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Toward Liberalization of International Direct Investment in Korea: Retrospects and Prospects

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Contents

Tables & Figures

I. Introduction

The Korean government has implemented various liberalization measures for foreign direct investment (FDI) as one of the main sources for fostering economic development. FDI, particularly in high-tech industries, has been recognized as a catalyst to facilitate industrial restructuring of the Korean economy. Furthermore, it would also enhance Korea's competitiveness in the international market since FDI tends to bring with it various advanced technologies. Liberalization of FDI in Korea has been paralleled by the government's efforts to improve the domestic investment environment. Foreign firms operating in Korea have increasingly been given equal protection and fair treatment comparable to domestic firms, and foreign investors are now allowed to participate in a wider range of investment activities than ever before. All of these have resulted in freer and fairer competition in the Korean economy.

Korea's voluntary undertaking of FDI liberalization would not stop here. The Korean government is planning to pursue further improvement in FDI environment by improving relevant rules, regulations and procedures to conform with international standards. A new Foreign Direct Investment Law, which will be introduced before the end of 1996, will set the principles for liberalization of FDI and deal with comprehensive incentives for and the protection of FDI. This new law will be a milestone for institutional reform designed to build a better investment environment in Korea.

In what follows, chronicles of Korea's liberalization policy for international direct investment, both inward and outward, and its future policy directions will be presented. Section II deals with an overview of the Korean economy and discusses the role of FDI in Korea's economic development. Section III examines the FDI policy in Korea followed by review of Korea's overseas direct investment (ODI) policy in Section IV. Finally, Section V concludes the paper.

Ⅱ. Overview of the Korean Economy and the Role of Foreign Direct Investment in Korea

The 1995 Nobel Prize winner, Robert E. Lucas Jr., professor of economics at the University of Chicago, explored the sources of the miraculous growth of the Korean economy in a theoretical journal of economics in 1993.[1] He emphatically concluded that the main engine of Korea's remarkable economic growth has been the on-the-job accumulation of human capital while physical capital accumulation has played an essential but secondary role. Paul Krugman, a leading international economist at Stanford University, is not an ardent admirer of East Asia's economic miracle.[2] He argued that the newly industrializing countries of the Pacific Rim, including Korea, have received rewards for their extraordinary mobilization of resources, but that there is no secret to the East Asian Growth. Despite contrasting viewpoints of the two eminent economists, it is clear that Korea's success story has drawn wide attention from many prominent economists and policy-makers throughout the world. The discussions by these scholars would serve as relevant and useful references to help understand diverse aspects of the Korean economy. However, Korea's dramatic transformation is still not fully grasped by the Koreans themselves.

Half a century ago, in 1945, Korea was liberated from the Japanese colonial rule. No doubt, Korea was one of the poorest countries in the world at that time. Furthermore, the division of the Korean Peninsula caused great pain and sorrow to many Koreans. The Korean War, which erupted shortly after the independence, left Korea with economic devastation. Nevertheless, there remained a firm belief among Koreans not to give up hope. Koreans worked hard not merely to escape from poverty that had distressed the Korean for a long period of time, but also to achieve

1) Lucas (1993) emphasizes that it is in no way an exaggeration to refer to continuing transformation of the Korean economy as a miracle.

2) Krugman (1994) concludes that if there is a secret to Asian growth, it is simply deferred gratification, the willingness to sacrifice current satisfaction for future gain.

economic independence as a sovereign state.

Due to a weak industrial foundations and vulnerable financial capabilities, Korea relied on foreign assistance for the nation's economic reconstruction. In the late 1950s, Korea showed a set of chronic problems normally associated with import substitution: market saturation, low levels of manufactured exports, high dependence on imports, and balance of payments deterioration. Furthermore, cuts in U.S. longer-term financial aid forced Korea to seek alternative sources of foreign exchanges. Accordingly, economic reforms in a more outward-looking direction were followed primarily in exchange rate and import-control systems.

The adoption of an outward-looking development strategy in the 1960s triggered the take-off of the Korean economy.[3] The government policy has been since then a key ingredient in the entire process of Korea's economic development. However, the hallmark of Korean economic policy has been the feedback mechanism through which policy mistakes are rapidly corrected. Faced with continuing advent of external shocks, the Korean government has been constantly keen to changing international environment in its policy formation.[4]

The new emphasis on the export-oriented growth strategy went hand in hand with the welcoming of foreign capital to finance economic development. Active mobilization of financial resources from home and abroad in conjunction with Korea's high-quality, low-cost manpower allowed Korea to exhibit a dramatic growth performance. Nevertheless, Korea's industrialization was based on national enterprises in the course of outward-looking development. State-owned enterprises and heavily government supported domestic firms were designed to prevent the domination of major industries by foreign firms.[5]

3) According to Fei and Ranis (1975), Korea experience the take-off in the early 1970s in the sense of dualistic economy.

4) See Amsden (1989, 1995), and Auty (1995) for further discussion.

5) Among East Asian countries, government intervention via state-owned enterprises has been

In the 1970s, advanced countries began to raise trade barriers against exports of labor-intensive goods from developing countries. This prompted the Korean government to turn to the promotion of heavy and chemical industries. Excessive government intervention in resource allocation through taxation, financing and restriction of imports brought about inefficiency in the financial sector and a concentration of economic power. Excessive government support resulted in a drastic increase in the money supply. The oil crises also caused economic difficulties, accelerating inflation, weakening cost advantages of exports, undermining growth potential and aggravating the current account imbalance.

During the period of worldwide recession in the early 1980s, the primary goal of Korean government's economic policy lay in the economic stabilization. Since 1982, inflation has been tamed drastically. By the mid-1980s, relatively uniform incentives, rather than selective preference for a few targeted industries, were reinstated as the main economic policy instrument for resource allocation among industries. The success in government's attempt to relieve inflationary pressures had a positive effect on Korean exports.

The period between 1986 and 1988 witnessed the emergence of a sizable current account surplus. This led to the acceleration of import liberalization in Korea. The favorable balance of payment condition also paved the road for more active liberalization measures in other areas. Since 1989, however, the balance of trade has returned to annual deficits due to a number of reasons, including increasing pressures for market opening from developed countries, the currency appreciation and wage increases. A noticeable response to these changes is further liberalization rather than a recourse back to import-substitution.

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much more significant in Taiwan, Malaysia, and Indonesia than in Korea and Thailand.

New Liberalization Policies in the 1990s

Faced with declining competitiveness of manufacturing exports in the late 1980s, partly due to rising costs of production, the Korean government and private business elite recognized the need for technology enhancement in mid-technology industries. External and internal pressures intertwined together to trigger Korea's adoption of a new policy direction toward further liberalization.

First of all, there were intensified pressures for market liberalization from Washington, Brussels, and Geneva while the Uruguay Round of trade negotiations was in progress. These pressures increased even further with the completion of the UR negotiations. Broad coverage of the UR agreements made liberalization unavoidable for the countries engaged in multilateral trade, particularly for Korea whose economic growth is sensitive to external conditions.

Second, local business groups grew to become global players, demanding more vigorously government deregulation. As Alexander Gerschenkron (1962), the Harvard economic historian, put it in words, the government interventions in economic activities would be inevitable in the late starter's early stage of industrialization. However, Korea's post-industrialization period of the 1990s would not require as much government interventions as before.

Third, integration of national economies resulted in reducing the size of niche markets that individual economies had enjoyed for a long period of time. In general, comparative advantage based on national differences would determine the movement of goods and services across borders. However, technological superiority became more important in enhancing the competitiveness in higher value-added industries. Trade and Investment in the same industry became more prominent feature of international transactions. Foreign firms became more and more reluctant to share technology with Korean firms, as the gap in the technological capability narrowed. Due to strongly enforced protection of intellectual property rights, local companies were no longer able to make use of foreign technology without permission of its original owner. However, Korea is still technologically less developed to engage in innovative activities in high-tech industries. Under these circumstances, the Korean government has chosen to encourage foreign direct investment in Korea, recognizing that the presence of high-tech foreign multinational firms in the local markets tends to encourage technology transfer.

In sum, Korea's switch to the outward-looking development strategy in the early 1960s had not been pursued consistently. The Korean government has at times accelerated or at other times contained liberalization of the domestic markets, depending on the external conditions. However, the basic tenet of the outward-looking development strategy has been maintained throughout the years, ensuring a right direction for economic development. It would not be an overstatement to say that Korea's outstanding economic performance has been driven solely by the government. Of course, the outward-looking strategy would not have been as effective as actually demonstrated by Korea unless the government gave adequate attention to building the infrastructure. The same would be true, had resources been unavailable for capital formation. In addition, an increasing number of well-educated and well-trained labor force, a reasonably well functioning labor market, and a myriad of other conditions and policy variables have also contributed to Korea's rapid economic growth.

The Role of Foreign Resources

Capital inflow is an additional resource available to a country in financing its economic growth. However, it has been acknowledged that there exist inherent risks on relying too much on external financing to accelerate economic growth. Foreign debt accumulation cannot be sustained indefinitely. There always exists a point at which debt accumulation is unsustainable. Without the efficient use of the foreign capital, therefore, a country would never make a smooth transition from a debtor economy to a self-sustained one. Observing that the vicious economic cycle of hyper inflation and stagnant economic growth in major debtor economies of Latin America was in part attributed to careless management of foreign capital inflows, the Korean government became very cautious when it was once ranked as the world's fourth largest debtor country in the early 1980s. Despite the potential risks of relying too much on foreign capital, a large portion of Korea's economic development has still been financed by external borrowings.

The contribution foreign resources ultimately make to economic growth and development hinges on the relationship they have with domestic savings and the quality of investment. Korea's economic development needed to be financed by foreign capital due to its inadequate domestic savings. Thus, the key question was about how to efficiently use foreign capital. In that sense, the Korean government intervened in the allocation of foreign resources in order to avoid duplication of investment by channeling the borrowed funds into expanding social overhead capital, including power and electricity, communication, roads and harbors, as well as strengthening the major strategic industries, such as iron and steel, petro-chemicals, and electric-electronics. Thus, foreign capital inflows have bolstered savings, investment, and growth in Korea.

There exist various types of foreign capital inflows and their impact on domestic savings, capital formation, and long-term economic development can be quite different. Despite their financial fungibility, various types of inflows are not perfect substitutes to each other. Inflows of foreign economic assistance, for example, are usually tied with specific projects and imports of specific goods and services. Foreign direct investment is thought to have much different effects on long-term economic development than does borrowing from international capital markets.

The way industrialization has been financed in East Asian countries has taken different forms. Korea relied on foreign borrowings, Singapore and Hong Kong on foreign direct investment, and Taiwan on tax transfers from the agriculture sector. Table 1 presents shares of East Asian countries' foreign direct investment in their gross domestic capital formation. It is clear from the table that foreign direct investment is merely a side show in capital formation of East Asian countries, except for smaller economies of Hong Kong, Malaysia, and Singapore. In response to rising domestic demand for more sophisticated technology, virtually all countries in East Asia have raised their reliance on foreign direct investment in the 1980s by relaxing various regulations that have restricted investment from abroad. However, liberalization of foreign direct investment has been implemented only selectively. Since the early 1980s, foreign firms have found it easy to establish greenfield operations in East Asia, but it is still difficult to carry out acquisitions of domestic firms through stock market transactions.[6)]

Figure 1 also shows the role of foreign direct investment in Korea's long-term capital inflows (see also Table 2 for regional comparisons). Until the mid-1980s, most of the long-term capital inflows needed for economic development was channeled through official loans, hence the role of foreign direct investment was not significant. Since the mid-1980s, however, Korea has been repaying its foreign debt, and foreign direct investment in long-term capital inflows has gradually increased its importance.

6) Foreign acquisitions of Japanese firms have been almost impossible until recently although Japan obtained its membership to the OECD in 1964. A number of reasons can be suggested. The Japanese private practices on corporate governance distinguished by cross share holdings are more important than other restrictive policy measures in explaining a few incidence of foreign acquisitions in Japan relative to those in the Western countries. For further reading, see Fukao (1995).

Table 1. **The Ratio of Foreign Direct Investment Inflows to Gross Domestic Capital Formation**

Country	1971-1975	1976-1980	1981-1985	1986-1991
China	0.0	0.1	0.9	2.3
Hong Kong	5.9	4.2	6.9	12.1
Indonesia	4.6	2.4	1.0	2.4
Korea (Rep.)	1.9	0.4	0.5	1.1
Malaysia	15.2	11.9	10.8	9.7
Philippines	1.0	0.9	0.7	5.7
Singapore	15.0	16.6	17.4	29.4
Taiwan	1.4	1.2	1.5	3.5
Thailand	3.0	1.5	3.1	6.3

Source: United Nations, *World Investment Report 1993*. Based on International Monetary Fund balance-of-payment statistics.

Table 2. **Net Foreign Resource Inflows into Developing Countries in Selected Region, 1986-1993** (US$ billion)

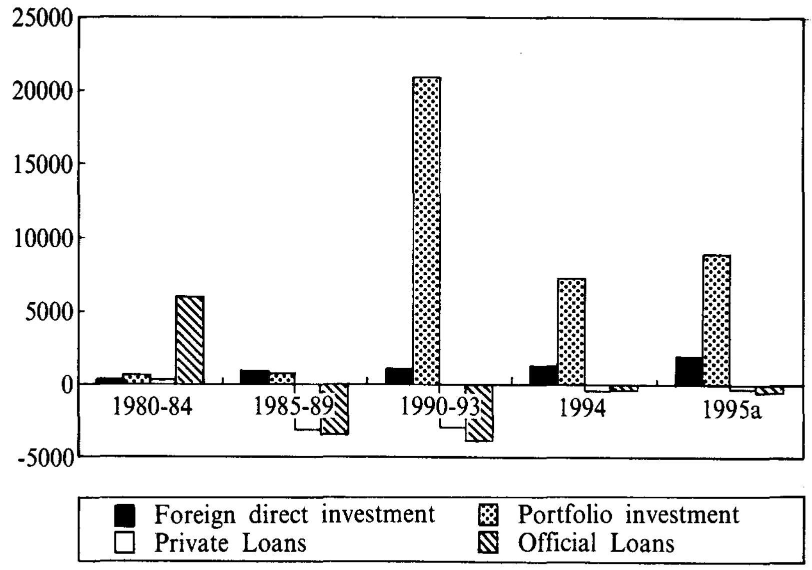
Type of flow	1986-1990 (Annual average)	1991	1992	1993[a]
South, East and South-East Asia				
Foreign direct investment	7.5	14.5	21.1	26.1
Portfolio investment	2.2	4.3	8.1	-
Private loans	2.8	8.9	15.0	-
Official Loans and grants	15.0	17.8	17.7	21.1
Total	27.5	45.5	61.8	72.3
Total, developing countries				
Foreign direct investment	16.9	30.0	38.9	-
Portfolio investment	0.8	12.7	13.7	-
Private loans	5.0	6.7	22.4	-
Official loans and grants	43.1	48.6	46.2	-
Total	65.8	98.0	121.1	-

Source: World Investment Report 1994, Table II.11., UNCTAD.

Note: a denotes estimation.

Figure 1. **Long-term Capital Inflows into Korea, 1980-1995**

(US$ million)



Source and Notes: See Annex table 1.

Less attention given by the Korean government to foreign direct investment can be explained as follows. First, since foreign direct investment is essentially intrusive of territorial sovereignty of a state, the Korean government has the fear that the economy would become dominated by foreign interests unless the Korean firms have competitive edges over their foreign rivals. Second, the Korean government would like to channel limited amount of capital resources to industries vital to long-term growth, while restricting capital flows into other non-productive areas. With this strategy in mind, the Korean government preferred foreign borrowings to foreign direct investment in which foreigners kept control of foreign resources.

However, the Korean government that took office in 1993 has renewed the movement toward liberalization and has been introducing deregulation programs to promote FDI. The speed of liberalization has been unprecedentedly fast. The government recognized the need to harmonize and liberalize its economy according to international standards and has initiated a broad policy direction called *Segyehwa*, which literally means "globalization." In particular, the government expressed its strong intention to create a more hospitable environment for foreign direct investment.

Foreign Direct Investment and Technology Transfer in Korea[7]

Despite a relatively minor role of foreign direct investment in Korea's economic development, we can find many cases where foreign multinationals have contributed greatly to the technological improvement of Korean firms. One of the most successful episodes, which reflects the role of foreign direct investment in the field of technology transfer, can be found in the Masan EPZ (Export-Processing Zone). About 9,000 workers and technicians in the Masan EPZ benefited from the opportunity of having an overseas training program until 1993. More importantly, subcontracting outside the Masan EPZ increased significantly, contributing to the value-added of products manufactured by foreign investors. These efficiency gains outside the EPZ, induced by backward linkages, emphatically reflect the existence of technology spillovers through foreign direct investment.

The development process of the Korean semiconductor industry also illustrates the important role of multinational corporations in the area of technology transfer. In the mid-1960s, U.S. firms (Comy, Fairchild, Signetics and Motorola) began to assemble transistors in order to take advantage of the cheap labor in Korea. Following the lead of U.S. firms, Japanese firms (Toshiba, Sanyo, and NEC) entered into joint ventures with Korean firms. Since the beginning of the 1970s, many Japanese firms producing parts have also established subsidiaries in the Masan EPZ. Before Korean firms emerged as competitors in the domestic market, foreign firms dominated the production and the export of semiconductor products. Subsequently, multinational corporations introduced wafer processing and IC pro-

7) This part is significantly borrowed from Byun and Wang (1995).

duction technologies, and the possibility of the development of domestic firms in this high-tech industry.

In the mid-1970s, many Korean firms entered the market by operating simple assembly plants of semiconductor products. However, fierce competition in the small internal market enabled only a few firms to survive. By the end of the 1970s, Samsung and Lucky-Goldstar had established firm positions in the semiconductor industry through mergers and acquisitions of domestic firms and joint ventures that went out of business. In the early 1980s, these big conglomerates invested heavily in equipment and R&D despite successive annual deficits, since they could internalize the risks of investment. By the mid-1980s, they began to produce highly sophisticated memory chips.

As Korean firms became more competitive in the production of memory chips, the relationship between Korean firms and foreign firms changed. During the early stages, domestic firms had made considerable efforts to catch up with foreign rivals in the domestic market. When the Korean firms established a dominant position in the domestic market, foreign firms tended to specialize in other subsectors of the industry where Korean firms had not yet acquired technological capabilities. The specialization of foreign firms in the high-tech sectors related to the production of memory chips has reduced technological bottleneck in the Korean semiconductor industry, and is expected to induce new Korean entrants in the non-memory sectors as technological know-how and expertise spill over to domestic firms.

Ⅲ. Foreign Direct Investment Policy in Korea

The basic direction of the Korean government's FDI policy is to foster further economic development by encouraging a worldclass industrial structure through FDI into high-tech manufacturing and service industries and by raising international competitiveness through the transfer of the state-of-the-art technologies. In addition, the government's aim is to provide foreign companies in Korea with protection comparable to that given to domestic companies and to open the domestic market wider to foreign investment so that free competition can prosper through market opening.

In this regard, the government promotes FDI by providing investment incentives to high-tech businesses and by improving the investment environment. Its policy is also to protect the rights necessary for foreign companies to do business in Korea. Transfer of invested capital and profits is guaranteed by law, and foreigners can expect national treatment except in a few cases where specifically prohibited by law.

The Korean government continues to pursue further liberalization in the area of FDI by conforming to international standards of investment protection, such as WTO/TRIMs, OECD Code and NTI (National Treatment Instrument).

1. Historical Overview of Foreign Direct Investment Policy

The role of foreign capital in Korea's economic growth has varied during the different phases of postwar development. The development pattern in Korea is characterized by a transition, first from a primary commodity exporter under colonial control, then to import substituting industrialization, and finally to a strategy of export-led growth. Now, Korea continues to pursue further outward economic development in order to join the ranks of advanced economies.

In contrast to Latin America, FDI played a negligible role in Korea during the early stages of its economic development. Manufacturing in Brazil and Mexico received substantial FDI in the 1950s, to serve large internal markets in line with an industrial strategy of expanding in consumer durables and intermediate goods.

Korea was then too small and politically risky to attract much investment interests. Furthermore, Korea's economic relations with Japan were severed altogether until normalized in the mid-1960s. Thus, the decade of the 1950s in Korea was characterized by the pursuit of an import-substituting industrialization strategy, financed largely by American aid. During this phase, new and existing Korean firms established strong positions in the domestic market free from competition, imports, and foreign investment.

In the late 1950s, a set of chronic problems normally associated with import substitution set in. As the United States sought to cut its longer-term aid commitments, Korea faced the task of earning foreign exchange. Significant economic reforms, primarily in the exchange rate and import-control systems, shifted the incentive system toward a more outward-looking direction.

Development of Foreign Direct Investment (1960～1983)

The new emphasis on an export-led growth strategy went hand in hand with the policies of welcoming FDI and establishing new relations with foreign buyers. In 1960 the Korean government enacted and implemented the Foreign Capital Inducement Act (FCIA) and related decrees. Since then, the FCIA has been one of the primary laws that regulate inward direct investments in Korea. FDI and subcontracting helped ease balance-of-payment difficulties, supply technology and expertise, and open the market channels required by an outward-looking development strategy. Foreign direct investors were welcomed to enter the light manufacturing export sector, but they were still discouraged from investing in import-substituting sectors.

Despite the increasing role of FDI in Korea's outward-looking development, Korea's industrialization was greatly based on national enterprises since 1965. State-owned enterprises and heavily government supported domestic firms acted as checks against foreign firms' domination in heavy industries.

A major change occurred in the early 1980s, as the Korean economy began to experience serious difficulties as a result of the negative effects of the Heavy and Chemical Industry Plan of the 1970s. The new industrial strategy, constituting a second outward turn, was based on an attempt to upgrade Korea's industrial structure as a whole by moving into more technology- and skill-intensive niches. A key component of this technological upgrading was to liberalize foreign investment rules.

In 1981, the discretionary control of foreign direct investment was eased by opening 427 types of industries to foreign ownership, constituting about 50% of all products in Korea's standard industrial classification system. In addition, the minimum investment level was lowered significantly, from US$ 500,000 to US$ 100,000, a move that met strong opposition from small- and medium-sized firms and paved the way for greater Japanese participation in the economy.

Liberalization of Foreign Direct Investment (1984～1992)

A fundamental FDI policy shift occurred in 1984. The Korean government replaced the positive list system with the negative list system. This increased the share of manufacturing subsectors open to foreign investment from 80% to 86%. Under the previous positive list system, FDI was allowed only in those sectors on the positive list subject to certain conditions. That gave the Korean government the ability to direct FDI to "priority industries" where it saw a need for foreign capital, technology, and general know-how. Those on the positive list generally included sectors which were conductive to "export promotion, import substitution, development of domestic natural resources, and large-scale projects listed in the five-year economic development plans.

Under the negative list system, all industries not listed were qualified for FDI approval. To liberalize further, the government implemented the *automatic approval* *system* which exempted certain categories of FDI projects from government screening before approval. This has since evolved into the prior notification system, whereby FDI in designated categories could be conducted as long as they met predetermined criteria.

The new investment rules permitted 100% foreign ownership in a large range of business categories. Before 1984, foreign ownership was limited up to 50% for only certain business categories. With the elimination of this restriction under the Foreign Capital Inducement Act, foreign invested ratios were determined by the parties concerned, except in cases where the foreign ownership was limited under individual laws.

In December 1989, various performance requirements imposed on foreign-controlled firms, such as export, local content, and technology transfer requirements, were abolished. At present, foreign-controlled firms can engage in their businesses freely without any performance requirements.

In 1992, business categories subject to notification were expanded to yield a notification-oriented system with approval as exceptions. Prior to 1993, however, the notification system was applied to projects in liberalized sectors that had foreign equity holdings of less than 50%. Since 1993, all liberalized sectors, with a few exceptions, have been covered by the prior notification system regardless of the foreign investor's equity share.

Further Liberalization of Foreign Direct Investment (1993 to Present)

The recent conclusion of the Uruguay Round negotiations has led to great changes in the international economic climate. Consequently, the need for the Korean economy to upgrade its industrial structure to enhance its international competitiveness is greater than ever. As a link to its pursuit of globalization in an international economy, the Korean government is pursuing a more active investment liberalization policy by expanding liberalization measures which have been implemented thus far.

In 1994, notification acceptance matters were delegated to foreign exchange banks, thus reducing the processing period for notification from 20-30 days to no more than 3 hours. The processing period for applications subject to approval was also reduced from 30 days to 5 days (15 days, if consultation with related ministries is required).

In February 1995, foreign investment procedures for trading firms, with the exception of Japanese trading firms, were simplified from the previous approval system to the notification system. In April 1995, the Korean government established a comprehensive service system for FDI by introducing an *One-Stop Service System* in Seoul and in the provinces. This improved system is now able to resolve grievances of foreign-controlled firms, arrange linkages to joint partners and provide comprehensive information and administrative services. In addition, the approval authority was transferred from the Ministry of Finance and Economy to other relevant ministries.

The Korean government also expanded the scope of the subject of FDI by amending the enforcement decrees related to Foreign Capital Inducement Act. It abolished the approval system applied to reinvestment of foreign-controlled firms which infringed on labor-related decrees, and allowed foreign investors to acquire stocks owned by domestic partners of existing foreign-controlled firms. Moreover, procedures for stock sales of foreign investors and for disposition of capital were simplified.

The Five-Year Foreign Investment Liberalization Plan (November 1995)

According to the Five-Year Liberalization Plan, restricted business categories are scheduled to be open to FDI in several stages from 1996 to 2000. By January of 2000, the number of restricted businesses will be brought down to 21, while 1,078 categories will be fully open and another 47 partly open to foreign investment. Those businesses in the open category fall under the ambit of liberalized investment. They are subject to a notification requirement that grants the government the authority to reject the application only for reasons related to maintenance of public order, the protection of public health, morals and safety, the protection of its essential security interests, or the fulfillment of its obligations relating to international peace and security.

Despite these liberalization commitments, the Korean government firmly believes that further liberalization in currently restricted business categories is necessary. In the foreseeable future, the government plans to speed up the ongoing process of liberalization, *inter alia*, by abolishing restrictions the objectives of which could also be achieved by non-discriminatory regulation, and by establishing a timetable for business categories not yet scheduled to be liberalized by 2000.

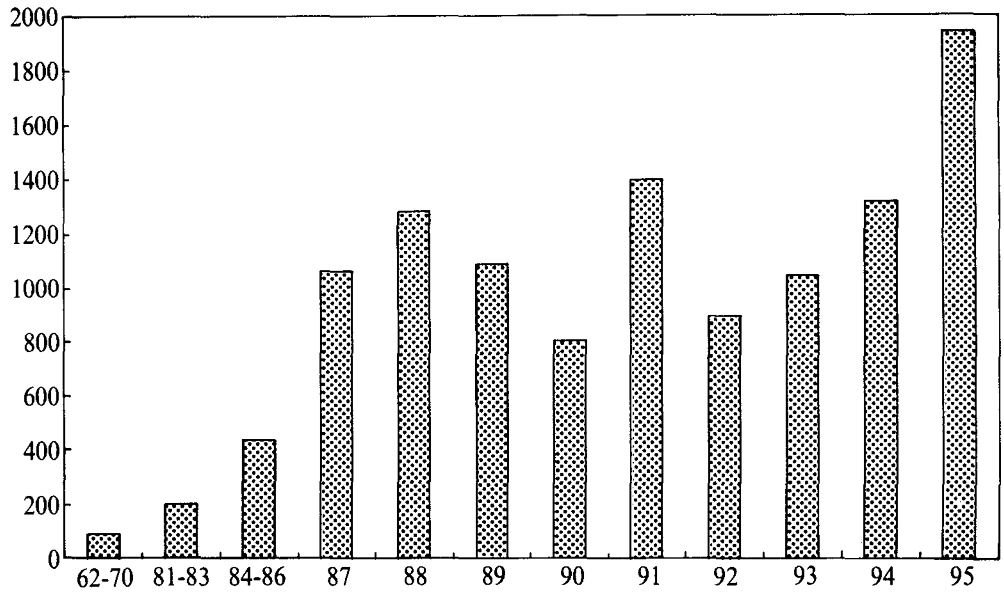
2. Trends in Foreign Direct Investment

The total foreign direct investment into Korea, during the period of 1962 to 1995, is depicted in Figure 2. From the 1960s to the mid-1980s, FDI in Korea showed no significant change. Since that period, however, FDI inflows into Korea has undergone a dramatic increase, from an annual average of little more than US$ 500 million to over US$ 1 billion.

The robust growth in FDI into Korea during the latter half of the 1980s is attributed both to the country's booming domestic economy and to the improved market access for foreign invested enterprises, owing to the implementation of foreign investment liberalization policies.

Figure 2. **Foreign Direct Investment Inflows into Korea, 1962-1995**

(US$ million)



Source: Ministry of Finance and Economy, Korea

Note: Figures before 1987 are annual averages for the corresponding period.

However, after peaking in 1988, FDI inflows into Korea has declined. The decline of FDI can be attributed to the following factors. First, increased labor disputes and the ensued wage hikes in the late 1980s made Korea less attractive as a source of low-cost labor. Second, rises in real estate prices and wages, and difficulties for foreign-controlled firms to procure funds in the domestic financial market worsened the business environment for foreign investors. Third, Korea's foreign investment climate was relatively less attractive than those of South-East Asian countries which had undergone great improvements in their investment climates after the second half of the 1980s.

After a brief period of setback, FDI inflows increased again in 1993, restoring the previous peak level of US$ 1.3 billion in 1994 and reaching US$ 2 billion in 1995. This increase was due to the Korean government's policy of FDI promotion which included the expansion of business categories eligible for FDI and simplification of its procedures.

Overall, the manufacturing sector was the largest recipient of FDI inflows into Korea, constituting a 60% in the total cumulated stock during 1962-1995. FDI into the primary sector (agriculture, fishing and mining) was insignificant with less than 1% of total FDI inflows.

Until the early liberalization period, FDI into the manufacturing sector took more than 65% of the total inward FDI. Since 1994, however, service sector restrictions to foreign investors lessened, and the relative importance of service sector in the economic activity rose. Accordingly, FDI into the service sector increased significantly so as to take the largest portion (69.5%) of the total FDI inflows in 1994. However, in 1995, the manufacturing sector's share increased again to about 50% due to the Korean government efforts to promote FDI, particularly in the field of high-tech industries.

In the service sector, restaurant and hotel businesses were the largest recipient of FDI with 44% of total FDI inflows during 1962-1995. However, the recent composition of FDI in the service sector has also changed. The share of FDI into the restaurant and hotel businesses reduced from 49.9% in 1984-93 to 27.2% in 1994-1995. On the other hand, the share of FDI into finance and insurance rose from 24.5% in 1984-1993 to 38.4% in 1994-1995.

Within the manufacturing sector, the chemical industry was the largest recipient of FDI with 33.2% of total FDI inflows during 1962-1995, followed by electronics (26.9%), transportation equipment (15.4%), and machinery (12.9%).

3. Current Foreign Direct Investment Regime

The basic law governing FDI is the Foreign Capital Inducement Act, which is accompanied by Presidential Decrees and working rules specifying matters under the Act and its enforcement measures. There are also Regulation on Foreign Investment which provide matters necessary for enforcement.

The Notification-Oriented System

Article 7 of the Foreign Capital Inducement Act, which went into effect after March 1, 1993, stipulates: "In the event that a foreign national intends to acquire the new stocks or shares of an incorporated enterprises of the Republic of Korea or of an enterprise owned by nationals of the Republic of Korea, he or she shall notify in advance." However, in exceptional circumstances, the approval of the Minister of Finance and Economy or other relevant ministers need to be obtained under the approval criteria specified in the Regulation on Foreign Investment. There are also a few business categories where certain requirements are prescribed in specific laws, such as those relating to joint ventures, and so acceptance of notification is carried out on the condition that the specific requirements are met. In sum, business categories subject to approval are exceptional, and in principle, FDI is subject only to notification. The introduction of the one-stop service system in 1995 already ended the cumbersome old notification procedure and reduced notification to a maximum of three hours.

At present, approval is still needed for foreign investment in partly liberalized sectors. As from 1997, the present approval and notification system will be replaced by a simpler notification system. Approval will no longer be needed for greenfield investment, while only notification at designated banks will be required.

National Treatment

Unless otherwise specified in the laws, foreign investors and foreign-controlled firms are treated equally as Korean nationals and firms. Tax exemption and deduction pertaining to Korean firms are equally applied to foreign-controlled firms. Foreign-controlled firms are required to wait one year before registering for national treatment. However, business operations in Korea by foreign-controlled firms would not be significantly restricted by this requirement. While foreign-controlled firms established in Korea do not have national treatment status, their business activities are restricted only in portfolio investment.

Guarantee of Overseas Transfer and Foreign Investors' Property

The overseas remittance of dividends from the stock or shares acquired by a foreign investor, and of the sales of proceeds of stocks or shares is guaranteed in accordance with the contents of the approval, the acceptance of the notification or the agreement at time of the remittance. The property rights of a foreign investor and a foreign-invested enterprise are guaranteed in accordance with the provisions of the laws.

Protection of Intellectual Property Rights

The Korean government's efforts to protect intellectual property rights (IPR) are being pursued in three ways:

a) by cracking down on IPR violators;
b) by upgrading the legal framework and the institutions for IPR protection; and
c) by raising public awareness of IPR.

As a result of such strong and continuous efforts since 1986, foreigners can expect protection that is in line with international standards. In particular, Korea has enacted several amendments to its legislation in order to fully comply with WTO/TRIPs agreement before the end of 1995.

The Korean government has a strong belief that effective protection of IPR is critical to fostering technological development in Korea and to attracting high-tech multinational corporations from abroad.

Taxation and Incentives for Foreign Direct Investment

The Korean government is providing tax incentives and support for foreign-controlled firms which bring in advanced technology that is deemed necessary in achieving an advanced industrial structure. The basic framework for advanced technology eligible for financial and tax benefits was established in 1984. Since then, however, the industrial structure has changed and more advanced technology has emerged, necessitating the readjustment of Korea's industrial development policy. Hence, the Korean government recently enlarged the scope of advanced technology by including some service sectors.

In 1995, the Korean government introduced a new incentive system in which the government's discretion is significantly reduced. Under the old system, foreign investors would not benefit from tax deduction and exemption unless investment were accompanied by advanced technology. Tax exemption lasted for five years upon the occurrence of positive profits followed by 50% tax reduction in the subsequent three-year period. Moreover, these benefits were limited to foreign investors who brought in the said technology itself and had no record of receiving technology-related tax benefits on other grounds. These qualifications were examined by three or more relevant government ministries, which tended to lengthen the application procedure for tax benefits and reduce the chance for approval. Under the new incentive system, however, eligibility for tax benefits no longer depends on the types of technology initially provided by the investor or on the history of tax exemption and deduction. Furthermore, the application procedure for tax benefits has been significantly simplified since only two government ministries, the Ministry of Finance and Economy and the Ministry of Science and Technology, are involved in the approval process. This is intended to streamline the application procedure and to shorten the decision-making process from 30 to 20 days.

Korea has thus far signed bilateral tax treaties with 52 countries. Most of the recently signed treaties closely follow the guidelines set by the OECD Model Tax Convention. In addition, the Law for the Coordination of International Tax Affairs (LCITA), was passed for enactment in the National Assembly in November 1995. Under this law, Korea's tax levying practices will be brought more in line with standards set by the OECD. In particular, by incorporating the OECD's transfer pricing guidelines into Korean law, the LCITA seeks to improve the resolution procedure of treaty-related disputes with other countries and gives greater attention to the OECD Model Tax Convention and Commentary in the interpretation of tax treaties. The LCITA also includes a number of other measures designed to improve the operation of the National Tax Administration in international taxation,particularly in the areas of administrative reviews and appeals of assessments. Arbitrary tax auditing by the Korean tax authority was a focus of complaint by foreign investors in Korea. With the implementation of the LCITA, however, the Korean government expects that there will no longer be such complaints from foreign investors.

Acquisition of Real Estate in Connection with Foreign Direct Investment

High population density has been behind strict government regulations of the real estate market in Korea. Moreover, land price bubble that occurred in the late 1980s further strengthened the restrictions by creating such measures as tax disincentives or zoning regulations. These regulations are equally applied to foreign and domestic investors, but foreign investors, including those enterprises whose ownership exceeds 50% of total share capital, are subject to additional restrictions in purchasing real estate properties in Korea.

Rules on land purchases by foreigners differ from rules on purchases of other types of real estate. Non-residents are required to have authorization from the Ministry of Finance and Economy before purchasing real estate properties other than land pursuant to the Regulation on Foreign Exchange Management. On the other hand, land purchases are regulated under the Act on the Acquisition of Land by Foreigners and Control Thereof, which replaced the old law managed by the Ministry of Home Affairs. According to this new Act under the jurisdiction of the Ministry of Construction and Transportation, foreign-controlled firms are easily able to purchase land, as long as they do so for legitimate business purposes.

For foreign-controlled firms belonging to the manufacturing sector, they need only to notify purchases of factory sites for legitimate business operations. The title of ownership shall then be issued within fifteen days upon the notification. However, different rules apply to foreign-controlled firms in the service sector. A number of service sectors impose ceilings on real estate acquisitions by foreign investors according to sectoral laws. Notification is the only requirement for purchases that do not exceed the specified ceilings. However, large-scale acquisitions, and real estate investment in sectors where no ceilings exist, require authorizations from the provincial governor. In these cases, the decision is made no more than sixty days.

The Korean government has made continuing efforts to reduce the soaring land prices by various measures. Such government's efforts will continue in the future. In particular, the government is creating Free Investment Zones in Kwangju and Cheonan to make sure that an inexpensive and stable land supply is provided to foreign investors in Korea.

4. Future Directions

Recent changes in FDI policy result from a culmination of several factors. First, Korea's restrictive economic policy has been facing increasing pressure from the international community. While Korea has already conformed to international trade-related norms stipulated by WTO, it continues to follow more liberal standards as much as it can afford.

Second, Korea's fear of an economy dominated by foreign interests may have been ameliorated by the strength of Korean firms as global players. Direct preferential treatment or protection for Korean firms against foreign firms is no longer efficient and desirable even in the dynamic sense. It is widely recognized that Korean firms have grown and can keep growing only in a more competitive business environment. In this sense, an oligopolistic market structure or dominant market shares of Korean firms in the domestic market are regarded as a source of declining international competitiveness.

Third, the Korean government has an incentive to introduce some foreign presence into the domestic economy. Increasing competition in the domestic market will result in more efficient allocation of resources and will contribute to enhancing competitiveness of local companies. In addition, the presence of foreign multinationals will introduce invisible technological assets to resident-owned firms through technology transfer, particularly in high-tech industries.

New Foreign Direct Investment Law

The Korean government is currently undertaking a reform to rectify the Foreign Capital Inducement Act. If completed, the reform will bring the legislation more in conformity with the OECD standard. The new legislation will set the principles for Korea's FDI liberalization and deal with comprehensive incentives for and protection of FDI made in Korea. To fulfill these goals, the government is seriously considering the inclusion of various reform packages in the legislation, such as the permission of FDI through mergers and acquisitions of Korean firms. The enactment of the legislation will be completed before the end of 1996. The timetable for implementation will be determined immediately after consultations with the relevant ministries.

Mergers and Acquisitions

FDI through mergers and acquisitions is not permitted in Korea under the current legislation. Only portfolio investment in shares listed in the Korean Stock Market Exchange is allowed, but foreigners' purchases of listed shares are limited by ceilings set by the government. Beginning in January 1997, mergers and acquisitions having the characteristics of FDI will be almost completely liberalized. Even in this circumstance, it is true that foreign acquisitions through stock market transactions will still be limited because these stock market transactions fall under the purview of regulations on portfolio investment. However, with further progress in liberalization and with the gradual elimination of ceilings on stock market purchase, mergers and acquisitions in the form of stock market transactions will become more widely open to foreign investors. The modalities of foreign acquisitions will be incorporated in the new Foreign Direct Investment Law.

Loans of Five Years or More

Under the current foreign investment law, loans of maturities more than three years are treated as commercial loans rather than FDI. Commercial loans are allowed only for imports of facilities and equipment by foreign-controlled firms in high-tech industries, small- and medium-sized firms in manufacturing industries, firms engaged in the construction of infrastructure, and firms that have already repaid existing loans. Loans with maturities of more than three years are subject to approval by the Korean government, considering that various liberalization measures on capital movements may induce excessive capital inflows from abroad.

Under the new Foreign Direct Investment Law, loans with purpose of direct investment and maturities of five years or more will be classified as tantamount to FDI. In this circumstance, long-term loans satisfying the OECD Benchmark Definition of Foreign Direct Investment will no longer be restricted.

Ⅳ. Overseas Direct Investment Policy in Korea

1. Historical Overview of Overseas Direct Investment Policy

The changing patterns of Korea's overseas direct investment policy can be categorized into four periods: the introduction period (1968~1974), the institutionalization period (1975~1980), the liberalization period (1981~1989), and the reorientation period (1990~present).

Introduction (1968~1974)

It was first allowed in1968 to invest abroad by inserting a chapter of Overseas Direct Investment in the regulations on foreign exchange control. In the early 1970s, Korea started investing abroad, mainly in forestry, manufacturing and trade. However, in this period, Korean firms were lacking in capital, technology and managerial capabilities and so were not fully equipped with the ability of ODI. At the same time, the chronic current account deficits gave no room for investing abroad. Accordingly, the Korean government's direction for ODI policy was to restrict ODI.

Institutionalization (1975~1980)

In this period, all systems relevant to ODI were established. Applications for overseas investment were approved with some restrictions, when its purpose was to develop and import those raw materials which could not be supplied domestically, to relieve bottlenecks in exports, to secure a fishery area, or to relocate an industry from home to abroad in order to revitalize the industry's international competitiveness.

According to guidelines for the approval and monitoring of ODI, applicants had to satisfy restrictive qualifications. In addition, the government monitored each investment that was made by analyzing the business performance of the overseas subsidiaries. In order to control these risky investment, the government initiated a system of prior authorization of the investment projects and reinforced the investors' qualifications.

Liberalization (1981~1989)

In 1981, a number of changes were made in the regulations concerning ODI. Restrictions on investor's qualifications were eased and prior authorization of investment projects was abolished. The government also removed the requirement of recovering the invested principal within ten years. In short, the relevant procedure for ODI was simplified. The aim was to remove unnecessary restrictions in accordance with the general principle of deregulation that was promoted at that time.

It was not until 1987, however, that a genuine liberalization policy on ODI was adopted. With the emergence of a current account surplus, the foreign exchange constraint on overseas investment was removed. Also, traditional labor-intensive industries were losing international competitiveness due to rising wages and currency appreciation. ODI helped these declining industries to regain international competitiveness by relocating them to less developed countries. In addition, with rising protectionism against Korean products, ODI was gaining its importance as a means to jump over the protectionist barriers of developed countries.

For these reasons, the government took aggressive measures to liberalize ODI. In 1987, the government reduced its role as an agent of approving overseas investment and adopted a notification system that allowed firms to invest abroad simply with notification to the Bank of Korea. Both the application procedure and investor's qualifications were further simplified. Restricted categories were opened for investment, while 14 businesses remained restricted. Owing to these policy changes, Korea's ODI has scored since 1987, with an average annual growth rate of 77%.

Re-orientation (1990~Present)

In this period, Korea's current account balance turned to deficit and ODI showed poor performance in some countries. On the one hand, the Korean government continued its efforts to liberalize ODI. Not only did the government significantly broaden the qualifications for investment which required notification, it also dramatically relaxed the conditions for approval. In 1994, procedures were once again simplified to allow ODI to be implemented simply by obtaining a certification from foreign exchange banks. The restricted categories were further liberalized so that ODI could be undertaken in all business categories except for three real estate-related ones.

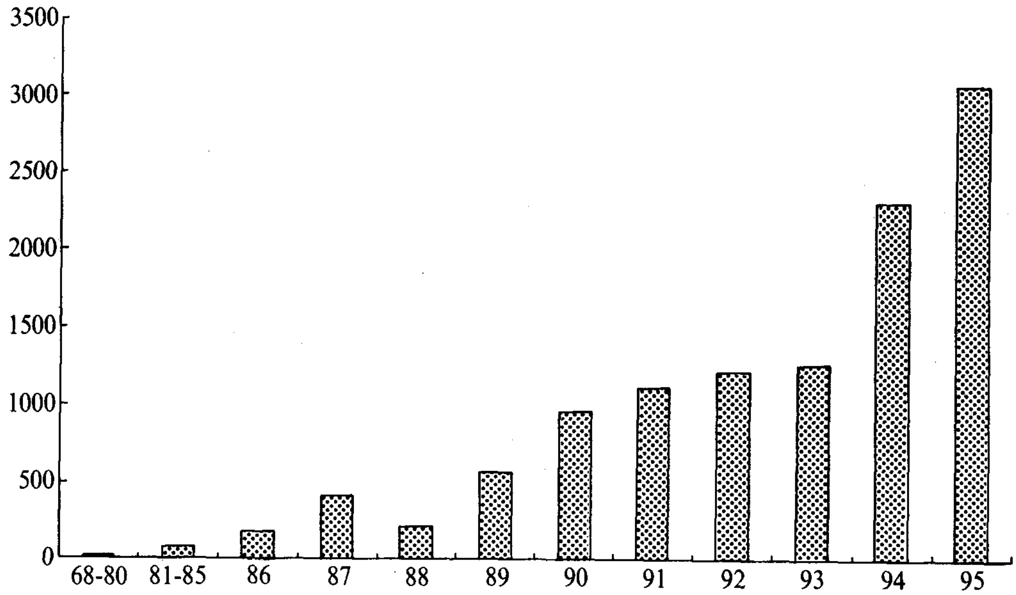
At the same time, the government adopted policies to improve and re-establish the systems on ODI. It reinforced inspection on large-scale ODI and set a standard on voluntary restraint of ODI. In 1995, it established a "prudential guidance" as a preventive measure to induce more careful planning and healthy management of direct investment abroad and thus to prevent any adverse side-effects arising from liberalization of ODI.

2. Trends in Overseas Direct Investment

Korea's overseas direct investment began in 1968, but its flows remained insignificant until the mid-1980s as shown in Figure 3. ODI was almost nonexistent in the 1970s, never exceeding US$ 20 million. Because Korea was in shortage of capital resources at that early time, ODI as one of the capital outflows was generally discouraged by the government except for special cases that aimed at securing a stable supply of important raw materials or at facilitating exports.

Figure 3. Korea's Overseas Direct Investment, 1968～1995

(US$ million)



Source: Ministry of Finance and Economy, Korea

Note: Figures before 1986 are annual averages for the corresponding period.

Korea's ODI rapidly increased since the mid-1980s. The total value of actual overseas direct investment increased from US$ 0.18 billion in 1986 to US$ 3.1 billion in 1995.

During the early period of time, the first and most important forms of ODI were done in resource development projects. Like Japan and other resource-scarce economies, Korea had to import most of its materials and natural resources. ODI in areas such as forestry and mining was motivated by the need to secure stable supplies of natural resources to serve domestic production requirements.[8] Investment in forestry development to gain access to timber supplies for the Korean plywood industry was exclusively concentrated in the South-East Asian region, particularly Indonesia. Investment in mining was concentrated in North America and Oceania , particularly Australia and Papua New Guinea.

Another motive for ODI was to overcome protectionism in foreign country's import-substituting manufacturing sector. In cases where access to markets were hindered by either tariff or non-tariff barriers, Korean investors, like their developed-country counterparts, invested in the protected country to "jump the tariff wall".

Korean manufacturing firms also set up overseas ventures in the retail and distribution sectors in developed and developing countries to facilitate marketing of Korean products overseas. This form of investment was predominantly undertaken by *Chaebols* as part of their marketing strategy for their manufacturing subsidiaries making differentiated brand-name products.[9]

8) In 1984 for instance,the stock of overseas direct investment in mining, forestry, fishing and agriculture constituted 53 percent of the total.

9) According to Blomstrom and Kokko (1995), the industrial policies that have been biased in favor of large firms and an institutuional setting where regulations and controls have facilitated investment abroad by national firmsm while impeding foreign direct investment in home market may result in relatively good performance of home multinationals in the world market. However, it does not necessarily imply that these industrial policies are desirable in the nation's overall economic welfare.

3. Current Overseas Direct Investment Regime

The methods of investing abroad specified in the regulations on foreign exchange management can be summarized as follows:

(A) Acquisitions of Shares of an Incorporated Enterprise

It is considered ODI when residents acquire not less than 20% of the ordinary shares of voting power of an incorporated enterprise in a foreign country. It is also considered ODI when residents establish such economic relations with an incorporated foreign enterprise through exchange of managerial personnel, or signing of contracts for transactions of products or intermediate materials for more than one year or of contracts of transferring important manufacturing technology.

(B) Provision of Loans

Provision of long-term loans to the incorporated foreign enterprises mentioned in (A) is considered ODI.

(C) Participation in Joint Projects

Participation in joint development project of overseas natural resources or technology is considered to be ODI.

(D) Acquisition and Management of an Unincorporated Enterprise

Acquiring and managing an unincorporated foreign enterprise is also considered ODI.

Procedures for Approval, Notification and Certification

The maximum amount for ODI under the auspices of the foreign exchange bank certification process is currently expanded from U.S.$ 300,000 to U.S.$ 10 million.

ODI requiring notification to the Bank of Koreahas also made a substantial improvement in its procedure. The new investment range which requires notification is now expanded to the range of US$ 10 million to US$ 50 million.

Meanwhile, the threshold amount of ODI requiring the government's approval has increased from US$ 10 million to US$ 50 million. Only 0.6% of the total number of overseas investment cases made by Korean firms in 1994 fell under this category. However, Korea's approval system has been used for investment applications in practically the same manner as the notification system. The approval system is currently under review to ensure that applications be processed within a certain period, 15 days for example, and automatically approved without undue delay.

Liberalized Business Categories

Except for three real estate-related business categories, all business categories are now allowed to make investment abroad. The three business categories excluded from this liberalization measure are leasing and selling in lots of real estate by residents other than overseas construction companies and general trading corporations, and the construction and operation of golf courses. The Korean government is reviewing further liberalization in these restricted businesses while taking into account the pace of liberalization of foreign exchange management.

Self-Financing Requirement as a Prudential Guidance

There is no restriction on local financing which requires no loan guarantee from the parent company. But, the local subsidiaries with financial assistance of less than US$ 100 million from the parent company are required to have 10 percent of that amount financed internally. If the financial support from the parent company exceeds US$ 100 million, the local subsidiary is required to finance 20% of the supported amount through self-financing. This newly introduced requirement that at least 10/20% of an outward direct investment be financed from the investor's own capital does not intentionally restrict the investment abroad. Korea has similar regulations on investment made in Korea. This regulation can be characterized by prudential guidance, the purpose of which is to prevent firm managers from taking undue risks which would ultimately be at the significant loss of shareholders and creditors, particularly, domestic banks.

It is more important to evaluate the economic consequence of this self-financing requirement on domestic economy rather than to judge whether this requirement itself is of regulatory characteristic. According to Feldstein(1994), OECD data shows that each dollar of cross-border outflows of domestic capital reduce domestic investment by approximately one dollar.[10)] In this regard, self-financing requirement may have a more or less adverse effect on domestic capital formation rather than discouraging effect on the volume of overall ODI. When local financing requires loan guarantee from the parent company, this requirement obliges the parent com-

10) According to Feldstein (1994), only about 20 percent of the value of assets owned by U.S. affiliates abroad is financed by cross-border flows of capital from the United States. An additional 18 percent represents retained earnings attributable to U.S. investors. The rest is financed locally by foreign debt and equity. Local financing of ODI as a major financial source does not reduce domestic investment. However, cross-border outflows of domestic capital accompanied with ODI results in the decrease of domestic investment by the equivalent amount.

pany to mobilize its own funds. Hence, additional cross-border outflows of domestic capital brought about by this requirement consequently will displace domestic investment. This dollar for dollar displacement of domestic investment by ODI is consistent with the Feldstein-Horioka picture of segmented capital market.

4. Future Directions

Korea's ODI will continue to increase as Korean companies feel it more necessary to delocalize production sites due to increasing demand for global networking. International strategic alliances with the worldclass multinational corporations and joint ventures with local companies in the emerging markets will accentuate the ongoing trends. Furthermore, Korea is firmly committed to liberalizing all the unnecessary regulatory measures in the foreseeable future. The Korean government's policy orientation toward further liberalization will ensure that capital outflows in the form of ODI will contribute to world growth and development by transferring Korea's development experiences as well as capital and technology to local companies in other countries.

Current regulations that need to be reflected in the reservation under item I/B of the OECD Code of Liberalization of Capital Movements will be liberalized as Korea manages to accommodate a more liberal scheme in ODI. For instance, the regulatory measure that individual businessmen cannot invest abroad more than the equivalent of 30% of their previous accounting year's total assets or more than US$ 0.5 million if they have no sales performance will be abolished by creating an effective regulatory scheme that prevents illegal capital flight by individual businessmen. In addition, ODI in the three restricted sectors can be revised by the Overseas Capital Project Deliberation Committee at the request of the ministry concerned. In this regard, the Korean government is reviewing further liberalization of ODI in these restricted sectors.

V. Concluding Remarks

Korea has achieved remarkable economic growth in mere three decades that would take almost a century to attain in other nations. This economic miracle has made Korea one of the world's fastest growing economies and set the cornerstone for on-going transition in non-economic areas as well. Literally, the "New Korea" will begin once again with aspiration and perspiration of the Korean people preparing to build Korea as a leading country in the world in the 21st century. After achieving a historical rebirth from the "Hermit Kingdom" only a century ago, Korea has continued political, economic, and social reforms required to build the nation as the world's model country. In the economic arena, particularly, drastic reforms and liberalization have been implemented with unprecedented speed. Carrying out these reforms and liberalization will cause a serious burden. However, it will facilitate Korea's accession to the OECD. The Korean government and people firmly believe that official membership to the OECD will be a milestone for further economic advancement.

Korea is located at the crossroads of Northeast Asia, a region that is about to emerge as the largest and most dynamic economic area of the 21st century. Comprised of China, Japan, and Korea, the area is expected to catch up with and surpass the economic clout of both the North American Free Trade Agreement (NAFTA) and the European Union (EU) during the next few decades. Korea will play a pivotal role in Northeast Asia, bridging the gap between Japan's highly industrialized economy and China's rapidly developing one. Korea intends to share the economic prosperity of this region with other nations. To foster mutual cooperation and balanced development, Korea is actively participating in the Asia Pacific Economic Cooperation (APEC) and the Asia Europe Meeting (ASEM). These interregional cooperation will greatly contribute to global economic development.

At present, Korea is reportedly losing its merit as a suitable location for foreign direct investment. Nonetheless, Korea has an abundant supply of scientists and technicians distinguished by their sincere work ethic and depth of expertise in their respective fields. This important advantage will offset other disadvantages this country may have. In particular, Korea's highly educated engineers and managers cannot be found at current wage level in other nations. Furthermore, when Korea achieves peaceful reunification in the next decade or so based on economic prosperity and political democracy, Korea will have an abundance of skilled and unskilled human resources, land, and other resources available for enhancing its international competitiveness. The current cost disadvantages associated with rising wages will consequently disappear and thereby attract more FDI.

Korea is currently undertaking a number of large-scale infrastructure expansion projects, including a high-speed railway and a new international airport. The government has pushed ahead with an ambitious infrastructure expansion policy which outlines expansion of road, railway, airport, harbor, information, and telecommunication networks. When this comprehensive plan is completed, Korea will be able to provide foreign and domestic investors with a truly impressive infrastructure.

As the process of *Segyehwa*, Korea's unique reform programs, continues, Korean firms will become ideal partners rather than competitive rivals. Considering the dynamism of the Northeast Asian market, foreign investors will find excellent partnership opportunities for strategic alliances and joint investment with Korean counterparts. Korea has over 70,000 creative and active small and medium-sized firms that offer flexibility as well as ample production capacity. These firms are following the industrial trend toward rapid growth in high-tech fields including metals, electric and electronics, precision machinery, and transportation. The Korean government has carried out a comprehensive support program for small and medium-sized businesses since the late 1980s and actively supports joint investment and cooperation with foreign partners in high-tech industries. Foreign corporations that have partnership with domestic firms will find substantial financial and tax incentives for even small-scale ventures. Opportunities also exist with a large number of Korean conglomerates. These business groups possess basic technologies, production facilities, and marketing networks and are looking for partners in the global market. For the foreign corporation, alliances with one of these conglomerates will allow them to have access to substantial business expertise, capital, and manpower, as well as a foothold in the Korean market.

Korea's bold liberalization process is one amongst a number of attractive factors for foreign investors expecting beachhead effects. To create the world's best business environment, the Korean government is strongly committed to the liberalization of all the other remaining regulations in a foreseeable future. In particular, the new Foreign Direct Investment Law will be a basic institutional framework. The genuine purpose of the law is not to regulate foreign direct investment, but to protect foreign investors and promote FDI.

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