Killing Five Birds with One Stone:1 Inward Foreign Direct Investment in Post-Crisis Korea
Cherry, Judith
Pacific Affairs; Spring 2006; 79, 1; ProQuest Central
pg. 9

Killing Five Birds with One Stone:[1] Inward Foreign Direct Investment in Post-Crisis Korea

Judith Cherry

For the first 35 years of the Republic of Korea's[2] economic development, the government showed a clear preference for foreign capital in the form of loans rather than inward foreign direct investment (IFDI) as a means of financing its development plans. This reluctance to allow a greater degree of foreign participation in the domestic economy stemmed from a desire to control the allocation of financial resources and also reflected public concerns that increased levels of IFDI might lead to foreign domination of the Korean economy. The 1997 crisis led to a fundamental change in Korean attitudes towards inward investment, as a desperate need for capital, advanced technology and know-how prompted a comprehensive reform of FDI policy and promotional systems. However, while many Koreans recognized the contribution made by inward investment to the country's economic recovery and its potential role in promoting sustainable growth, anti-foreign capital sentiment lingered in some areas of society.

The past two decades have seen a remarkable increase in global flows of capital and credit, most notably in the form of foreign direct investment. Although FDI in developed countries has accounted for the lion's share of these transactions, flows to developing countries have also accelerated in recent years. The rising level of inward investment in developing countries reflects, to a significant extent, changes in their perceptions of and attitudes towards IFDI. Whereas, in the 1970s and early 1980s, many potential host countries expressed concerns that inward investment might create monopolies, exploit the local economy and restrict competition in the domestic market, this negative view had changed to a more upbeat assessment by the 1990s, as scholars and practitioners had identified a range of beneficial effects of inward FDI in terms of promoting economic development.[3]

---

1 The title is taken from the work of Chang Yun-jong; the author acknowledges her debt to his 2001 publication "Woegugin chikchŏpt'uja-ŭi ilsŏgojohyokkwa punsŏk" [An Analysis of the 'Five Birds with One Stone' Effect of Inward Foreign Direct Investment] (Seoul: Sanŏp Yŏn'guwŏn).

2 Hereafter "Korea" or "South Korea."

3 Neil Hood and Stephen Young, *The Economics of Multinational Enterprise* (London: Longman, 1979); Mi-a Kim, "Kungnae woegugin chikchŏpt'uja-ŭi kungmin kyŏngjejŏk hyogwa" [The Effects of Inward Foreign Direct Investment on the Korean Economy] *Muyŏk'ak Hoeji* [Trade Studies Journal], vol. 24, no. 2 (1999), p. 81.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

Accompanying this more positive view of inward FDI was a growing awareness that host governments would have to create a favourable business environment and offer incentives to multinational corporations (MNCs) in order to enjoy the benefits that inward investment might bring.[4]

This paper analyzes the changes in Korean attitudes towards inward investment before and after the 1997 financial crisis within the context of the debate on the costs and benefits of IFDI and increasing global competition to attract inward investment. The Korean experience sheds light on the forces driving the liberalization and deregulation of inward FDI by countries that had previously restricted and controlled it. It also provides insight into the problems facing governments seeking to attract higher levels of FDI, particularly in terms of the need to change perceptions of and attitudes concerning inward investment as well as reforming systems and structures for the promotion of inward foreign direct investment.

The Theoretical Debate

Proponents of the industrial organization approach to FDI theory, including Dunning (1981, 1988), Hymer (1976) and Kindleberger (1969), have argued that the possession of a firm-specific monopolistic advantage is a necessary precondition for foreign direct investment activity; the source of such an advantage may lie in the possession of superior technology, know-how, information or access to financial resources. It is these intangible assets that allow a multinational corporation investing in a foreign market to compete on a more equal basis with local firms, and the entry into a foreign market by an MNC in possession of these advantages can lead to spill-over effects, defined as "the transfer of certain specific firm assets from the foreign MNC to the domestic sector."[5]

Over the past four decades a substantial body of literature has been generated by scholars seeking to determine the exact nature of the costs and benefits of inward FDI from the perspective of the host country. Hood and Young identified four categories of effects deriving from inward investment: resource transfer effects, trade and balance of payments effects, competitive and anti-competitive effects and sovereignty and autonomy effects. A foreign investor may introduce capital, technology and management skills that are scarce or lacking in the host country and thus help to enhance the productivity and efficiency of domestic firms. Funds

---

4 Michael Veseth, *Selling globalization: The myth of the global economy* (Boulder, CO: Lynne Reinner Publishers Inc, 1998), pp. 33-36; John Zysman, "National roots of a global economy," in Cho Lee-Jay and Kim Yoon Hyung, eds., *Hedging bets on growth in a globalizing industrial order: Lessons for the Asian NIEs* (Seoul: Korea Development Institute, 1997), p. 271.

5 Nigel Driffield and Karl Taylor, "Spillovers From FDI and Skill Structures of Host Country Firms," *Cardiff University Business School Discussion Papers in Economics* (2000), p. 3.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

raised by the MNC in its home country may help to make up a shortfall in investment finance in the host country; similarly, projects financed with capital sourced within the host country may put to productive use local funding that would otherwise have remained idle. However, it is also possible that the funding of an MNC project by local financial institutions might deprive domestic firms of capital needed for their own projects.[6]

The introduction of advanced technology contributes to economic growth by raising the marginal productivity of labour and capital, as it diffuses through a number of direct and indirect routes[7] to local firms, suppliers and subcontractors, resulting in an improvement in their technological capabilities.[8] The introduction of new technology may also create forward linkages as the investor provides local associates with the information and intermediate products needed for their own production processes, and backward linkages as local suppliers strive to meet the quality and reliability requirements of the foreign firm and its customers. Finally, the "demonstration effect" encourages local firms previously wary of using new technology (due to the costs or risks involved) to make use of it, once foreign investors have demonstrated its advantages.[9]

If the foreign firm is actively engaged in research and development (R&D), visits by or contact with specialist research personnel may also enable local firms to enhance their technology. Local firms without close links to the investor may be motivated to increase their own research efforts or to accelerate the introduction of new technology, in order to keep pace with their foreign competitors.[10] Similarly, the introduction of different financial, management and corporate governance systems can lead to increased transparency, improved management quality and higher standards of corporate governance in domestic firms.[11] However, the transfer of technology is not a guaranteed benefit of inward FDI: if it is the mother company rather than the overseas affiliate that is engaged in technology

---

6 Hood and Young, *Economics of Multinational Enterprise*, pp. 179-184.

7 These include contractual agreements, reverse engineering and the training of local staff, who later transfer to domestic companies.

8 Jian-ye Wang and Magnus Blomström, "Foreign Investment and Technology Transfer: A Simple Model," *European Economic Review*, vol. 36 (1992), pp. 137-155.

9 Ronald Findlay, "Relative Backwardness, Direct Foreign Investment, and the Transfer of Technology: A Simple Dynamic Model," *Quarterly Journal of Economics*, vol. 92 (1978), p. 1.

10 Magnus Blomström and Ari Kokko, "The effect of foreign investment on host countries: A review of the empirical evidence," World Bank Policy Research Working Paper no. 1745 (1996), available at <http://econ.worldbank.org/docs/739.pdf> (6 December 2004); Ari Kokko, "Technology, Market Characteristics and Spillovers," *Journal of Development Economics*, vol. 43 (1994), p. 279; Sŏng-il Ch'oe, "Woegugin chikchŏpt'uja-ŭi kŏshi kyŏngjehyogwa-e kwanhan yŏn'gu" [A Study of the Macroeconomic Effects of Foreign Direct Investment] (unpublished master's thesis, Kangnŭng University, 2003) p. 63; Korea Institute for International Economic Policy (KIEP), "Kyŏngjenan kŭkpog-ŭi chirŭmgil: Woegugin t'uja" [The Shortcut to Overcoming Economic Difficulties: Inward Foreign Investment] (Seoul: KIEP, 1998) pp. 54-55; Mi-a Kim, "Kungnae woegugin chikchŏpt'uja," pp. 82-83.

11 Ch'oe, "Woegugin chikchŏpt'uja," p. 63.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

development, there may be little R&D carried out in the host country and the MNC may wish to retain ownership and control over its technological advantage.[12]

In terms of trade and balance of payment effects, when a foreign investor enters the market and replaces exports with local sales, the host's trade balance situation will improve as imports decline. If the MNC increases its market share, it may begin to import capital goods, intermediate materials, parts and components from the mother company or overseas suppliers, thus increasing imports; over time, the firm may begin local production of these items, thus restoring the status quo.[13] The host country's exports may be boosted by MNC sales to third countries, and local firms can acquire valuable information on export practices and foreign markets from their contact with MNCs and thus improve their own export performance.[14] Although inward FDI will have an initial effect of improving the balance of payments, subsequent payments of dividends, royalties and interest to the mother company and the repatriation of profits may offset this positive effect to some degree.[15]

The tendency of MNCs to enter sectors with high entry barriers where monopolies or oligopolies already exist may lead to an increase in competition and efficiency in those sectors, as local firms come under pressure to improve their performance and compete with the new entrants. However, despite the short-term increase in competition, concentration levels may increase over time as less efficient domestic enterprises are forced to exit the market.[16] Finally, given the influence of the mother company over the business operations of its overseas subsidiary, inward FDI can be expected to result in some loss of decision-making power for the host government. In this respect, inward FDI always results in a cost for the host government, regardless of any other economic benefits that derive from foreign direct investment.[17]

In addition to the four categories of costs and benefits identified by Hood and Young, other scholars have cited the importance of effects on employment and wealth creation. Although greenfield investments require

---

12 Yŏng-gyu Hŏ, "Woegugin chikchŏpt'uja-ga han'gukgyŏngje-e mich'inŭn yŏnghyang" [The Influence of Foreign Direct Investment on the Korean Economy] (unpublished master's thesis, Korea University, 2001), p. 21.

13 Shi-jin Mun, "Woegugin chikchŏpt'uja-ŭi ipchi kyŏltchŏgwŏnin-e kwanhan yŏn'gu" [A Study of Factors Determining the Choice of Location in Foreign Direct Investment] (unpublished master's thesis, Pusan University, 2004) p. 36.

14 Yŏng-gŭm Pak, "What does Korea need to do to induce more foreign direct investment?" (unpublished master's thesis, Ewha Woman's University, 2003), p. 6.

15 Hood and Young, *Economics of Multinational Enterprise*, pp. 179, 190.

16 Blomström and Kokko, "The Effect of Foreign Investment," p. 29; Chun-uk Ch'oe, "Woegugin chikchŏpt'uja-ŭi yŏk'al" [The role of inward foreign direct investment], *Chaejŏng P'orŏm* [Financial Forum] (April 1998), p. 55; Hood and Young, *Economics of Multinational Enterprise*, pp. 180, 191-194.

17 Hood and Young, *Economics of Multinational Enterprise*, pp. 191-195.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

the creation of a new workforce, mergers and acquisitions (M&A) and post-investment improvements in productivity and efficiency may result in job losses. Inward FDI can create additional jobs indirectly, as local firms increase their workforce to handle work contracted to them; conversely, a decision by the MNC to source materials from overseas may lead to a reduction in local employment levels. Finally, increased competition in an industry or sector may force weaker local firms out of business, contributing to a rise in unemployment levels.[18] In terms of the creation of national wealth, investors who have not negotiated tax exemptions as a condition of entry will contribute to higher tax revenues through the payment of corporate and personal income tax. The profits from the business may be reinvested, contributing to further fixed capital formation and creating additional tax revenues.[19]

Inward Foreign Direct Investment: The Korean Experience

The history of inward FDI in South Korea is relatively short and, until 1997, annual inflows were small, both in absolute terms and in comparison with the size of the domestic economy. In the early 1960s, the shift in economic policy from postwar recovery and import substitution to growth and export promotion, combined with the lack of domestic funding, made it necessary for the state to introduce foreign capital in order to finance economic development. At this stage, the government's preference was for foreign loans rather than FDI, so its aim was to regulate and control rather than promote and encourage inward investment. This approach enabled the state to limit foreign participation in the economy and to channel financial resources to enterprises willing to support its developmental goals. Although the Park government welcomed foreign investment in light manufacturing, it discouraged FDI in sectors protected by import substitution measures and often imposed performance requirements relating to technology transfer, local content and exports on FDI projects.[20] During the first two decades of economic development, cumulative inward investment amounted to just US$1.9 billion on a notification[21] basis and

---

18 Chin-u Hwang, "Woegugin chikchŏpt'uja-e taehan myŏt kaji ohae" [A Few Misconceptions About Inward Foreign Direct Investment], *Hanhwa Kyŏngje* [Hanhwa Economy], (March 1999), pp. 5-6; Mi-a Kim, "Kungnae woegugin chikchŏpt'uja," p. 81; Mun, "Woegugin chikchŏpt'uja-ŭi ipchi," pp. 35-36; KIEP, Kyŏngjenan kŭkpog-ŭi chirŭmgil, pp. 67-68.

19 Ch'oe, "Woegugin chikchŏpt'uja-ŭi yŏk'al," p. 55; Hŏ, "Woegugin chikchŏpt'uja," pp. 14-15, 18.

20 Kyoo H. Kim, "Foreign Direct Investment in Korean Economy," *Korea Observer*, vol. 30, no. 3 (1999), p. 390; Kyttack Hong, "Foreign Capital and Economic Growth in Korea: 1970-1990," *Journal of Economic Development*, vol. 22, no. 1 (1997), p. 80; June-Dong Kim, *Inward Foreign Direct Investment Regime and Some Evidences (sic) of Spillover Effects in Korea* (Seoul: Korea Institute for International Economic Policy, 1999), p. 9; June-Dong Kim and Sang-in Hwang, *The Role of Foreign Direct Investment in Korea's Economic Development: Productivity Effects and Implications for the Currency Crisis* (Seoul: KIEP, 1998), p. 7.

21 The gap between notifications and actual investment shows to what extent investors are failing to follow through on their investment proposals.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

US$1.5 billion on an actual invested basis (see table 1) (all dollar amounts mentioned hereafter are in US dollars, unless otherwise specified).

Table 1
Trends in Inward FDI, 1962-1997 (in billions of dollars)[22]

	Notification	Actual
1962-1981	$1.9 billion[23]	$1.5 billion
1982-1986	1.8	1.2
1987-1988	2.3	1.5
1989	1.1	0.8
1990	0.8	0.9
1991	1.4	1.2
1992	0.9	0.8
1993	1.0	0.7
1994	1.3	1.0
1995	1.9	1.4
1996	3.2	2.3
1997	7.0	3.1
Total	$24.6 billion	$16.4 billion

The shift in economic policy in the 1970s, away from the traditional labour-intensive light manufacturing sectors towards the development of heavy and chemical industries, necessitated an easing of the restrictions on inward FDI, which could bring in the capital, technology and skills needed for the successful transformation of the economy. From the mid-1980s, the Korean government continued to implement measures to deregulate and liberalize inward investment and to improve the FDI environment. These measures achieved some degree of success, as cumulative investment between 1982 and 1986 increased to $1.8 billion on a notification basis and $1.2 billion in terms of actual investment. The boom years of the late 1980s saw FDI performance improve even further, boosted by investment in the service sector ahead of the 1988 Olympic Games: FDI projects carried out in 1987 and 1988 had a total value of $2.3 billion on a notification basis and $1.5 billion on an actual basis.

By the end of the 1980s, as Korea's exports declined and economic growth slowed, foreign investors were discouraged by political instability, rapidly rising wages, labour unrest, high real estate prices and complex bureaucratic procedures. The resulting decline in inward FDI levels to $800 million on a notification basis in 1990 made it more difficult for Korean firms to gain access to the foreign capital, technology and skills they needed to enhance

[22] June-Dong Kim, *Inward Foreign Direct Investment Regime*, p. 14.

[23] Korean IFDI statistics are not adjusted for price changes: the year-to-year changes must, therefore, be considered in the context of annual exchange rate movements and price changes.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

their competitiveness and cope with the rapidly changing domestic and international business environment.[24]

In the face of continuing pressure from major trading partners and in line with its ambitions to join the Organization for Economic Cooperation and Development (OECD), the Korean government further eased FDI regulations in the 1990s, allowing foreigners to acquire outstanding shares issued by Korean firms and to engage in non-hostile takeovers.[25] As a result, inward FDI gradually increased, rising from annual totals of $800 million (notification) and $895 million (actual) in 1990 to $3.2 billion and $2.3 billion in 1996. However, the amount of inward investment remained small in comparison to the overall size of the Korean economy; in 1996, inward FDI accounted for less than 1 percent of domestic fixed capital formation.[26]

Despite the restrictive and controlling nature of Korea's inward investment policy, foreign multinationals were entering the country and making a contribution to domestic economic growth that was acknowledged by some Korean scholars and practitioners. There was evidence of a positive contribution to total factor productivity growth in the manufacturing sector, with significant spillover effects in the electronics, chemicals and textiles sectors.[27] Hong concluded that foreign capital had been "an essential part of Korea's economic development from the beginning" and had played a key role in enhancing productivity through the transfer of technology and know-how.[28] Kim June-dong observed that, despite the lack of substantial amounts of firm-level data, case studies and anecdotal evidence indicated that foreign investment and technology transfer had played a significant role in the development of key industries such as consumer electronics, semiconductors, pharmaceuticals and retailing. Foreign investors had helped to raise domestic productivity by training workers, introducing advanced technology, skills and know-how, increasing levels of competition and engaging in R&D activities.[29] Kim Hee-kyung concluded that "[a] majority of the research conducted in Korea has confirmed that foreign direct investment has positively impacted Korea's economy through gains in gross factor productivity and exports."[30]

Nevertheless, the government had continued to limit the role played by foreign multinationals in the country's industrialization, demonstrating a

---

24 Ch'oe, "Woegugin chikchŏpt'uja-ŭi yŏk'al," pp. 51-52; Kyoo H. Kim, "Foreign Direct Investment in Korean Economy," p. 390.

25 Kim and Hwang, *The Role of Foreign Direct Investment*, p. 11.

26 Kim and Hwang, *The Role of Foreign Direct Investment*, pp. 10, 17, 35; Mikyung Yun, "Foreign Direct Investment: A Catalyst for Change?" in *The Korean Economy in an Era of Global Competition* (Washington: Korea Economic Institute of America, 2000), p. 141.

27 Cited in Yun, "Foreign Direct Investment: A Catalyst," p. 152.

28 Hong, "Foreign Capital and Economic Growth," pp. 79, 88.

29 June-Dong Kim, *Inward Foreign Direct Investment Regime*, pp. 40-49.

30 Hee-kyung Kim, "FDI in Korea: Recent Trends and Policy Issues," *Korea Focus*, vol. 12, no. 6 (November-December 2004), p. 140.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

preference for "indigenous industrialization rather than FDI-based development"[31] and maintaining a "restrictive and passive" attitude, reflecting a "tacit agreement" that economic growth and industrial development should centre on Korean, rather than foreign firms.[32] Even as liberalization progressed in the mid-1990s, the government's stance remained fundamentally passive; in contrast to the promotional activities being carried out by Korea's competitors in Southeast Asia, the Korean government was "not interested in removing various impediments or promoting FDI in general."[33]

The relatively low levels of FDI in Korea between 1962 and 1996 can be attributed to a number of factors, including government and public attitudes to foreign participation in the Korean economy, an adverse business environment and low levels of appreciation of the potential benefits of inward FDI. Although the Roh T'ae-woo and Kim Young-sam governments took action to liberalize inward investment and improve the business and investment environment, there was still a strong preference for loans over FDI. Specific factors that mitigated against an improvement in FDI performance included restrictions on distribution, a lack of access to key sectors such as finance, bubbles in asset values, labour unrest and high wages, weak infrastructure and the high-cost, low-efficiency economic structure that was forcing even Korean firms to relocate overseas. Korea's FDI promotion activities and post-investment support structures were weak, there was a lack of incentives for investors and the quality of life for expatriate businessmen was a cause for concern.[34] FDI levels were not low because potential investors were discouraged by strong domestic competition; on the contrary, the weak competitiveness of key industrial sectors in Korea demonstrated the need for access to their capital and technology. By restricting inward investment, the Koreans were denying themselves the opportunity to enhance their competitiveness and to create a new market discipline.[35]

The financial and economic crisis of 1997 prompted a sea change in the Korean government's attitude towards inward investment, leading to the "dramatic liberalization measures and aggressive solicitation of foreign investors" and marking a change from "passive liberalization to active promotion."[36] High levels of corporate debt and low levels of profitability prior to the crisis had weakened the financial structure of Korea's leading companies, created vulnerability among domestic financial institutions faced with

---

[31] Kim and Hwang, *The Role of Foreign Direct Investment*, p. 7.

[32] P'yŏng-gi Ha, *Kukche chikchŏpt'uja-wa sanŏp kujojojŏng* [International Direct Investment and Industrial Restructuring] (Seoul: Sanŏp Yŏn'guwŏn, 2001), pp. 1-3.

[33] June-Dong Kim, *Inward Foreign Direct Investment Regime*, pp. 9-10.

[34] Ch'ang-gŭn Yu, "Han'gug-ŭi kŭmnyungwigi-wa woegugin chikchŏpt'uja" [The Financial Crisis in Korea and Inward Foreign Direct Investment], *Yŏngsan Nonch'ong* 5 [Yŏngsan University Collection of Theses, vol. 5] (2002), pp. 85-86.

[35] Ch'oe, "Woegugin chikchŏpt'uja-ŭi yŏk'al," p. 53.

[36] Mikyung Yun and Sungmi Lee, *Impact of FDI on Competition: The Korean Experience* (Seoul: Korea Institute for International Economic Policy, 2001), p. 3; June-Dong Kim, *Inward Foreign Direct Investment*

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

significant amounts of actual and potential non-performing loans, and contributed to the nation's heavy burden of external debt. The switch from reliance on foreign loans to the inducement of FDI would reduce the levels of risk associated with investment in new or existing business ventures by removing the possibility of interest rate fluctuations, demands for repayment or reluctance to roll over maturing loans being used to finance business operations, and by transferring some or all of the burden of investment risk to foreign multinationals.

Sweeping changes were made to improve the FDI environment, beginning with the enactment of the Foreign Investment Promotion Law in November 1998. Changes to FDI promotion systems focused on enhancing investor support services, removing controls on foreign ownership of companies and real estate, accelerating sectoral liberalization, providing tax and other incentives and broadening the scope of local government FDI promotion activities. The government established the Korea Investment Service Centre as a one-stop service to offer consultation and assistance to investors, created the office of investment ombudsman, strengthened intellectual property rights protection and took steps to bring accounting and corporate governance standards in line with international best practice. The government also restructured inward FDI promotion systems to offer more competitive incentive packages, including tax benefits and reduced rents on plant sites, eliminated the ceilings on foreign equity ownership, liberalized hostile M&A transactions and opened up the domestic real estate market.[37]

Table 2
Trends in Inward FDI, 1996-2000 (in billions of dollars)[38]

	Notification	Actual
1996	$3.2 billion	$2.3 billion
1997	7.0	3.1
1998	8.9	5.3
1999	15.5	10.8
2000	15.2	10.2
Total	$49.8 billion	$31.7 billion

into Korea: Recent Performance and Future Agenda. (Seoul: Korea Institute for International Economic Policy, 2003), p. 24.

[37] Yun and Lee, *Impact of FDI on Competition*; Pak, "What does Korea need to do"; Invest Korea, *Adapting to a Changing Economic Environment: Toward a New Foreign Direct Investment Policy* (Seoul: Invest Korea, 2004). For a detailed overview of changes to and the current status of Korea's IFDI policy, legal framework and structure, see the Invest Korea Web site, available at <http://www.investkorea.org/> (26 January 2006).

[38] Inward FDI statistics are available from the Invest Korea Web site, at <http://www.investkorea.org> (look under laws and statistics/economic statistics/foreign direct investment) (30 January 2006).

المنارة للاستشارات
Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

The results of these actions were as dramatic as the shift in policy: notifications of inward FDI increased from $3.2 billion in 1996 to $15.5 billion in 1999; on an actual invested basis the increase was equally impressive, with the total annual value soaring from $2.3 billion to $10.8 billion. These record levels were maintained in 2000, with the value of notifications and actual investments dipping slightly to $15.2 billion and $10.2 billion respectively (see table 2).

Analysis of the role played by inward FDI in Korea's recovery from the crisis has focused mainly on the benefits identified in the theoretical literature: domestic total fixed capital formation, productivity, technology and skills transfer, trade and balance of payments, economic concentration, sovereignty and autonomy, employment and wealth creation. Chang identified five major contributions made by inward FDI in post-crisis Korea: promoting industrial restructuring; securing advanced technology; increasing exports and thereby improving the trade account situation; boosting production and creating employment; and securing stable foreign exchange reserves.[39]

After the crisis, a substantial number of domestic firms moved quickly to sell off assets, pay down their debts and improve their financial health and, faced with a lack of suitable local investors, they turned to foreign corporations.[40] The Korea Institute for Industrial Economics and Trade (KIET) estimated that the top 30 conglomerates raised a total of $8.0 billion by entering into joint venture agreements with foreign investors, enabling them to proceed with their restructuring plans.[41] The Korean government also benefited from foreign participation in the restructuring process; the sale of public corporations such as POSCO and Korea Telecom accelerated the process of privatization, provided additional funding to expand the nation's social safety net and publicly demonstrated the government's commitment to restructuring and liberalization.[42]

Inward FDI also helped to upgrade the technological capabilities of domestic firms and to enhance national competitiveness immediately after the crisis. A survey of 305 large-scale foreign-invested firms (those with investments in excess of $100 million) carried out by KIET in 1999 revealed that 75 percent of the firms had introduced technology from their mother companies, with particularly high levels of activity in the chemicals, ceramics and transportation equipment sectors. Of the total, 68.5 percent of the firms were engaged in R&D activities, 73.2 percent had their own research facilities in Korea and 28.5 percent were involved in training their components

---

39 Yun-jong Chang, *Woegugin chikchŏpt'uja-ŭi ilsŏgojohyogwa punsŏk* [An Analysis of the 'Five Birds with One Stone' Effect of Inward Foreign Direct Investment] (Seoul: Sanŏp Yŏn'guwŏn, 2001), p. 50.

40 Yun, "Foreign Direct Investment: A Catalyst," pp. 140, 144.

41 Chang, *Woegugin chikchŏpt'uja*, pp. 40-41.

42 Ch'oe, "Woegugin chikchŏpt'uja-ŭi yŏk'al," p. 56; KIEP, *Kyŏngjenan kŭkpog-ŭi chirŭmgil*, pp. 77-78.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

suppliers and providing advanced skills and know-how in areas such as global management and financial systems.[43] The same survey revealed that 267 of the firms were engaged in exports and 282 were involved in importing activities. KIET estimated that these foreign-invested firms contributed almost $5 billion to the trade surplus in 1999 (see table 3); when oil refining and other industries that relied heavily on imported oil were excluded, the contribution increased to an estimated $6 billion.[44]

Table 3
Contribution to Trade Account by Foreign-Invested Firms, 1999
(in billions of dollars)[45]

	Exports	Imports	Trade account
Total	$143.7 billion	$119.8 billion	$23.9 billion
All foreign-invested firms (estimated)	21.4	16.5	4.8
Excluding oil refining, etc.	19.6	13.6	6.0
Foreign-invested firms' share of total	14.9%	13.8%	20.3%

Table 4
Ratio of Annual FDI Inflows to GDP, 1995-2000
(actual invested basis: in billions of dollars, %)[46]

	Annual FDI Inflows (A)	GDP (B)	A/B
1995	$1.4 billion	$489.4 billion	0.3%
1996	2.3	520.0	0.4
1997	3.1	476.6	0.7
1998	5.3	317.7	1.7
1999	10.8	405.8	2.7
2000	10.2	457.4	2.2

As can be seen in table 4, the ratio of annual FDI inflows to GDP increased from 0.4 percent the year before the crisis to 2.7 percent in 1999, before falling back to 2.2 percent in 2000. Table 5 shows the improvement in the ratio of annual inward FDI to domestic fixed capital formation, from 1.2 percent in 1996 to 8.3 percent in 1999. The ratio declined to 6.6 percent in

43 Chang, *Woegugin chikchŏpt'uja*, pp. 37-40.
44 Chang, *Woegugin chikchŏpt'uja*, pp. 34-36.
45 Chang, *Woegugin chikchŏpt'uja*, pp. 25, 30-36.
46 Chang, *Woegugin chikchŏpt'uja*, p. 25.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

2000, as FDI inflows slowed down but total fixed capital formation continued to grow. In the two years immediately following the crisis, foreign investors' share of domestic manufacturing production increased steadily, rising from 10.1 percent at the end of 1997 to 11.3 percent in 1998 and 13.3 percent in 1999. During the same period, domestic manufacturing production increased by $45.3 billion, with foreign-invested firms accounting for $20.0 billion, or 44 percent of the total. Foreign investors also played an important role in creating jobs; although there was a net decrease of 190,000 jobs in the Korean manufacturing sector between 1997 and 1999, employment at foreign invested firms increased from 149,000 (5.5 percent of the total workforce) in 1997 to 200,300 (8 percent of the total) in 2000.[47]

Table 5
Ratio of Annual FDI Inflow to Total Fixed Capital Formation, 1995-2000 (in billions of dollars, %)[48]

	Annual FDI Inflow (A)[49]	Total Fixed Capital Formation (B)	A/B
1995	$1.8 billion	$179.6 billion	1.0%
1996	2.3	191.3	1.2
1997	2.8	167.3	1.7
1998	5.4	94.6	5.7
1999	9.3	112.8	8.3
2000	8.7	131.3	6.6

Although foreign indirect (portfolio) investment made no significant contribution to the replenishing of Korea's foreign exchange reserves between 1997 and 1999, foreign direct investment accounted for more than 40 percent of the annual increase in foreign exchange reserves between 1999 and 2001, and contributed more than half of the increase of $6.6 billion seen in 2001. Between 1998 and 2002, Korea's foreign exchange reserves increased by a total of $101 billion; inflows of foreign capital in the forms of FDI contributed $29.2 billion, or 28.9 percent of the total.[50]

In addition to the benefits of inward FDI identified in the general theoretical literature, a crucial benefit deriving from higher levels of inward FDI was the potential long-term effect on Korea's business environment and

47 Chang, *Woegugin chikchŏpt'uja*, pp. 30-33.

48 Chang, *Woegugin chikchŏpt'uja*, p. 30.

49 The statistics presented in tables 2 and 6 are taken from the Invest Korea Web site and may be considered to be the "official" inward FDI statistics. These statistics are regularly revised and updated and may differ from the data presented in journal articles; hence the discrepancy between tables 2 and 7 (Invest Korea data) and table 5.

50 Chang, *Woegugin chikchŏpt'uja*, p. 21.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

culture. Just as the "demonstration effect" could encourage Korean firms to upgrade their technology, the success of foreign-invested firms in the domestic market might persuade local businesses to adopt the management, financial and corporate governance systems that contributed to foreign investors' success. In addition, as majority shareholders in or owners of Korean firms, foreign investors were in a position to demand and implement changes that would bring their companies' management and financial systems into line with international best practice.[51] The introduction and reinforcement of international best practice in financial and corporate governance and the enhancement of transparency would weaken the environment in which corruption and moral hazard could flourish, and it would boost investor confidence and enhance the attractiveness of the national business and investment environment.[52] Finally, the success of government efforts to induce major multinationals to invest in Korea and the entry of global players, including Procter and Gamble, Philips and General Motors, helped the country restore its international credibility, which had been badly damaged in the crisis.[53]

During the recovery period, therefore, it appeared that the government's efforts to induce foreign capital were successful and were also justified in terms of the beneficial effects seen in the domestic economy. With various branches of the media reporting this success story, people who expressed negative views about inward FDI were regarded as "ultranationalists" or deemed to be out of touch with the needs of the times.[54] Nevertheless, before long, negative perceptions about inward investment began to spread once more; there was "great suspicion of the negative effects of FDI"[55] and, as early as 1999, discussions could be heard in some quarters of Korean society as to whether inward FDI was, in fact, an "absolute good."[56] The Korea Institute for International Economic Policy (KIEP), which had been unequivocal in its pronouncements on the value of inward investment in post-crisis Korea, expressed frustration at the prevalence of these negative views, which focused on the domination of the Korean economy by foreign interests and the outflow of national wealth.[57]

---

51 Yun, "Foreign Direct Investment: A Catalyst," pp. 140, 148; *Shisa P'yŏngnon* [Review of Current Affairs] "Woegugin chikchŏpt'uja-nŭn kukpu ch'angch'urida" [Inward Foreign Direct Investment Creates National Wealth] (August 2003), p. 158.

52 Invest Korea, "Adapting to a Changing Economic Environment," pp. 13-15; Yun and Lee, *Impact of FDI on Competition*, p. 3.

53 Ha, *Kukche chikchŏpt'uja*, p. 1.

54 Sŏng-su Yang, "Woejayuch'i, idae-ro-nŭn kollanhada" [As it Stands, the Attraction of Foreign Capital is in Trouble], *Chugan Han'guk* [Korea Weekly] (8 July 1999), p. 34.

55 Yun, "Foreign Direct Investment: A Catalyst," p. 158.

56 Yang, "Woejayuch'i," p. 34.

57 Korea Institute for International Economic Policy (KIEP), *Woegugin chikchŏpt'uja-e taehan olbarŭn ihae* [The Correct Understanding of Inward Foreign Direct Investment] (Seoul: Korea Institute for International Economic Policy, 2000), p. 15.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

By the end of 1999, foreign investors had established a strong presence in a number of industrial sectors, including paper, automobile parts, chemicals, retailing, beverages and vegetable seeds, fuelling concerns about foreign domination of the Korean economy and the erosion of economic sovereignty.[58] The KIEP maintained that such views were not based on any clear evidence; although in some sectors the combined market share of foreign-invested firms might enable them to dominate the market, the real issue was that of fair competition within the sector, regardless of the nationality of the major players. After analyzing the influence of foreign investment on the competitive environment in key sectors, KIEP concluded that abuse of power by foreign firms was not a problem. The institute did, however, recommend constant monitoring to ensure that neither foreign nor domestic firms acted against the interests of fair competition.[59]

In the immediate aftermath of the crisis, the owners of Korean companies facing bankruptcy had sold their assets to raise funds needed to improve their companies' financial health. These transactions raised concerns about an outflow of national wealth; the sheer number of businesses for sale kept prices low and many firms, desperate for cash, agreed to sell at rock bottom prices. In the face of mounting anger at this outflow of national wealth, the KIEP pointed out that domestic firms had to accept responsibility for having failed to manage their businesses and that, in many cases, the only alternative to foreign investment was bankruptcy. Selling off assets, even at heavily discounted prices, limited losses and the outflow of wealth to that one occasion, while continuing to support weak and uncompetitive firms would require further injections of cash and could lead to even greater losses in the long term.[60]

Other negative views regarding inward FDI included scepticism about the actual levels of technology transfer and concerns that foreign-invested firms might focus on product development and improvement rather than basic research, and thus would transfer only a low level of technology to suppliers and contractors. There were also concerns about the focus on M&A transactions rather than greenfield investment, which could increase levels of concentration and ultimately lead to streamlining, plant closures and job losses.[61] The limited amount of empirical data that was available in the immediate post-crisis period suggested that such fears were unfounded: the number of foreign firms benefiting from tax advantages as a result of introducing advanced technology to Korea more than doubled between 1998 and 1999, from 27 to 67 firms. Furthermore, although the share of all invested funds accounted for by

---

58 Ch'ŏl-hwan Cho, "Woeguktchabon-i mollyŏonda: "Han'gug-ŭn maeryŏktchŏgin t'ujach'ŏ" inshik hwaksan" [Foreign capital is flooding into Korea: A spreading recognition that "Korea is an attractive place to invest"], *Chugan Han'guk* [Korea Weekly] (2 March 2000), pp. 44-45.

59 Yun, "Foreign Direct Investment: A Catalyst," p. 151; KIEP, *Woegugin chikchŏpt'uja-e taehan olbarŭn ihae*, p. 17.

60 KIEP, *Woegugin chikchŏpt'uja-e taehan olbarŭn ihae*, pp. 19-22.

61 Yun and Lee, *Impact of FDI on Competition*, pp. 3-4.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

greenfield transactions declined between 2001 and 2003, they remained the dominant form of inward investment, taking a 68.7 percent share in 2003.[62]

Table 6
Trends in Inward Foreign Direct Investment, 1998-2004 (in billions of dollars)[63]

	Notification	Actual
1998	$8.9 billion	$5.3 billion
1999	15.5	10.8
2000	15.2	10.2
2001	11.3	4.9
2002	9.1	3.7
2003	6.5	5.0
2004	12.8	8.6
Total	$79.3 billion	$48.5 billion

As the debate on the costs and benefits of inward FDI continued, the post-crisis investment boom began to show clear signs of slowing down and the value of both notifications and actual investments went into a decline that continued for the remainder of Kim Dae-jung's term of office. By the end of 2002, notifications had dropped to $9.1 billion and the value of actual investment had fallen by 64 percent to $3.7 billion in the space of two years. The gap between notifications and actual investment was also widening, from $4.7 billion in 1999 to $5.4 billion in 2002, indicating an increasing tendency for investors not to follow through immediately on their proposed investments (see table 6).[64]

The major factors in the downturn in inward investment activity at the start of the twenty-first century included a fall in the global economic growth rate, from 4.0 percent in 2000 to 1.3 percent in 2001 and a 40 percent year-on-year decline in global FDI flows in 2001—the first downturn since 1991 and the largest fall in 30 years.[65] Some FDI projects were postponed or even

---

62 Taehan Muyŏkt'uja Chinhŭng Kongsa, *Urinara woegugin chikchŏp t'uja hyŏnghwang mit t'ŭkching punsŏk* [An analysis of the current status and characteristics of inward foreign direct investment in Korea] (Seoul: Taehan Muyŏkt'uja Chinhŭng Kongsa, 2000) pp. 37-38; O Ho-yŏng, "Woehwanwigi ihu woegugin chikchŏp t'uja-ŭi hyŏnhwang-gwa kwaje" [The current status of and issues regarding inward foreign direct investment after the foreign exchange crisis], *Korea International Trade Association Trade Report* (May 2004), p. 62; inward FDI statistics are available from the Invest Korea Web site, at <http://www.investkorea.org> (look under laws and statistics/economic statistics/foreign direct investment) (30 January 2006).

63 Inward FDI statistics are available from the Invest Korea Web site, at <http://www.investkorea.org> (look under laws and statistics/economic statistics/foreign direct investment) (30 January 2006).

64 Hee-kyung Kim, "FDI in Korea: Recent Trends," p. 135.

65 United Nations Conference on Trade and Development, "The World Investment Report 2002: TNCs and Export Competitiveness, 1-22," available at <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2399&lang=1> (30 January 2006).

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

cancelled after the terrorist attacks of 11 September 2001 and there were heightened concerns over the possibility of a war in Iraq and tensions between the United States and North Korea. In addition, on the international scene, the emergence of China as a major host for foreign direct investment highlighted its advantages as a host for inward FDI, including low wages, relatively few labour problems and low land prices.

The rapid improvement in the health of the Korean economy after 1999 and the recovery in the value of Korea's currency and corporate assets also reduced investment activity; fewer businesses were put up for sale and creditors often chose to build up the value of companies under their control before selling them.[66] Perhaps more importantly, as the Korean economy showed signs of a strong recovery, some observers noted a weakening in the social consensus in Korea to accept inward investment as a necessary and desirable element in future growth. Labour unions were vocal in their opposition to some FDI transactions and labour unrest and the continuing inflexibility of the labour market acted as a deterrent to inward FDI, as did anti-American sentiment and demonstrations. Although the FDI systems had been improved, foreign investors still had complaints about the business and investment environment and continued to view Korea as "regulatory and discriminatory." Problems persisted despite the government's best efforts: high rates of corporate and personal tax, difficulties transferring funds in and out of Korea, continuing inflexibility in the labour market and the comparatively low quality of life for expatriates working in Korea.[67]

Inward FDI had clearly made a major contribution to the post-crisis economic recovery, the replenishment of Korea's foreign exchange reserves and the promotion of corporate reform and restructuring. However, the cooling of public sentiment towards inward investment and the apparent decline in Korea's attractiveness as a host nation now threatened the nation's access to the capital, advanced technology and know-how that would be crucial to Korea's global competitiveness and future economic success. As levels of inward direct investment continued to decline, the change of government in February 2003 led to a further shift in the Korean government's approach to the promotion of inward investment.

At the height of the investment boom in 2000, the KIEP had recommended a new direction for FDI policy that would move the focus from the post-crisis "scattergun" approach of simply attracting as much foreign capital as possible, to a targeted and strategic approach that would make IFDI a key instrument

---

66 June-Dong Kim, *Inward Foreign Direct Investment into Korea*, pp. 22-23.

67 June-Dong Kim, *Inward Foreign Direct Investment into Korea*, pp. 11, 24-27; Chin-sun Kim, "Woegugin chikchŏpt'uja pujin, muŏsh-i munjein'ga" [Stagnating Inward Foreign Direct Investment—What's the Problem?], *Shisa P'yŏngnon* [Review of Current Affairs] (March 2003), p. 130; Samsung Economic Research Institute, *Woegugin chikchŏpt'uja pujin-ŭi wŏnin-gwa ch'ŏbang* [Reasons and Remedies for the Stagnation of Foreign Direct Investment] (Seoul: Samsung Economic Research Institute, 2003).

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

in achieving national economic objectives, including sustainable long-term economic growth. In addition, KIEP recommended focusing on attracting more greenfield projects, promoting reinvestment by MNCs already active in the Korean market and, following the successful reform of Korea's FDI "hardware"—its promotional systems, legal and administrative frameworks—seeking changes in the FDI "software," including local business culture and perceptions of inward investment.[68]

In November 2003, the Roh Moo-hyun government re-launched the national investment promotion agency with objectives that reflected many of the proposals made by KIEP: Invest Korea's principal aim was to create an investor-focused promotional system and target the cutting-edge investment needed to advance Korea's economic goals, providing funding, support and incentives for specific industrial sectors. Invest Korea intensified its investor support initiatives by creating a team of project managers, who would offer one-on-one support from the initial enquiry through to the start of business operations. In addition, it recruited experts from specific industries and sections of the business community to offer targeted advice and support to existing and potential investors. On the "software" side, the agency took action to address negative perceptions about doing business in Korea by, for example, arranging meetings between investors and labour unions to discuss issues of mutual interest and providing seminars on Korean traditions, business culture and everyday life for foreign residents. For its part, the government made a commitment to achieving "significant improvements" by 2008 in six areas including medical services, housing, transportation and education facilities for expatriates and their families.[69]

In 2004, after a four-year decline in FDI notifications, Korea experienced the largest year-on-year increase since the financial crisis of 1997, as notifications almost doubled to $12.8 billion. Actual investment levels, which had begun to recover in 2003 with a 35 percent year-on-year increase to $5.0 billion, maintained the upward momentum in 2004, rising to $8.6 billion.[70] By the end of that year, it appeared that the new policy for promoting inward FDI and Invest Korea's efforts to enhance the national business and investment environment were beginning to pay dividends.

Conclusion

For more than three decades, the South Korean government restricted and controlled inward foreign direct investment, which, despite its potential

---

68 KIEP, *Woegugin chikchŏpt'uja-e taehan olbarŭn ihae*, pp. 27-28.

69 Invest Korea, *Adapting to a Changing Economic Environment*, p. 11 and *Invest Korea*. Online, cited 12 April 2005]. Available from http://www.investkorea.org.

70 Inward FDI statistics are available from the Invest Korea Web site, at <http://www.investkorea.org> (look under laws and statistics/economic statistics/foreign direct investment) (30 January 2006).

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

economic benefits, was seen as a less desirable option than using foreign loans to finance economic development. However, the 1997 crisis brought about a fundamental change in the government's attitude towards inward investment. The need to gain access to the capital, technology and know-how that would be crucial in restructuring the corporate and financial sectors, enhancing global competitiveness and ensuring the continued growth of the economy prompted major changes in Korean IFDI policy at the end of the twentieth century.

The Korean experience clearly demonstrates the forces and pressures that can drive changes in FDI policy in countries that have previously sought to restrict inward investment but now view it as a crucial element of their strategy for survival and growth. Furthermore, it highlights the problems inherent in seeking to change deeply rooted attitudes towards foreign participation in the domestic economy, perceptions of the value of inward FDI, and the impression investors have of a country and its investment environment. As the Korean government has discovered, while legal frameworks, promotional systems and structures can be changed or enhanced with relative ease, the more problematic issue is that of changing investors' perceptions of Korea and the Koreans' views of inward investment.

The negative and passive attitude that the Korean government had displayed towards inward FDI prior to 1997 might well have prompted those who had viewed Korea as a difficult, highly regulatory and discriminatory market to doubt that the newfound enthusiasm for foreign investment would outlast an upswing in Korea's economic performance. However, as the Korean economy began to show signs of recovery and IFDI levels declined from 2000, the government redoubled its efforts to attract investors. Returning to the restrictive and controlling policies of the past was not an option; to do so would invite criticism and possibly retaliation from trading partners. It was clear that for Korea to maintain or even enhance its position within the regional and global economy, her companies would have to gain access to advanced technology and enter into strategic alliances with foreign multinational corporations. There might be continuing resistance from unions and outbursts of anti-foreign capital sentiment, but government policy was set on a new track that could not be reversed. By the end of 2004, it seemed that the government's increased efforts to attract investment were bearing fruit: should the recovery in FDI inflows seen in 2004 continue in the medium to long term, the determination shown by the national investment promotion agency to address these issues and its decisive action across a broad range of FDI-related areas could provide a valuable model for other countries seeking to attract inward investment.

However, a short-term recovery in investment flows should not be taken as a sign that the process of creating a favourable business and investment environment in Korea is complete. Fundamental changes in the mindsets and perceptions of the Koreans and of foreign investors will not be achieved

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

in the short term. The controlling and restrictive nature of government FDI policies in the pre-crisis period, combined with the unfamiliar and sometimes hostile business environment, understandably created a perception among foreign executives that Korea is a difficult place to do business. On the Korean side, a long history of foreign domination, strong nationalistic sentiments and a desire for economic autonomy created a deeply rooted suspicion of foreigners in many sectors of society.

Now that the "hardware" issues have been addressed through the liberalization and deregulation of inward FDI, the formulation of policies to promote inward investment and the creation of institutions to support those policies, attention must focus on the more difficult "software" problems. These range from the broader issue of developing and promoting a positive national image or national brand for Korea to overcome the negative associations of the Korean War, military rule, tensions with North Korea and the 1997 financial crisis, which have tended to dominate press and media coverage, to the ongoing task of creating a more pleasant living environment for foreign executives and their families.

Continuing with action to respond to grievances and suggestions made by existing foreign investors and to publicize success stories relating to inward FDI will help to create an environment in which potential investors gain a good impression of the market and its opportunities from the media and foreign corporations operating in Korea. Highlighting the contributions made by foreign firms to the domestic economy and the positive experiences of Koreans employed by foreign MNCs will help to convince Koreans further of the benefits of IFDI. The creation of a more favourable view of inward investment will be facilitated by efforts to bridge the cultural gap and to create between foreigners and Koreans the bonds that underpin social and business activity in Korea. Some foreign-invested firms have already taken the initiative to raise their profile in Korea through projects within the business and wider community, including the sponsorship of studies abroad.

Many of these initiatives are already underway with the support and leadership of Korean inward investment promotion agencies, foreign embassies, chambers of commerce and business associations, clearly demonstrating the Korean government's determination to transform the country's business and investment environment and attract high-quality inward investment. Given the high level of regional competition to host IFDI from industrialized nations, these efforts must continue and even intensify in the future. Failure to develop strong locational advantages will put Korea at risk of losing crucial investments to regional competitors with a more attractive business, investment and living environment, and will jeopardize Korea's efforts to enhance the global competitiveness of its firms and to promote sustainable economic growth and development in the years ahead.

University of Sheffield, Sheffield, England, November, 2005

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

ABSTRACTS

Killing Five Birds with One Stone:
Inward Foreign Direct Investment in Post-Crisis Korea

Judith Cherry

This paper analyzes Korean attitudes towards inward foreign direct investment (IFDI) before and after the 1997 financial crisis, within the context of the debate on the costs and benefits of IFDI and intensifying global competition to attract inward investment. The Korean experience sheds light on the forces driving the liberalization and deregulation of inward investment by countries that had previously restricted and controlled IFDI and on the problems inherent in implementing these policy changes. For more than three decades, the South Korean government maintained a negative or passive attitude towards inward investment, which, despite its potential economic benefits, was seen as a less desirable option than using foreign loans to finance economic development. However, the 1997 crisis brought about a fundamental change in the Korean government's attitude, and led to sweeping policy changes that resulted in an investment boom in the immediate post-crisis period. After this initial success, the subsequent decline in FDI inflows prompted further measures to attract high-quality foreign investment. As the Korean government has discovered, while legal frameworks, promotional systems and structures can be reformed with relative ease, the issue of changing investors' perceptions of Korea and the Koreans' views of the role and value of inward investment is more problematic. Failure to resolve these problems and to develop strong locational advantages will put Korea at risk of losing crucial investments to regional competitors and will undermine efforts to enhance the global competitiveness of Korean firms and to promote sustainable economic growth and development in the years ahead.

The Political Economy of Japanese Foreign Aid:
The Role of Yen Loans in China's Economic Growth and Openness

Tsukasa Takamine

Over the past quarter of a century, China's economic growth, its transition from a socialist to a market-based economy and the integration of the Chinese economy into the global economic system have all progressed significantly. On the other hand, during the same period Japan has been the single largest source of foreign aid to China of all donor nations and international aid organizations, by providing more than half of China's total bilateral aid receipt. This article looks at the role of Japanese foreign aid in China's economic growth and increasing openness, and explains Japan's grand strategy in implementing its aid policy to China. My analysis suggests that there is a positive, albeit indirect, link between Japanese development fund, which is widely known as *yen loans*, and the growth and increasing openness of the Chinese economy. The evidence also indicates that the link between Japan's provision of yen loans to China and Japan's immediate corporate gains is surprisingly weak. Indeed, Japan has benefited indirectly because yen loans have contributed to the economic growth and openness of China, which in turn make it a better economic partner and more responsible regional neighbour for Japan. In the end, China's economic development, the incorporation of the Chinese economy into the global economic framework and China's transition to a market economy are in Japan's national economic as well as political interests.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

NATIONALISM AND ETHNIC CONFLICT IN INDONESIA. By Jacques Bertrand. *Edward Aspinall* 151

THE INDONESIAN MILITARY AFTER THE NEW ORDER. By Sukardi Rinakit. *Steven Drakeley* 153

STATE TERRORISM AND POLITICAL IDENTITY IN INDONESIA: Fatally Belonging. By Ariel Heryanto. *John Roosa* 154

THE INDONESIAN REVOLUTION AND THE SINGAPORE CONNECTION, 1945-1949. By Yong Mun Cheong. *Robin Ramcharan* 156

AND THE SUN PURSUED THE MOON: Symbolic Knowledge and Traditional Authority Among the Makassar. By Thomas Gibson. *Kathryn Robinson* 157

POWER PLAYS: Wayang Golek Puppet Theatre of West Java. By Andrew N. Weintraub. *Michael H. Bodden* 159

A NOT-SO-DISTANT HORROR: Mass Violence in East Timor. By Joseph Nevins. *David Webster* 160

Australasia and the Pacific Region

NEW ZEALAND IN A GLOBALISING WORLD. Edited by Ralph Pettman. *Katie Pickles* 162

A CONCISE HISTORY OF AUSTRALIA: Second Edition. By Stuart Macintyre. *Charlie Fox* 163

A TRIAL SEPARATION: Australia and the Decolonisation of Papua New Guinea. By Donald Denoon. *Steffen Dalsgaard* 164

AS MOTHERS OF THE LAND: The Birth of the Bougainville Women for Peace and Freedom. Edited by Josephine Tankunani Sirivi and Marilyn Taleo Havini. *Nancy Sullivan* 166

PAINT ME BLACK: Memories of Croker Island and Other Journeys. By Claire Henty-Gebert. *Clare Archer-Lean* 167

CONTRIBUTORS TO THIS ISSUE

JUDITH CHERRY is a lecturer in the School of East Asian Studies at the University of Sheffield. Her research interests include Korean outward and inward foreign direct investment, state-business relations and post-crisis corporate reform. Her book *Korean Multinationals in Europe* (Richmond, Surrey, UK: Curzon) was published in 2001. Email: <judithkbs@aol.com>

TSUKASA TAKAMINE is Assistant Professor of Politics in the Department of Integrated Arts and Science at Okinawa National College of Technology, Japan and Research Associate of the Asia Research Centre at Murdoch University, Australia. He is the author of *Japan's Development Aid to China: The long-running Foreign Policy of Engagement* (Routledge 2006). Email: <takamine@okinawa-ct.ac.jp>

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.