NEW DIRECTION OF KOREA'S FOREIGN DIRECT INVESTMENT POLICY IN THE MULTI-TRACK FTA ERA: INDUCEMENT AND AFTERCARE SERVICES

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Breakfast Session 1: New frontiers in investment promotion

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New Direction of Korea's Foreign Direct Investment Policy in the Multi-Track FTA Era*: Inducement and Aftercare Services

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I. Introduction

In line with changes brought forth by the rapidly globalizing world economy, the Korean government has recently pursued an FDI policy regime very different from that of the previous 'compressed industrialization' era. At the outset of industrialization, Korea emphasized the promotion of absorptive capacity as well as the indigenization of foreign technology through reverse engineering, while restricting both FDI and foreign licensing (Ahn, 2001a). As a result, Korean firms were able to assimilate imported embodied technology so rapidly that they managed to achieve subsequent expansion while upgrading industrial structure to emerge as global brands like Samsung, Hyundai, and LG from an agrarian economy in just three decades.

After the Asian financial crisis in 1997/98, Korea was forced to pursue FDI-friendly policy initiatives in order to fulfill the conditionality of the International Monetary Fund (IMF) in exchange for standby credit. In the past decade, policy makers in Korea have striven to devise a new FDI policy regime appropriate to the age of globalization and acclimated to the global economy by welcoming greenfield investment and M&As to augment investment activities which has thus lead to the development of a more competitive economy.

This has meant dramatically shifting policy direction from conventional loan-based

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borrowing to an FDI-based development strategy. In the interest of doing so, the need to establish a system capable of inducing new FDI and providing effective aftercare services to resolve the problems faced by foreign-invested companies in Korea has been fully recognized. Indeed, Korea has been very active in attracting foreign investment by setting up comprehensive service institutions to provide one-stop services.[1]

In terms of trade policy, Korea has also recently changed its focus on the WTO multilateral process to regional trade arrangements. In this context, most Koreans now view the recently concluded KOREA-US FTA and other multi-track FTA initiatives as an offensive tool to upgrade not only Korea's socio-economic system but also to implement proactive FDI measures. At this point in time, there appear to be great challenges and tasks ahead for Korea to become an advanced open economy, the pursuit of which has been envisaged as a national priority objective by the newly inaugurated Lee Myung-bak administration.

The purpose of this paper is to review several special features of Korea's FDI policy from a historical perspective and to discuss new proactive policy measures to induce FDI under the new government in the middle of Korea's ongoing multi-track FTA initiatives to upgrade the country's competitiveness. Section II describes Korea's FDI inducement policy and subsequent performance in recent years. Section III discusses the importance of aftercare services to existing foreign investors. Section IV will detail Korea's initiatives regarding regional FTA policy with a special reference to the recently concluded Korea-U.S. FTA and its implications on FDI policy. Section V concludes the paper with some new directional guidelines for Korea's future FDI promotion policy.

II. Korea's Recent FDI Inducement: Its Critical Role in Reviving the Korean Economy

Korea's loan-based development of the past is unique compared to the development models of other relative latecomers. Owing to the low level of domestic savings during the early stage of industrialization, the Korean government maintained distinctive foreign investment policies, giving preference to loans over direct investment. From 1962 to 1986, cumulative long-term foreign capital amounted to US$49 billion. Of this amount, commercial loans and borrowings from development agencies represented 65 percent and 32 percent, respectively, of which FDI accounted for a mere 3.9 percent (Ahn, 2001a).

As Table 1 and Table 2 show, Korea's heavy reliance on foreign borrowing to finance its investment requirements is in sharp contrast to Malaysia's dependence on FDI (Ahn, 2001a). For example, Korea's inward stock of FDI as a percentage of GDP was a mere 2.1 percent in 1990, whereas that of Malaysia and Singapore recorded 23 percent and 83 percent, respectively. Thus, FDI in Korea until very recently played only a marginal role in the country's rapid industrialization process. Even after Korea's switch to a more proactive FDI regime, the ratio of inward FDI stock to GDP was still one of the lowest in the world, far lower, in fact, than the global average or that of developing economies.

[1] For this purpose, the Korea Trade-Investment Promotion Agency, better know as "KOTRA," has established Invest KOREA and the Foreign Investment Ombudsman

Table 1: International Comparison of Inbound FDI

(Unit:%)

	Inflow of FDI/Total Fixed Capital Formation			*Inward Stock of FDI as a Percentage of GDP*		
	2004	***2005***	***2006***	***1990***	***2000***	***2006***
Developed Economies	6.6	9.3	11.8	8.2	16.4	24.2
Developing Economies	12.9	12.6	13.8	9.6	25.6	26.7
EU	8.1	18.2	18.1	10.5	26.0	38.0
United Kingdom	16.1	52.9	33.9	20.6	30.4	47.8
U.S.A.	6.2	4.9	6.8	6.8	12.8	13.5
Netherlands	1.8	34.1	3.3	22.4	63.1	68.2
Africa	12.6	17.8	19.6	11.7	25.5	29.5
Asia	10.3	11.3	12.9	9.1	26.5	24.9
Latin America	17.0	15.3	12.9	9.1	21.1	26.6
China	8.0	8.8	8.0	5.4	17.9	11.1
Hong Kong	96.4	90.4	103.9	58.6	269.9	405.7
Malaysia	19.1	15.2	20.1	23.4	58.4	36.0
South Korea	4.5	3.0	1.9	2.0	7.4	8.0
Singapore	77.5	57.6	79.5	82.6	121.5	159.0
Thailand	14.0	17.5	16.5	9.7	24.4	33.0

Source: UNCTAD, World Investment Report 2007

Table 2: International Comparison of Inward FDI Stock

(Unit: US$ billion)

Nation	***1990***	***2000***	***2006***
Hong Kong	45.1	455.5	769.0
China	20.7	193.3	292.6
Singapore	30.5	112.6	210.0
Brazil	37.2	103.0	221.9
Bermuda	13.8	59.0	98.0
South Korea	5.2	38.1	71.0
Chile	10.1	45.8	80.7
France	86.8	259.8	782.8
Thailand	8.2	29.9	68.1
Malaysia	10.3	52.7	53.6
United kingdom	203.9	438.6	1,135.3
Mexico	22.4	97.2	228.6
Netherlands	68.7	243.7	451.5
Iceland	0.15	0.5	7.5

Source: UNCTAD, World Investment Report 2007

In recent years, particularly since the Asian financial crisis, Korea has experienced rather sluggish economic performance as shown in Table 5. Korea's average annual growth rate from the early 1960s to the mid-1990s was 8 percent, but declined to slightly over 4 percent in the past 5 years. Due to a rapidly shrinking workforce coming as a result of population growth that ranks as the lowest among OECD member economies, low-pitched domestic facilities investment, and a relatively conservative ratio of FDI inflow in light of the increasing global trend toward decreased capital stock, Korea's potential growth rate had sharply declined from around 8 percent up until the mid-1990s to 5.1 percent in the period from 2000-2005. Despite the low level of domestic investment in 2006, the growth rate of Korea's outbound FDI exceeded inbound FDI during the sample period. Furthermore, the growth rate of capital formation in the same period was only 2.9 percent per year, dropping sharply from 5 percent average annual growth in the previous decade.

Table 3: Annual Growth Rate of GDP, Labor, Fixed Capital Formation, and FDI Inflows

(Unit:%)

	1987-1997	**2000-2005**
Average Growth Rate of GDP	8.03	5.24
Potential Growth Rate	8	5.1
Growth Rate of Labor Force	1.6	0.6
Growth Rate of Fixed Capital Formation	5	2.9
Contribution of Domestic Investment and Consumption	8.9	3.4
Outbound FDI (Growth rate)	35.8	7.9
Inbound FDI (Notification growth rate)	29.0	2.8

Source: Samsung Economic Research Institute (SERI)

Given this economic backdrop, raising the inflow of FDI to Korea is a matter of great significance in order to increase economic growth potential, achieve sustainable growth, and actively adjust to the age of the growing global supply chain. Even the once self-reliant Japan, whose focus had been solely on developing the competiveness of domestic industry, not to mention Southeast Asia, China, Singapore, Hong Kong, Malaysia, and Indonesia, has undertaken regulatory reform in an effort to draw foreign investment. As globalization becomes pervasive, thus affecting the world economy, FDI is likely to continue to play a very important role in Korea.

As a result, several new institutions came into being in Korea as foreign investment advocacy organizations immediately following the foreign exchange crisis in 1997/98. Most notable of these were Invest KOREA and the Office of the Foreign Investment Ombudsman. Invest KOREA is Korea's national investment promotion agency mandated to offer one-stop service as a means of attracting foreign direct investment, while the Office of the Investment Ombudsman was established to provide investment aftercare services to foreign-invested companies in Korea. Both are affiliated with KOTRA, the Korea Trade-Investment Promotion Agency.

As is the case with other economies competing to attract foreign direct investment, Korea enacted a new comprehensive foreign investment promotion act in 1998 directly following the onset of the Asian financial crisis to provide foreign investors lucrative incentives which include tax exemptions and reductions, financial support for employment and training, cash grants for R&D projects, and exemptions or reductions of leasing costs for land for factory and business operations for a specified period as shown in Figure 1.

Specifically, major tax incentives eligible for high-tech and industry supporting businesses and companies located in Foreign Investment Zone include full exemption of corporate income tax for five years from the year in which the initial profit is made and 50 percent reduction for the subsequent two years. In case of high-tech foreign investments in the Free Economic Zones are eligible for the full exemption three years and 50 percent for the following two years. Cash grants are also provided to high-tech greenfield investment and R&D investment subject to the government approval.

Figure 1: FDI Incentive Track

	Qualifications	Benefits	Procedure
HIGH-TECH Status	Business within the category of - HIGH-TECH BUSINESS or - INDUSTRY SUPPORT SERVICES	• Tax Holidays (5yrs 100%, 2yrs 50%) • Lease of land in Industrial complex • Financial Support for Employment & Training	• Application to MOFS* • Evaluation of the Application • Final Decision in 20 days
Foreign Investment Zone	Manufacturing • FDI $30M • New Establishment of Plant R&D • HIGH-TECH Status • New R&D Facilities & FDI $5M • Over 10 R&D Personnel	• Tax Holidays (5yrs 100%, 2yrs 50%) • Lease of Land • Support for Basic Infrastructure • Financial Support for Employment & Training	• Documentation with Local Government • Application to MOKE** • Evaluation by Foreign Investment Committee
Cash Grant	HIGH-TECH status(or Parts & Material Specialty) Manufacturing • New Plant Facilities & FDI $10M R&D • New R&D Facilities & FDI $5M • Over 20 R&D Personnel	Granted Cash can be used for… • Employment & Training • Land Acquisition & Rent • Construction Cost • Set-up Cost for Basic Infrastructure • Purchase of Capital Goods, R&D equipment & Materials	• Designation of Negotiation Partner • Preliminary Negotiation with MOKE • Application to MOKE • Evaluation by Foreign Investment Committee

* MOFS: Ministry of Finance and Strategy **MOKE: Ministry of Knowledge Economy

As a result of Korea's aggressive FDI inducement policy, inbound FDI notifications for 2007 recorded US$10.5 billion. This total marked the fourth consecutive year in which notifications reached or exceeded the US$10 billion mark. It should be pointed out that the volume of arrived FDI for 2006 totaled just over US$9 billion, a slight decrease from the previous year but on par with a three-year annual average of US$9.2 billion as shown in Table 4. Also of note is that total arrived FDI over the three-year period from 2004-2006 was far greater than the total from 2001-2003. As Korea's inbound FDI increases, particularly during the decade since the Asian financial crisis, the country's outbound FDI has also risen sharply as Korean companies take advantage of rapid globalization and subsequent supply chain expansion.

Table 4: Korea's Overall Inbound FDI Trends

(Unit: US$ million, %)

	2001	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***
Inbound FDI Notifications (Rate of increase)	11,286 (26.0)	9,093 (19.4)	6,471 (28.8)	12,792 (97.7)	11,563 (9.6)	11,233 (2.9)	10,509 (6.5)
Inbound FDI Arrivals (Rate of increase)	5,073 (50.6)	3,807 (25.0)	5,112 (34.3)	9,268 (81.3)	9,643 (4.0)	9,038 (6.3)	5,057 (3Q)
Outbound FDI	5,164	3,702	4,007	5,991	6,560	10,759	20,734

Source: Ministry of Knowledge Economy, FDI Trends
Note: Figures for arrived investment are tentative

In the past two years, the EU has been the largest source of Korean inbound foreign direct investment, contributing more than 40 percent of total arrived FDI, followed by the U.S. and Japan. In 2006, greenfield investment was up 10 percent to US$6.9 billion. On an individual country basis, the U.S. has been the largest provider of FDI to Korea as shown in Table 5.

Table 5: Korea's Inward FDI by Country of Origin

(Unit: US$ thousand, %)

Nation		*Number of Firms*	*Inward Stock as of July 1, 2007*	*Ratio*
USA		2,392	12,886,625	19.0
Japan		3,012	12,414,665	18.3
EU		1,691	29,332,456	43.2
	Germany	448	4,225,606	6.2
	United Kingdom	306	6,474,331	9.5
	France	206	3,199,949	4.7
	Belgium	56	2,714,287	4.0
	Netherlands	387	8,920,170	13.1
	Ireland	84	1,178,012	1.7
	Sweden	67	941,725	1.4
	Hungary	8	305,074	0.4
	Slovakia	1	54	0
	Other European nations	284	1,373,250	2.0
Other nations		6,455	13,264,399	19.5
Total		13,550	67,898,144	100

Source*:* Ministry of Knowledge Economy, FDI Trends

By industry sector, FDI inflows for manufacturing in 2006 accounted for 37.8 percent of total notified FDI, mainly in the electronics and chemicals sectors. The service sector accounted for 60 percent of that number. Manufacturing-focused greenfield investment was up in 2006 with large scale investment in LCDs, the chemical industry, health and sanitation. In the same year, despite a major upturn in mergers and acquisitions globally, M&A investment was down 20 percent compared with the previous year (Table 6). M&As occurring in the service industry were down 33.7 percent year-on-year in 2006 with M&A FDI recorded at just US$2.8 billion. Mergers and acquisitions in the manufacturing sector, however, jumped 18.7 percent to US$1.3 billion.

Table 6: Inward FDI to Korea by Investment Type

(Unit: Million, %)

		2001	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***
M&A	Cases	297	285	288	339	371	363	344
	Value	2,649 (23.5)	2,084 (22.9)	2,943 (45.5)	6,169 (48.2)	5,268 (45.6)	4,305 (38.3)	2,481 (23.6)
Greenfield	Cases	3,046	2,125	2,280	2,737	3,298	2,745	3215
	Value	8,637 (76.5)	7,009 (77.1)	3,528 (54.5)	6,625 (51.8)	6,295 (54.4)	6,927 (61.7)	8029 (76.4)
Total	Cases	3,343	2,410	2,568	3,076	3,669	3,108	3559
	Value	11,286	9,093	6,471	12,794	11563	11,232	10.509

Source*:* Ministry of Knowledge Economy, FDI Trends
Note: The numbers in parentheses indicate the relative percentage of the total.

Table 7 shows a dramatic surge in Korean outbound FDI in 2007, surpassing a record US$10 billion. Of Korea's outbound FDI, Asia took the lion's share with 60 percent. China has proven the most favored destination among Korean investors wishing to take advantage of the country's close proximity and its status as the world's most populous and rapidly growing market. It should be pointed out that 2007 marked the first year that outbound FDI exceeded inbound FDI.

Table 7: Korea's Outbound FDI by Region

(Unit: US$ mi1lion)

	1995		***2000***		***2005***		***2006***		***2007***	
Region	**Cases**	**Value**	**Cases**	**Value**	**Cases**	**Value**	**Cases**	**Value**	**Cases**	**Value**
Asia	1,045	1,703	1,186	1,576	2,990	3,932	3,472	6,059	3,966	11,000
North America	139	549	714	1,420	1,099	1,277	1,334	2,142	1,331	3,557
Latin America	31	122	51	1,505	45	307	60	527	86	1,201
Africa	7	42	7	156	19	113	20	214	38	239
Middle East	1	32	4	30	16	130	34	391	97	194
Europe	71	613	67	291	140	645	166	1,195	278	4,027
Oceania	38	39	53	90	80	153	99	202	107	513
Total	**1,332**	**3,102**	**2,082**	**5,069**	**4,389**	**6,557**	**5,185**	**10,731**	**5,903**	**20,734**

Source: Export-Import Bank, Korea, Foreign Investment Statistics Data File

In contrast to the very low levels of FDI even after Korea's drastic adjustments to its FDI policy regime, the inflow of foreign portfolio investment has been remarkable as seen in Table 8. A key strategy for corporate restructuring as a follow up to the IMF conditionality following the financial crisis in 1997/8 was a substantial conversion of debt to equity, which required a change in domestic capital market and a shift in household savings patterns as improvements have had to be made in the corporate financial market structure in order for corporations to raise necessary funds directly (Ahn, 2001b). As a result, the Korean government lifted the daily transaction ceilings of foreign investors in Korea's stock market in order to encourage the inflow of foreign portfolio investment. Korea's bourse is the most open among Asian countries and on par with those in the most open western economies. Consequently, in terms of foreign presence, there exists a substantial asymmetry between portfolio investment and FDI, respectively.

Table 8: Foreign Share of Aggregate Market Value of Listed Stock in Korea 1992-2006

(Unit: %)

Year	**1992**	**1995**	**1998**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Foreign Share	4.9	11.9	30.1	30.1	36.62	36.01	40.11	41.97	39.73	37.26

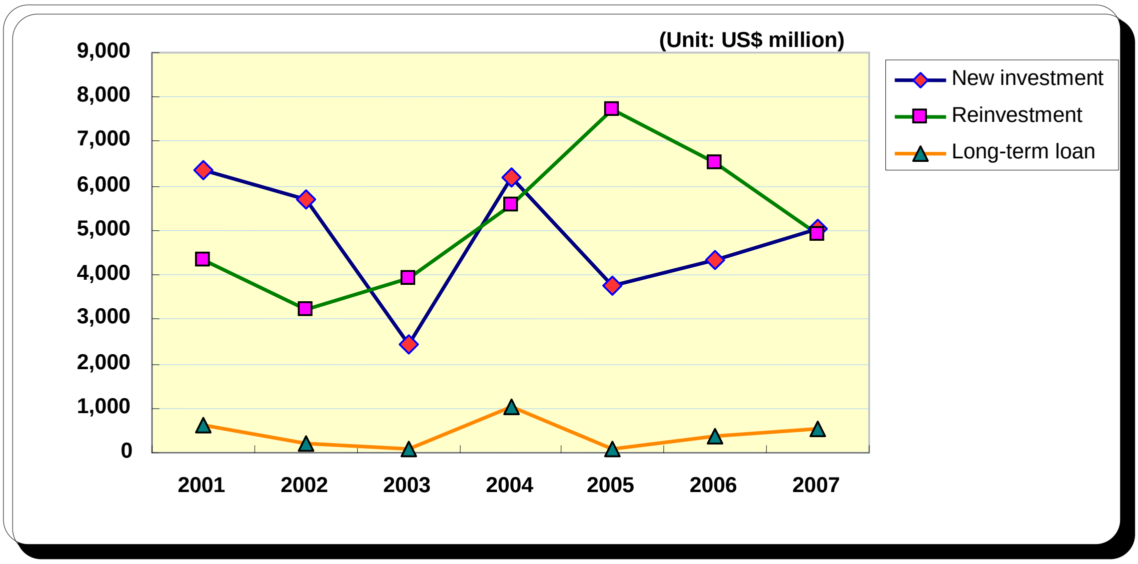
Source: Korea Stock Exchange

III. The Importance of Aftercare Services to Existing Foreign Investors

The United Nations Conference on Trade and Development (UNCTAD) pointed out the need for individual economies to pay keen attention to the problems faced by transnational enterprises and work to effectively address their grievances. Foreign investors in Korea have already registered a wide range of difficulties in the areas of taxation, labor-management, accounting, construction, technology standards, law, and lack of knowledge regarding how to take advantage of various available incentives. As a result, UNCTAD has placed greater emphasis on global investment aftercare and related advocacy measures. By improving the investment environment for existing investors, it would be a very effective way of improving international investor relations.[2]

Of the average US$10 billion in FDI that Korea has been able to attract for the past four years, the ratio of re-investment made by established investors accounted for nearly 60 percent of this total. This trend suggests that the need to place emphasis on post investment care for those investors becomes increasingly important (Figure 1). Discussions on aftercare service provisions warrant the nature of complaints filed by foreign investors, the grievance resolution process, and resolution outcomes at the Office of Foreign Investment Ombudsman.

Figure 2: Trends of New Investment by Newly-Entered Foreign Companies and Reinvestment by Existing Foreign Companies



Source: Ministry of Knowledge Economy

[2] UNCTAD awarded KOTRA the 2006 World Association of Investment Promotion Agencies (WAIPA) trophy for excellence for the establishment of the Office of the Investment Ombudsman system which labors on behalf of subsidiaries of transnational companies in Korea and the Office's performance in garnering increased investment from existing investors.

A Variety of Grievances

Table 9 shows that foreign companies in Korea have registered a variety of grievances from 2001-2006, and subsequently demanded timely and effective aftercare services. In 2006, tax-related complaints accounted for the largest proportion and showed the sharpest increase of any type of grievance compared to previous years. In the past, the most frequently registered complaints, those related to labor-management relations, have now relatively declined. This is largely attributed to improvements made to stabilize Korea's labor-management culture. Changes made to the FDI system and a reduction of incentives consequently resulted in a rise in customs and trade, investment incentive, and procedure-related grievances. The number of tax and tariff-related grievances rose by 24.6 percent, while customs and trade-related grievances increased sharply by 76 percent. Those relating to investment incentives rose 20.0 percent during the six-year period from 2001-2006. Though the ratio on the whole was relatively low, what is particularly noteworthy is a 150-percent increase in environment-related grievances from 4 to 10 cases. Though we foresee a tightening of regulations in this area, more preemptive measures do need to be taken.

Table 9: Annual Grievance Registrations by Type

(Unit: case, %)

Year / Field	2001	2002	2003	2004	2005	2006	2007		Rate of Increase 2006~7 (%)
							Cases	Ratio(%)	
Tax & Tariffs	49	67	63	64	61	76	63	16.98	△17.1
Labor Management	63	106	93	75	42	38	24	6.47	△36.8
Investment Process	20	51	34	22	31	27	36	9.70	33.3
Customs & Trade	74	62	41	25	25	44	35	9.43	△20.5
Investment Incentives	1		1	3	25	30	42	11.32	40.0
Finance & Foreign Exchange	37	32	24	23	25	21	25	6.74	19.05
Visa & Immigration	15	20	17	19	20	21	21	5.66	0.0
Construction	52	43	34	35	19	16	22	5.93	37.50
Operations & Distribution	18	14	8	13	17	5	13	3.50	160.0
Plant Location	2	1	1	4	16	13	15	4.04	15.4
Private Disputes	6	6	4	1	11	5	10	2.70	100.0
Certification Examination	8	3	5	1	9	8	10	2.70	25.0
Insurance & Public Welfare	7	9	3	5	6	2	3	0.81	50.0
Environment	13	12	7	6	4	10	2	0.54	△80.0
Highway & Transportation	2			1	4	1	3	0.81	200.0
Living Conditions	15	6	2	7	3	2	2	0.54	0.0
Power Sources	7	1	3	2	2	1	0	0.00	△100.0
Other	39	42	29	18	31	33	45	12.13	36.36
Total	**428**	**475**	**369**	**324**	**351**	**353**	**371**	**100**	**5.00**

Source : Office of the Foreign Investment Ombudsman.

Labor-management grievances in 2002 accounted for the highest ratio with 106 cases, a number which fell to 38 in 2006. Aside from labor and management-related grievances, 2006 also witnessed lower totals in investment process-related grievances, finance and foreign exchange grievances, and those dealing with construction and land dropping 12.9 percent, 16 percent, and 15.8 percent, respectively. Operation and distribution complaints, private sector disputes, and those related to insurance and welfare also saw drastic respective drops of 70.6 percent, 54.5 percent, 66.7 percent in the number of related grievances. Again, the decrease in the number of complaints filed came as a result of changes implemented through regulatory reform affecting permit acquisition, the streamlining of construction and land, operations and distribution (the authorization of discount warehouses), and plant location. As a result of the actions instituted to improve the investment environment for foreign multinationals, grievances related to living conditions, power and water have also dropped drastically.

The Grievance Resolution Process

The resolution process takes many forms. Generally, senior consultants, better known as "home doctors," play a major role in the decision-making process. In the first stage, senior consultants do intake and evaluation in order to determine how a case should be processed. Then, they consult with representatives from relevant government agencies. After a case is reviewed and opinions exchanged between the home doctors and the Ombudsman, senior consultants submit a grievance resolution proposal through official channels. In the event that a case is rejected, the matter can be brought before the Foreign Investment Working Committee, the Regulatory Reform Committee, and/or the Office for Government Policy Coordination. A request for intervention can also be brought to the Ministry of Knowledge Economy's Business Grievance Consulting Center. Although grievances can be submitted to the Foreign Investment Working Committee, the process of doing so has proved ineffective due to the fact that meetings are held only on a quarterly basis. When cases require swift resolution, since convening meeting and holding subsequent hearings may require more time, working through the Foreign Investment Working Committee may not be preferable for foreign investors.

For cases in which transnational corporations filed grievances requiring systemic changes, regulatory reform and/or amendments to enforcement decrees, the Foreign Investment Ombudsman acts on their behalf, directly contacting the heads of relevant agencies and submitting proposals. The Foreign Investment Promotion Act dictates that government agencies should reply within a week once they receive a recommendation from the Ombudsman. Though many of the proposals submitted to the Office of the Foreign Investment Ombudsman are quite reasonable, government bureaucracy frequently keeps many cases from being resolved. Therefore, the taking of steps to strengthen the authority of the Ombudsman and improve the system is highly recommended.

Rise in Grievance Resolution Rate in 2006

Of the total number of grievances filed during the period of 1999-2007, those requiring systemic changes accounted for 237 cases and recorded a 41.3-percent resolution rate. However, 334 cases out of 625 cases have been successfully resolved through administrative intervention, a success rate of 59 percent. In addition, 221 cases were handled internally by home doctors. Cases requiring systemic changes that called for amendments to existing laws were relatively low in number, although it should be noted that the success ratios by systemic and administrative intervention have risen to above 90 percent, respectively (Table 10).

Table 10: Resolution of Grievances Filed by Transnational Companies

(Unit: case, %)

Year	Systemic Change			Administrative Intervention			Total		
	Cases	Resolved	Rate(%)	Cases	Resolved	Rate(%)	Cases	Resolved	Rate(%)
1999	20			35			55		
2000	39	5	12.8	64	23	35.9	103	28	27.1
2001	39	11	28.2	105	25	23.8	144	36	25.0
2002	36	6	16.7	76	20	26.3	112	26	23.2
2003	30	5	16.7	72	45	62.5	102	50	49.0
2004	23	10	43.5	72	42	58.3	95	52	54.7
2005	19	11	57.9	68	55	80.9	87	66	75.9
2006	19	12	63.2	73	66	90.4	92	78	82.6
2007	12	11	91.6	60	58	96.6	72	69	95.8
Total	237	71	41.3	625	334	59.3	862	405	54.2

Source: Office of the Foreign Investment Ombudsman

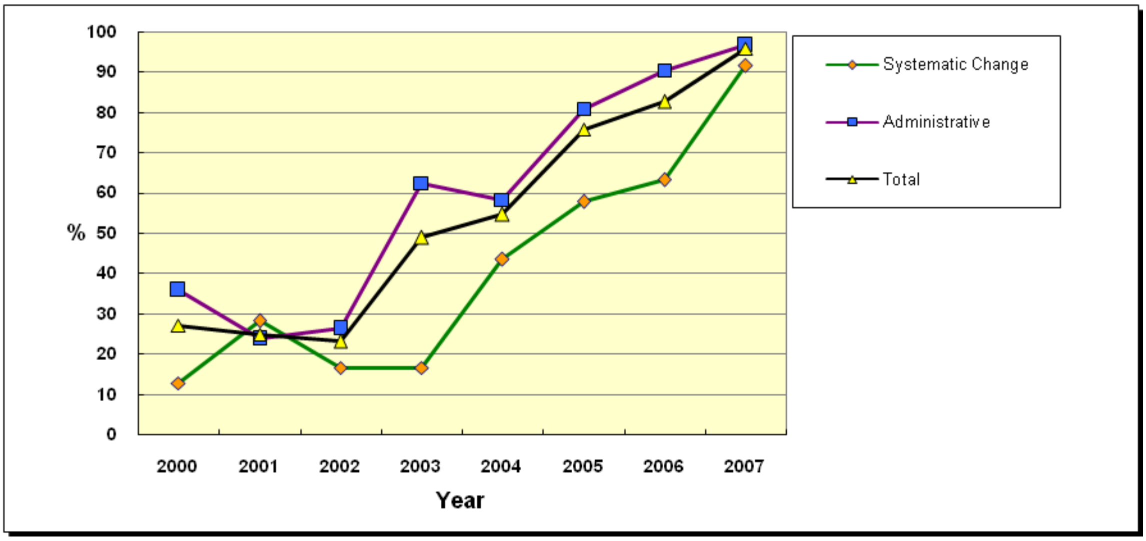
In the almost 9 years since the Ombudsman system was adopted in October 1999, home doctors have accumulated a wealth of insight into resolving grievances. Armed with this knowledge, and working closely with clients, the consultants have played a key role in resolving many of the grievances submitted.

Since 2003, government officials dispatched to Invest KOREA have worked alongside Investment Aftercare Team staff, paying on-site visits to those who have filed complaints, looking for feasible solutions to problems, and contributing to raising the resolution rate. A recent increase in the amount of dispatched government agents has increased the number of direct channels to various government agencies, allowing for a higher rate of resolution. In 2006, seven consultants from the Investment Aftercare Team paid visits to 482 transnational firms. One-hundred seventeen of these visits were to areas located outside of Seoul. They were accompanied by dispatched government officials on 47 trips.

Appointed to office in 1999, the Foreign Investment Ombudsman recognized the urgent need to pay personal visits to business sites to find real solutions to the problems investors faced. After meeting with the heads of foreign multinationals, he usually brought their issues before the proper authorities which, to date, have included both high level government officials as well as local administrators. In order to make an accurate assessment of the current state of affairs in terms of the resolution of foreign investors’ grievances, he also opened a door for cooperation between the Office of the Ombudsman, local autonomous government organizations, foreign missions to Korea, foreign chambers of commerce including the American Chamber of Commerce (AMCHAM), European Union Chamber of Commerce Korea (EUCCK) and the Seoul Japan Club, as well as other economic organizations.

The heightened level of cooperation occurring between the Regulatory Reform Committee of the Office for Government Policy Coordination and the Ministry of Knowledge Economy as well as other agencies came as a result of the efforts of the Foreign Investment Ombudsman to better resolve grievances as seen in Figure 2.

Figure 3: Resolution Rates by Year



Source: Office of the Foreign Investment Ombudsman

IV. Korea's Multi-Track FTA Policy

While Korea has participated in multilateral negotiations, it has adopted, somewhat belatedly, a multi-track approach to regional trade arrangements as evidenced in Table 11. Of these arrangements, both the Korea-U.S. and Korea-EU FTA are the most important. A comprehensive FTA with the world's two biggest economies would lead to greater economic growth, consumer welfare gains, production surpluses, and job creation for both parties through increased trade and investment.

Table 11: Korea's Multi-track FTAs

Nations	*Status*	*Mid & Long-term Effectiveness*
Chile	April 2004, Effectuation	Assuming that capital accumulation must occur by both domestic and foreign investors
Singapore	March 2006, Effectuation	
ASEAN 10	May 2006, Liberalized manufacturing Sector Service industry to be concluded in 2007	
EFTA (Switzerland, Norway, Ireland, Liechtenstein)	September 2006, Effective	
Japan	Negotiations suspended	
Canada, Mexico, India	Aim to conclude within one-two years	
EU	6 rounds of negotiation completed	
USA	Concluded on April 2, 2007	Assuming that inward FDI will rise to US$23-32 billion over 10 years

Source: Ministry of Foreign Affairs and Trade

In the midst of the global economy's rapid globalization, successful conclusions of free trade agreements are likely to result in transforming Korea further into a highly competitive and attractive investment destination. In this regard, an FTA between the U.S. and Korea, which was concluded on April 2nd, 2007 just prior to expiry of U.S. President George Bush's TPA, becomes highly significant once it is ratified. After all, this is an agreement between the world's largest and 13th largest economies.[3] Such an agreement would mark the largest ever cross-Pacific free trade deal and it will be watched closely around the world.

In regard to the likely beneficial impact of the Korea-U.S. FTA on the Korean economy, a study by the Korea Institute for International Economic Policy (KIEP) shows that incremental GDP growth via the KORUS FTA under a dynamic and capital accumulation scenario[4] of a CGE model during a new equilibrium path period.[5]

Table 12: Economic Impact of the Korea-U.S. FTA

		Short-term (Static effect[1])	Mid- to Long-term (Dynamic effect [2])
Real GDP		0.42% (US$2.9 billion increase)	1.99% (US$13.5 billion increase)
Welfare		0.61% (US$2.4 billion increase)	1.73% (US$6.8 billion increase)
Trade	**Export to U.S.**	12.1% (US$5.4 billion increase)	5.1% (US$7.1 billion increase)
	Import from U.S.	29.1% (US$9.6 billion increase)	39.4% (US$12.2 billion increase)
	Trade Balance	US$4.2 billion decrease	US$5.1 billion decrease
Production		0.61% (KRW8.5 trillion increase)	1.94% (KRW27 trillion increase)
Employment		-0.51% (down 85,000)	0.63% (up 104,000)

Source: Korea Institute for International Economic Policy
Note: 1. Static run is derived without the capital accumulation effect
2. Dynamic effect considers the capital accumulation effects arising from increased investment

However, it should be noted that a fundamental prerequisite for this additional growth due to the capital accumulation effects to be realized for Korea is that Korea should be able to enjoy additional inward FDI of US$2-2.5 billion on a yearly basis in addition to the present trend of annual FDI inflows of about US$10 billion. Unless this additional FDI is realized, all the economic benefits expected as a result of a ratified KORUS FTA could be substantially reduced.

For these reasons regarding the potential impact of the KORUS FTA, Koreans should see the agreement as a critical turning point, that is, a chance to deepen the country's commitment to becoming a sophisticated, advanced, and truly open economy. The KORUS FTA should serve as a golden opportunity for Korea to enhance trade, labor, and IPR-related laws and systems to meet the level of global standard.

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[3] For a Korean perspective on geo-economic and geo-political implications of the concluded KORUS FTA, see Ahn (2007)

[4] The capital accumulation effect refers to long-term positive impacts due to a virtuous cycle from market expansion through expanded trade, hence investment increases from domestic as well as foreign companies, and endogenous productivity increases.

[5] Lee and Lee (2005) carried on subsequent estimation on the economic impacts of the KORUS FTA under an assumption of an inward foreign direct investment to Korea.

Korea is exploring strategies aimed at commercializing the nation's position as a peninsular hub nation connecting a continental economic group headed by China and Russia and an 'ocean' economy group headed by Japan, the U.S. and other Pacific Rim economies, to remake itself as a major business hub of Northeast Asia. The success of this strategy rests largely on how successful the nation is in attracting new FDI and inducing reinvestment from already existing foreign investors by facilitating networking of finished goods, parts and materials, logistics, finance, local subsidiaries of transnational companies, and R&D centers. This will be possible if Korea manages to maximize returns from the recently concluded KORUS FTA as well as other free trade agreements and proactively attract FDI. It is well-documented that FTAs normally establish rights and protection for foreign investors as stipulated in investor-state dispute and investment liberalization and intellectual property right measures contained in the KORUS FTA.

Whether Korea manages to maximize returns on the effects of the KORUS FTA and subsequent multi-track free trade deals will depend largely on how actively quality FDI is attracted. Korea needs to carry out a number of tasks to create a foreign investor-friendly business environment as Korea moves forward to becoming an FTA hub nation as envisioned in the Korea's multi-track FTA roadmap. Of course, Korea should prepare itself to take full advantage of the potential benefits of the KORUS FTA. This begs the question as to which tasks must Korea face before achieving that objective.

V. FDI-Friendly Regime of the New Government: Actions and Challenges

On February 25, 2008, Korea launched a pragmatic government with President Lee Myung-bak taking office. Unlike his predecessors, President Lee comes from a business background, having served as CEO of Korea's leading construction company during the heyday of industrial growth in the 1970s. During his run-up to the Presidency, Lee emphasized his desire to head an action-oriented administration as he had already demonstrated during his tenure as Mayor of Seoul. One of the top five goals by the Lee government is to revitalize the sagging Korean economy and further open domestic markets. The new government has pledged to cut taxes to spur corporate investment and will undertake comprehensive deregulation to encourage foreign investment with renewed incentives and a more business-friendly environment. Upon his inauguration, President Lee created the Presidential National Competitiveness Council, on which many foreign experts serve as members.

At the first presidential meeting chaired by the President, the Council decided to dramatically reduce the time needed to authorize industrial parks to a maximum of six months, down from the current two to four years. This reduction of inefficiencies and red tape across government agencies will help to reduce the burden not only on private developers but also on startup companies.

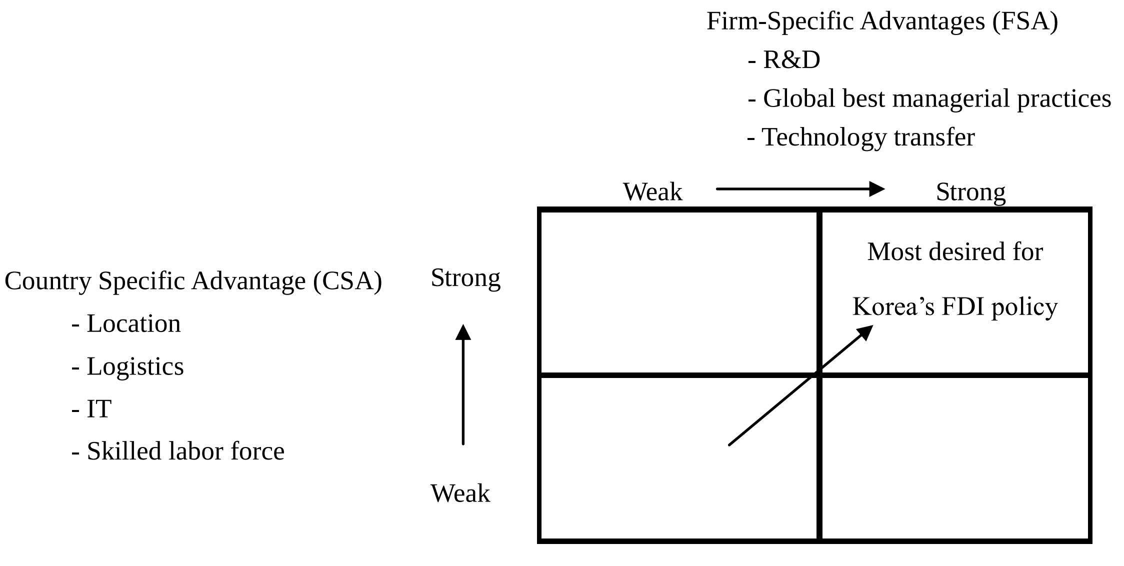
One of the central reasons for the delays in the construction process in Korea is said to be the lengthy environmental and cultural due diligence on proposed industrial park sites. A task force to shorten the due diligence process is to be formed by members of the Ministries of Land and Environment, respectively. In order to remove this complex web of regulations, the Presidential Committee is planning to put into effect both deregulation guidelines across related regulations together along with a "sunset clause" for existing regulations. This is one example of the lengths the new government is willing to go in implementing its plan of action to foster a more business-friendly environment.

To complete this process, the Lee administration is likely to face a host of challenges. From a broad and macroeconomic perspective, above all, Koreans need to grow their understanding of international economics to relieve deeply instilled xenophobia, and specifically, their negative sentiment against foreign capital. Korea needs also to recognize that many foreign companies have pointed out as some of Korea's most serious negative factors the unlawful and occasionally militant labor movements in addition to the already comparatively high wage levels amongst Asian countries. Korea also needs to supplement its FDI policy to function in a liberalized global trade environment as committed to in the KORUS FTA and forthcoming Doha Development Agenda negotiations.

Another broad set of tasks for changing the investment environment should be to improve the country's absorptive capacity for FDI. In this regard, a Rugman model (Figure 3) is worth noting as it harmonizes multinational firm-specific advantage (FSA) regardless of foreign and domestic origin[6] and country specific advantage (CSA), thus strengthening domestic economic absorptive capacity in order to select and attract transnational companies that can significantly help Korea remain competitive in a global market place.

Korea today has two-way flows of FDI and a symmetrical pattern of cross investments, which is typical of the mature economies in North America, Europe and Japan. The crux of FDI is the realization of FSAs. As Lee and Rugman (2006) suggest, Korea should realize that inward and outward FDI is closely related through the dynamic process of MNCs upgrading CSA and FSA in host countries as evidenced by globally accelerating production fragmentation and supply chains. The Korean government needs to design policy measures effective for attracting foreign MNCs with FSAs of high quality. In a nutshell, Korea should move from the third quadrant to the second quadrant of the Rugman model, where both FSA and CSA are strong in order to design new directional guidelines for future FDI policy.

Figure 4: Application of Rugman's FSA-CSA Matrix



6 In 2001 and 2004, Korea had 11 companies respectively listed among the Fortune 500.

In order to improve absorptive capacity, Korea needs to upgrade its education system for expatriate residents' school-age children by expanding the number of accredited international schools. It is also most crucial to make English more widely used as a business language by making both laws and government regulations readily available in English.

Korea must also increase transparency of laws and systems in relation to FDI. For example, the adoption of a future tax liability system, like that of the Netherlands, would be very effective to remove uncertainties for potential foreign investors. As UNCTAD points out, industrial clustering as contained in the Korea's business hub strategy is a highly effective way to attract desired and selective FDI.

Making central and local government agencies' incentive systems more consistent to achieve global standards by doing away with tax and non-tax barriers, as well as considering how to improve communication channels between the government and transnational companies, is also crucial. In this regard, the central government and its agencies should take a more proactive approach to providing administrative services to nurture and develop businesses.

Especially in regard to legal aspects, Korea must introduce global standards that will require the country to make regular revisions of laws and systems governing FDI. Much of the contents of the existing regulatory regime were formulated during the export-based industrialization process. Therefore, it is critical to shorten the time lag between the speed of technological progress and shortened life cycles of products and outdated existing legal structures.

Despite geographic restrictions, the Netherlands has managed to create a desirable business environment that has gained acclaim as a global logistics hub. Ireland, once the lowest income economy in the EU, has succeeded in rising to the ranks of an advanced economy mainly due to aggressive inducement of FDI. Singapore is another good example of a nation transforming itself into a hub of high valued foreign direct investments from MNCs. It is clear that we are no longer in an age of mere reciprocal FDI flows between developed nations, but instead, one in which less developed nations have joined the struggle for a piece of the global FDI pie.

Foreign investors in Korea file a variety of grievances regarding taxation, labor-management relations, accounting, urban planning and development, technology standards, law, and requests for assistance filing for various available incentives. Korea should strengthen aftercare services towards already existing foreign companies so that they can reinvest in Korea and effectively promote Korea as an attractive investment destination.

The bulk of future inflows will be in the form of M&A between developed markets, thus Korea should capitalize on this emerging global trend. Cross-border M&A deals are increasingly encountering resistance as host countries fear a threat to their managerial ownership and cultural identity. There are also two bills under consideration in the U.S. Congress which would subject foreign takeovers to more rigorous scrutiny. Even in Korea, there exists a legislative attempt to regulate potential foreign takeovers of key Korean industries.

Korea has a long way to go before its ratio of inward FDI stock to GDP meets the global average, allowing the country to become a regional business and financial hub. Any legislative action to regulate hostile M&As is likely to result in negative consequences. If necessary, Korea should approach this issue in terms of a corporate governance system or other indirect measures rather than direct regulation.

Korea as it stands at this point in time offers several attractive points for foreign investors: a) the 13th biggest economy in the world, b) its strategic location in the center of key regional markets, c) an IT power house with the leading penetration ratio of broadband internet system, and d) a high quality university-educated workforce and one of the world's highest advancement ratios from high school. With the Korean government's renewed determination to promote a business-friendly environment for domestic as well as foreign companies, Korea is certain to become a regional business center in East Asia.

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