

London Business
School



Prospect for Korean Economy & Investment Environment

March 14, 2005

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. Introduction

It is a great pleasure for me to speak at the London Business School, which has an international reputation and a long cherished history.

I heard that last January, the Financial Times rated the London Business School one of the top MBA schools in the world, and in fact, the top school outside the US. For this achievement, I congratulate all the students, administrators, and the faculty.

In Korea, more than 80 alumni of London Business School are making great contribution to the nation's economy and the academic circles.

On a personal note, I feel quite close to Europe, which is like a second home to me. As a Commercial Attache, I stayed in Brussels more than four years from 1994 to 1998, and witnessed firsthand the expansion of the EU and the growing mutual understandings within the Union.

The EU's expansion and strong partnership are opening a new chapter in the history of the global economy and politics.

From a political perspective, such developments will bring peace and stability not only to the EU, but also to the world.

From an economic perspective, they will open the EU in particular and the world in general to free trade.

European countries including the UK have developed political, diplomatic, and economic ties with Korea over the last century.

As an old saying goes, “A friend in need is a friend indeed,” Europe has always stood by Korea through thick and thin.

I believe that in the years to come, Korea and the EU will work together in close partnership in all areas ranging from trade, investment, politics, security, to culture.

II. Korea-UK Relations

The UK was the first European country with which Korea established diplomatic ties and since concluding trade agreement in 1883, the UK and Korea have maintained diplomatic and economic cooperation for 120 years.

And the ties between our two countries were strengthened by the first state visit to Korea in 1999 by Queen Elizabeth and the state visit to the UK by President Roh last December.

Korea and the UK have been working together across the board from economy to culture and to politics.

For example, an increasing number of young Koreans are visiting the UK to learn English or to pursue their studies, and this is helping to foster deeper mutual understanding.

In addition, Korea and the UK have closely cooperated with each other based on complementary economic structures. As a result, in 2004, the UK became Korea's second largest trading partner in Europe and third largest foreign investor.

III. Korea-UK Investment Relations

Many foreign investors are turning their eyes to Korea. I believe that many leading foreign companies show interest and make investments in Korea because of the nation's potential and bright future, competitive industrial structure, IT and logistics infrastructure.

UK companies do not remain on the sidelines. As I mentioned, the UK is Korea's third largest foreign investor among EU countries. Many UK companies such as British Tobacco and Prudential, TESCO, AMEC have entered the Korean market and they are up and running.

A case in point is TESCO. Since TESCO came to Korea in 1997 and opened its first Homeplus in Daegu, it has emerged as a strong leader in Korea's retail market with 30 branches and the sales of 2 billion dollars.

Subsequently, Korea topped the list in terms of TESCO's overseas sales and investment, and TESCO held its board of directors meeting in Korea last year.

Meanwhile, leading Korean companies such as LG Electronics, Samsung Electronics, and HUMAX also have a presence in the UK market and are doing brisk businesses.

IV. Prospect for the Korean Economy

1. Overcoming the 1997 Asian Financial Crisis

Korea is a country that experienced dramatic changes. Since 1960, the Korean economy has grown at the fastest rate that is unseen in the world.

In 1997, however, with skyrocketing interest and foreign exchange rates, Korea faced the Asian Financial Crisis and received an IMF bailout package.

At the time, more than 20,000 businesses went bankrupt and over 2 million workers lost their jobs with the unemployment rate reaching 8.7%.

Fortunately, Korea successfully overcame the crisis and is now on the road to sustainable economic growth, a result of far-reaching restructuring measures and popular participation.

In particular, ordinary Koreans joined the government efforts in coping with the crisis by voluntarily donating their gold jewelry valued at 2.2 billion dollars, an amount which moved the international price of gold.

2. Economic Achievements in 2004

In 2004, despite unstable oil and raw material prices and the sharp appreciation of the Korean Won, exports rose by 31.0% to \$253.8 billion from 2003. This was the second-highest rate increase after China

Trade surplus reached \$29.4 billion, making Korea the fourth largest

holder of foreign reserves, which stood at \$199 billion as of December 2004.

Foreign investment in Korea reached \$12.8 billion last year, with the accumulated amount recording \$100 billion.

It is notable that foreign investments made qualitative as well as quantitative progress. For example, Royal Philips of the Netherlands invested in Paju, which is not far from the Demilitarized Zone, and Sony of Japan launched seventh-generation LCD production lines in Korea.

Such developments are an encouraging sign that foreign investors are confident in the Korean economy.

As a result, amid sluggish domestic demand, the Korean economy registered a 4.7% growth rate, which is relatively higher than the average real GDP growth rate of 3.6% among OECD member countries.

Of course, Korea's growth may pale in comparison to growth rates of BRIC economies. However, Korea's economic growth is all the more remarkable in light of its per capita GDP.

3. Economic conditions and prospect for 2005

There are a few external and internal conditions to which the Korean economy must respond well in order to maintain stable and sustainable growth.

(1) External Conditions

Let me first discuss external conditions.

First, the rise of regionalism and the creation of economic blocs.

According to the WTO, there are a total of 162 RTAs, 62% or 101 of which are FTAs as of January 2005.

In addition, trade volume between FTA countries is expected to represent 51.2% of the total trade in the world.

In response to this trend, Korea signed FTAs with Singapore and Chile, and is planning to expand FTAs to include other countries.

Korea has been under FTA negotiations with Japan, and plans to open talks with ASEAN, EFTA and Canada, and is scheduled to launch joint studies with Mexico, India, Russia, and Mercosur. In the mid-to-long term, Korea aims to conclude FTAs with major economies, such as the US, the EU, and China.

Second, trade imbalance and the won appreciation. The strength of the Korean won vis-a-vis the US dollar continues to cloud the outlook for Korean exports.

Third, the rise of China. Since China opened its markets, it is emerging as the world's factory as well as the world's market place, with an annual growth rate of more than 9%. Korea, however, is successfully turning such challenges into opportunities.

Fourth, fluctuating raw material prices and oil price hikes. Though raw material and oil markets have shown signs of stabilizing recently, they continue to pose major concerns for Korea, which relies heavily on resource imports.

(2) Internal Conditions

Let's move onto internal conditions.

First, economic bipolarization. Korean economy has a huge gap between large conglomerates and SMEs, IT and non-IT industries, export-driven and domestic demand-oriented industries, the metropolitan areas and other regions.

Second, sluggish capital investment and weak job creation. In particular, the manufacturing sector has been slow in absorbing jobs.

Third, labor shortages. Despite high unemployment rates, industries have difficulties in finding technical experts, and SMEs also suffer severe shortage in skilled labour.

Fourth, declining birth rates and aging society. The graying society and its impact are raising concerns in the long run.

(3) Economic Forecast

Korea will make every effort to achieve an economic growth rate of 5% this year and create 400,000 jobs while successfully addressing internal and external conditions.

In particular, domestic demand, which had been depressed until last year, is expected to recover in the second half of the year with domestic consumption reaching 2.2%-2.4% and capital investment marking 5.5%.

Trade and foreign investment, two major engines behind economic growth, are expected to be strong with exports recording \$285 billion and imports \$257 billion. The Korean government will try to attract foreign investment worth \$12 billion, the same level as last year.

4. Key policy directions

The Ministry of Commerce, Industry and Energy, which I head, is committed to policies that increase economic vitality and foster growth potential industries in order to transform Korea into an advanced trading nation with a sustainable economy.

(1) Economic vitality

Various policy measures are being taken to boost economic vitality which is essential to continued industrial growth.

First, unwavering support for SMEs and start-ups.

SMEs serve as a backbone of the Korean economy, accounting for 86.7% of employment, 50.8% of production, and 39% of exports. However, due to a lack of innovation capability, the gap between SMEs and large corporations is widening.

In order to strengthen SMEs' competitiveness and foster strong SMEs, Korea plans to encourage large corporations and SMEs to form reciprocal partnerships and will extend support for start-ups.

Second, focus on corporate investment and job creation

It is important to foster corporate entrepreneurship. Amid increasing uncertainties and corporate restructuring drive, companies postponed their investment in recent years, which led to insufficient job creation.

Fortunately, however, corporate investment, mostly by large corporations, are picking up this year on hopes of economic recovery.

In order to encourage corporate investment, the government will do its best to create a business-friendly environment, to provide various incentives, and to promptly address business concerns.

Third, regional innovation and balanced national development.

Korea has a higher concentration of population, economic activities, and GRDP in the capital area than any other countries.

In this regard, Korea is following in the footsteps of the UK, which has already set a great example in regional innovation and balanced national development.

To reduce excessive concentration of economic resources, the government will foster strategic industries based on regional characteristics and create innovative clusters which can attract companies based in the capital area.

(2) Future growth potentials

Korea has a competitive edge in flagship industries such as shipbuilding (the world's 1st), semiconductor (3rd), digital home electronics (5th), steel (5th), and automobiles (6th).

Amid fierce global competition, however, Korea is continuing to identify new growth potentials and to develop the parts/materials industries as well as the knowledge-based service industry.

Accordingly, Korea is setting policy agenda as follows, with an utmost priority on growth potentials.

First, competitiveness of growth potential industries.

The government will help flagship industries - shipbuilding, semiconductor, digital home electronics, steel, automobiles - move up the value chain so that they can continue to serve as focal industries for Korea.

Thanks to technological development, new industries with high growth potential - futuristic automobiles, AI robots, next-generation fuel cells - will soon make significant contribution to the Korean economy.

Second, development of the parts and materials industries

Currently, large corporations and SMEs are working together to advance the parts and materials industries where Korea needs to improve.

Korea also has priority on developing related core technologies, considering that parts and materials are decisive factors in competitiveness of the manufacturing industry. Such an emphasis will help narrow the gap between large corporations and SMEs and guard against a structural overhaul of the Northeast Asian economy.

In particular, efforts will be made to attract leading foreign companies in the parts and materials industries.

Third, competitiveness of the service industry.

The government will promote the development of the knowledge-based services such as e-business, distribution/logistics, and design, which are directly associated with the manufacturing industry.

Though the service industry is growing, its share in Korea's national economy as well as its competitiveness and productivity are all lower than those of other OECD members.

In particular, the development of knowledge-based industries -- consulting, design, accounting, legal services -- is necessary for the Korean economy to move forward.

For these reasons, the Korean government is taking steps to improve productivity in these industries through advanced training and increasing expenditures in R&D.

(3) Advanced trading nation

As the industrial and trading environment changes rapidly around the world, Korea is adopting a new paradigm in response to the global trends.

Korea is the world's 11th largest economy and Korean companies are entering and making headway in overseas markets.

As I mentioned earlier, countries are active in their discussions at the multilateral level, including at the WTO, and at the same time, are seeking to conclude FTAs.

To respond to the changing trading environment, Korea is pursuing an advanced trade strategy.

The Korean government will pursue FTAs with a number of countries and actively participate in the WTO DDA negotiations to accelerate the opening of the Korean economy.

To create a business climate that matches the size of its economy and which is conducive to domestic and foreign companies' activities, relevant laws and institutions are being adapted to conform to global standards.

(4) Sustainable economy

Korea is the world's 10th largest energy consumer. It is also the 7th largest oil consumer and 4th largest importer of crude oil. For my country, energy is a top priority.

The global competition to secure resources has recently become intense. International environment regulations have become tighter as the Kyoto Protocol came into effect last month. Sustainable economy is also a goal that can no longer be put on the shelf.

Korea is trying to build a framework for energy cooperation among Northeast Asian energy consumers including Korea, China and Japan, and resources-rich nations like Russia.

To actively embrace changes in the global energy structure, Korea is seeking strategic cooperation with countries which have abundant resources.

One of the reasons I am visiting the UK is to attend the Energy/Environment Ministers' Meeting tomorrow.

Korea will continue to endeavor in reducing greenhouse gases to comply with the Climate Change Convention.

To this end, it will establish the base from which the shift to a hydrogen economy will be made, and concentrate on the development of new and renewable energy.

V. Korea's FDI Policy

1. Importance of foreign investment

Let me now touch upon Korea's foreign investment policy.

In order for Korea to recover its economic vitality, transform itself as a business hub of Northeast Asia, and achieve a per capita income of \$20,000, attracting foreign investment is crucial, and its importance cannot be stressed enough.

As mentioned previously, foreign direct investment, or FDI, was instrumental in Korea's overcoming the 1997 financial crisis as well as making its economy stronger.

During the crisis, the Foreign Investment Promotion Act was enacted to open Korea's doors to foreign investment. Previous FDI policy, which focused on the foreign exchange management, now aimed to promote investment and to improve relevant laws and institutions.

As a result, FDI since the crisis accounts for more than 75% of the total inflow from the past 40 years, demonstrating the significance of FDI in the national economy.

2. FDI policy

I turn my attention now to Korea's investment promotion measures and future FDI policy direction.

(1) Invest KOREA

To attract FDI, the government established Invest KOREA in 2003 as an agency in charge of investment promotion.

I would like to note that Korea had benchmarked Invest UK in setting up this agency.

What's more, a non-Korean national was named to head up Invest KOREA, and he happens to be from the UK. Mr. Alan Timblich has been working hard to promote Korea sending missions overseas.

Invest KOREA was established to promote seamless cooperation among central government ministries and local governments.

It provides comprehensive support to investors from the initial stage of investment decision-making process to the post-project management, helping them to find potential projects, dispatching investment missions and giving investment advice.

(2) Investment incentives

Korea is a country with high labor costs when compared to its competitors like China. Thus, diverse incentives have to be offered to attract investment.

Tax reduction is given to foreign companies in high-tech industry, industry-supporting service industry including R&D centers and firms in Foreign Investment Zones.

Companies bringing in large-scale investment are designated Foreign

Investment Zones, and are given not only tax reductions, but also free lease of industrial sites.

In addition, depending on the size of investment or number of employees, investors in the high-tech industry are given Cash Grants.

(3) Improvement of foreigners' business and living environment

Incentives alone are not enough to attract FDI. Foreign investors should not experience inconvenience with their business and living environment.

To drastically improve the investment environment, the Korean government identified 151 tasks that had to be addressed most urgently and laid out measures to make improvement.

For example, to address foreign children's education issue about which investors are most concerned, world-class foreign schools are currently being built in downtown Seoul and in the Free Economic Zone.

To simplify immigration procedures for foreign investors, special immigration desk has been created at the Incheon International Airport, earning their praise. Foreigners' unit will be designated in hospitals to provide better medical services to foreigners.

Of course, from a foreign investor's perspective, these efforts to improve the business and living environment may not be 100% satisfactory. But when all 151 tasks are completed in a few years' time, they will experience a different and changed Korea.

(4) Labor relations

Korea's labor issues have been the largest obstacle in attracting FDI.

It is true that because of its hard-lined unions, Korea has a negative image when it comes to labor relations.

The Korean government is making diverse efforts to bring about cooperative labor-management culture.

First, within Invest KOREA, there is a special team in charge of labor relations at foreign-invested companies.

It has selected 50 firms and provides them with intensive support and hosts regional meetings to discuss ways to stabilize labor relations.

When investment missions are dispatched overseas, representatives of labor unions are included to effectively publicize how Korea's labor situation has changed.

Labor relations are improving thanks to cooperation among labor, management and government, and I am confident that it will only become better in the years to come.

3. Korea's strength as an investment destination

Korea has many strengths as an investment destination. First and foremost, Korea possesses a highly-skilled workforce, which could be immediately put to use in making high-quality, sophisticated products.

In terms of the IT infrastructure, Korea's high-speed communications network is among the best in the world, and its Internet penetration rate

ranks in the second place among the OECD members.

Among other things, Korea is located at the center of huge markets, namely China, Japan and Russia, making it an important geographical base in Northeast Asia.

In particular, China is Korea's competitor and at the same time a huge market with an enormous purchasing power, presenting Korea with infinite opportunities. So, foreign companies in Korea could tap on this exporting market.

In the long-term, for these companies, Korea serves as the middle base to make inroads into China.

The Korean government is well aware that the surest strategy to attract foreign investment is to ensure that foreign investors are successful.

It will continue to work hard so that more foreigners will decide to invest in Korea upon seeing success stories.

VI. Conclusion

The UK was the first in the world to adopt democracy and implement the open-door policy.

It successfully overcame labor issues of the late 1970s and early 1980s and the foreign exchange crisis of the 1990s.

Like the UK, Korea too experienced many political, economic and societal changes in the past several years.

World history shows that countries that achieved rapid growth and prosperity placed their priority in opening their doors and promoting international cooperation.

As I mentioned before, Korea will do its utmost to become an advanced trading nation that contributes to the international community, matching the size of its economy.

In the process, the UK which experienced many things earlier than Korea and coped with them successfully, will be a good role model.

Personally, I am indeed pleased to give this lecture, because before being appointed the Minister of Commerce, Industry and Energy, I served as the President of Seoul National University of Technology until December 2003.

My experiences in dealing with the real economy led me to stress to students the importance of on-site education and teaching in industries.

As I look at the bright and eager students gathered here, I remember how much I then envied the young adults who studied hard and had a great future ahead of them.

I have no doubt that your creativity and passion will make you movers and shakers of not only the UK but also the world. I wish all of you the best of luck.

I would like to thank again the officials of London Business School for organizing this meaningful event, and wish you a good health and happiness. Thank you very much.