons of Productivity, December 2000.

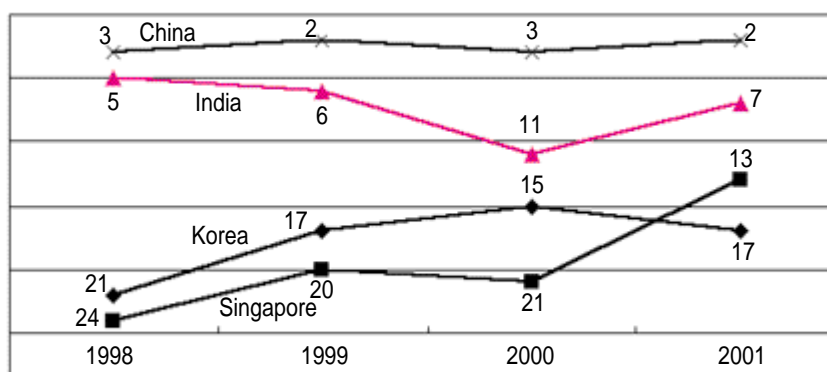
The relatively weak investment conditions in the labor sector were revealed in the comparisons of labor productivity.

The relatively weak investment conditions in the labor sector were revealed in the comparisons of labor productivity by the Korea Productivity Center. In the International Comparisons of Productivity, the productivities of 12 OECD member country were measured. Korea's value added labor productivity was 50.5% of the USA's, and 73.0% of Japan's.

In the A.T. Kearney FDI Confidence Index, which used primary data from a survey of senior executives of the world's 1000 largest corporations, Korea ranked 17th in 2001.

In the A.T. Kearney FDI Confidence Index, which used primary data from a survey of senior executives of the world's 1000 largest corporations, Korea ranked 17th in 2001. This was a fall from 15th in 2000. Korea's rank lags behind those of other Asian countries such as Singapore and China.

— Figure 4. FDI Confidence Rankings, 1998-2001 —



Source: A.T. Kearney, FDI Confidence Index, 2001.

These results reflect Korea's institutional improvement after the 1980's, such as tax incentives and various support for FDI, simplified procedures, and liberalized business sectors. However, the ineffectiveness of institutions, negative public attitudes, and the living environment were cited as the bottlenecks to investment. In addition, the one-stop service for FDI was not sufficiently enforced, labor-management relationships were unstable, labor practices were irrational, and laws lacked transparency. The shortage of foreign schools and lack of living space and healthcare facilities were also pointed out problems.

The ineffectiveness of institutions, negative public attitudes, and the living environment were cited as the bottlenecks to investment.

Improving investment attractiveness is essential

Since both developed and developing countries are trying to attract FDI, the competitiveness of investment conditions is important. This is especially true for Korea, which is undergoing a structural transition from labor-intensive industry to knowledge-based industry.

As mentioned above, Korea's FDI environment has improved. And the government has shifted its policy focus from quantitative growth to improving industrial competitiveness. This policy shift was to enhance the effectiveness of foreign invest. But because other countries are also trying to promote FDI, Korea has to raise the effectiveness of its investment promotion activities. First, investment attractiveness should be raised to induce more FDI. Now that the institutional system for FDI promotion has been created, the government should focus on effectively managing the system. One method to enhance R&D efforts is to encourage cooperation between industry and academia. The created knowledge should be diffused and be made available to foreign companies. Problems such as inconsistent policy or irrational business practices, should be corrected. Efforts should also be made to improve overall quality of life for foreigners working in Korea.

Because other countries are also trying to promote FDI, Korea has to raise the effectiveness of its investment promotion activities.

Second, Korea needs to create an optimal environment for foreign companies as a followup to its investment policy. India promoted education in information technology, which has resulted in investment by the world's top companies. Korea also needs to prepare for all conditions, including skilled labor, infrastructure, and living standards, to promote high value-added investment.

The advantages of Korea as an investment area need to be adequately publicized internationally. Currently, Asia has the world's highest growth potential. In addition, Korea is located near China, which has a larger market and growth potential than any other Asian country. Considering this point, Korea can be an optimal bridgehead to the vast Chinese market. Besides the locational advantage, Korea has highly skilled labor and technology that is comparable to any other Asian country, which makes it a promising production base for high value-added goods. **VIP**

The advantages of Korea as an investment area need to be adequately publicized internationally.