FOREIGN DIRECT INVESTMENT AND THE ROLE OF GOVERNMENT: A CASE STUDY OF SOUTH KOREA

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I. Introduction

As industrial economies have prospered, their business firms have also grown and matured resulting in increased foreign direct investment (FDI) and thus foreign direct investment has become a major issue for analytical discussion in an international perspective. Foreign direct investment is a major source of international resource transfer. The tremendous competition generated among host countries, regions, and localities for FDI has created an abundance of literature, some favorable some not so favorable. Those favorable writings are generally in defense of free markets and include Becker (1989) and Reich (1990).[1] Unfavorable discussions usually ex-

1) There is a great amount of literature regarding the causes of FDI. For example, Kindleberger (1969) studied the relationship of firmspecific advantages such as organizational and marketing skills. Vernon (1974) reviewed the linkage between product cycle and technology and the shift from exports to FDI. Buckley and Carson (1976) speak of an internalization advantage where market opportunity economies are associated with a foreign firm through its internal operations. These economies can be cost of contract enforcement, quality standards, and other standards. Magee's (1977) appropriability theory parallels the internalization advantage. According to Magee, the need to appropriate the private returns from investment becomes a cause of FDI. Among the most important of the firmspecific advantages are: experience in operating international markets; a competitive and superior product; technological capabilities; and multinational enterprise management skills (Buckley & Brooke, 1992). Dunning (1988) more recently, has pointed out that the advantages of internalization must interact with both firmspecific and locational advantages in order to more fully account for the causes of FDI.

press concerns over domestic economic and national sovereignty, and security issues. Recent criticisms of FDI feature the works of: Tolchin and Tolchin (1988), Burstein (1988), Prestowitz (1988), Glickman and Woodward (1989), Spencer (1988) and Frantz and Collins (1989). Other discussions by Morgan Guaranty (1989), Reich (1991), Peterson (1989) and Fry (1980) provide excellent, balanced arguments. Discussions of FDI in literature have focused mainly on the national economy as a whole, while FDI considerations on a regional basis, or more specifically on an urban basis, have been somewhat ignored. And while there is an established research base concerning the factors which attract industries to an urban regions, research on the role of government in encouraging foreign direct investment—based economic development is absent of any serious analytical discussion. The main objective of this paper is to fill the gap created by this absence.

Over the last half century foreign direct investment (FDI) has been greatly responsible for the development of the world economy.[2] After a period of sluggishness early in the decade of the 1980s, FDI increased with more businesses becoming international in scope and more countries functioning as both home and host countries. Unquestionably, the trade sector of the world economy has become increasingly important to world economic development and interdependence among countries. World trade in consumption goods and manufacturing goods, the linking of production licenses, and the coordination by production of multinational corporations, between countries, all has contributed to the faster rate of world output (Buckley & Brooke, 1992).

During the most recent surge of FDI and the long period of world economic growth, countries have developed greater interdependence with strengthened economic and financial integration. Businesses have adopted a global approach in terms of outlook, strategy, and operation. For example, the dynamic Asian economies were successful during this long period of world economic performance. Liberalization of policies toward FDI played a large role in world economic expansion during the 1990s.

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2) According to the Foreign Capital Inducement Act (FCIA), foreign investment shall mean subscribing to or holding stock or shares by a foreigner in an enterprise run by a judicial person or the Republic of Korea including a judicial person under incorporation or a national of the Republic of Korea in accordance with FCIA. Setting up a business in the form of a representative office or branch office does not constitute foreign investment under FCIA.

II. Korean Government Agencies for Promoting FDI

Korea's rapid economic development was government-led.[3] The system of resource use in Korea, throughout the period of this rapid growth, particularly during the 1970s, deviated markedly from the competitive market system.[4] Government and business formed a quasi-internal organization which could allocate capital efficiently. Korea was economically successful in the 1960s and again in the 1980s (Kim & Leipziger, 1993),[5] much of this success revolves around: (1) Korea's bureaucracy and planning apparatus, led by the Economic Planning Board (In 1993, EPB was merged with the Ministry of Finance and renamed as the Ministry of Finance and Economy); (2) the unique relationship between business and government; and (3) the intangibles of policy-making which revolve around Koreas unique culture and country-specific circumstances, but which account in large measure for the decisiveness of policy formulation and implementation.[6]

Perhaps the most important ministry to foreign businesses is the Ministry of Finance and Economy (MOFE) because it plays a vital role in essentially all business

3) The evidence is clear that the Korean government had: ① a clear vision of its industrial, as well as agricultural, goals; ② ability to control the economy via economic instruments, supplemented with jawboning and coercion when needed; ③ a willingness to share risks with industry or, put differently, to use business to achieve its national goals; ④ a track record of creating institutions, such as development banks, trade promotion agencies, and general trading companies; and ⑤ a unique ability to make pragmatic policy decisions.

4) The Korean economy was improved by a strong state and big business based on mass production, borrowed technologies, and low labor costs, but this resulted in an inflexible industry structure and centralized firm organization. Koreas next phase of economic development will require a more flexible industry structure and long-term technology-oriented strategies (Soh, 1997).

5) Foreign direct investment in Korea during the period 1989-1992 decreased due to the stagnant world economy. Since 1993, however, the volume has steadily increased because of the global economic recovery, as well as efforts by the Korean government to improve the foreign investment climate (MOTIE, 1996).

6) Foreign direct investment tends to flow where regional incentives are the highest in the host country and to lean toward relatively less developed areas. According to Gordon and Kees (1986), the major reasons for this are: host country governments often have conditions that are tied to or related to regional policies; to be seen as a good citizen and to win goodwill, the foreign firm will tend to invest and locate in a needy area of a host country; foreign firms are sensitive to price factors, including subsidies; in such a region, a foreign firm can become the centerpiece of the community and may likely have a captive labor market; a foreign firm entering a region generally has no prior commitments to it; and foreign firms tend to be more free spirited than domestic firms with fewer strict locational constraints.

transactions that involve foreigners. This involvement does not end with the initial establishment of the business; it continues year after year during business operations. The MOFE conducts overall economic planning for national revenue and expenditure, import and export, and long-term and middle-term economic planning. It has jurisdiction over the monetary system and circulation, banking, national loans and debt, national bonds, government financial accounting, national taxes and tariffs, foreign exchange and economic cooperation, and all property of the state. In addition, the MOFE interprets and administers the Foreign Capital Inducement Act (FCIA) and the Foreign Exchange Control Act (FECA).[7]

Perhaps the second most important ministry to most businessmen and to all manufactures is the Ministry of Trade, Industry and Energy (MOTIE) because this ministry controls all forms of manufacturing and trading of goods. It also controls the Free Export Zones at Masan and Iri, heavily influences the application of tariff and no-tariff barriers against foreign products, and sponsors trade mission for Korean exports. This ministry is made up of the following major bureaus and offices: International Trade Office, Basic Industry Bureau, Energy Policy Office, Industrial Policy Bureau, Technology Policy Bureau, Processing and Consumer Goods Industry Bureau, and Planning and Management Office.[8]

In Korea, foreign investment must be a minimum of 50 million won (about US$

7) The ministry contains the following bureaus and offices: International Economic Policy Bureau, Economic Policy Bureau, Tax and Customs Office, Financial Policy Office, Treasury Bureau, Welfare and Consumer Policy Bureau, Budget Office, and Planning and Management Office. The Foreign Capital Inducement Act (FCIA) is the basic law governing foreign investment; it is accompanied by the decree and working rules that specify the policies in regard to the enforcement delegated by the act. There are also the regulations of foreign investment providing the guidelines necessary for enforcement in connection with foreign investment pursuant of the act and working rules. The act is aimed at regulating matters concerning the inducement and supervision of foreign capital among foreign transactions of foreign exchanges and is the special law of the Foreign Exchange Control Act. The Foreign Exchange Control Act shall apply, unless specifically stated by the FCIA.

8) Another notable change was the establishment of the Ministry of Science and Technology (MOST) in late 1960s. As the economy began to take off, there was an urgent need for Korea to increase the inflow of foreign technologies and develop its own technologies. To achieve these objectives, the Bureau of Technologies, established first in the EPB, was expanded and transformed into a full-fledged Ministry in 1967. Most is involved in approval of many kinds of business transactions. It has the responsibility of selecting which technologies are most important to attract for Korean businesses and to decide on the degree and form of technology transfer required of the foreign investor or contractor. Also, MOST sponsors and oversees the research and development (R & D) activities of the nation (American Chamber of Commerce in Korea, 1996).

62,000) per project. If the investor wants to make a joint investment, the per capita investment minimum is 25 million won (with no ceiling on the investment amount). Foreign invested companies are domestic corporations established under domestic laws, thus, if they must acquire approval or permission under individual laws, they are required by individual laws to acquire approval or permission, they should satisfy the domestic requirements as indigenous companies to operate a business even if they have already met the FCIA criteria and/or regulations.[9)]

III. Korean Government's Commitment to FDI

Korea has transformed itself in the last half of the century from one of the world's poorest countries with a per capita income of under US $ 100 to the world's 11th largest economy with an annual per capita income of over US $ 10,000. According to the IMDs report (1996), Korean GNP ($ 451.6 billions) now exceeds that of Russia ($ 364.3 billions), Mexico ($ 361.0 billions) and Australia ($ 311.8 billions). Over the past two decades, Korea has achieved an average annual growth rate of 9 percent. Although this rapid growth has recently slowed, the country's growth rate remains over 5 percent, one of highest in the world.

Table 1. Foreign Investment in Korea (Amount: Million $)

Region\Year			1992	1993	1994	1995	1996	1997.1-4.	Total
Asia	Japan	Amount	155	286	428	418	255	55	5,621
		Number	72	85	132	169	154	52	2,845
	Malaysia	Amount	–	–	5	218	673	505	1,401
		Number	–	–	1	12	29	17	61
	Hong Kong	Amount	10	75	43	58	229	2	652
		Number	2	11	18	20	18	5	155
	Singapore	Amount	2	9	20	65	47	16	227
		Number	1	6	8	19	16	5	78

9) Article 7 of the FCIA stipulates "in the event that a foreign national intends to subscribe for the stock or own the shares of a juridical person of the Republic of Korea (including a juridical person under corporation) or an enterprise carried out by a national of the Republic of Korea, he shall report to the Ministry of Finance and Economy (MOFE) in advance. However, when the foreign investment falls under any of the following categories, the approval of the Minister of Finance and Economy (MOFE) shall be obtained." Thus, foreign investment is subject to notification and approval only in exceptional cases. Prior to March 1, 1993, foreign investment was, in principle, subject to approval in all cases.

Region\Year			1992	1993	1994	1995	1996	1997.1-4.	Total
	Total	Amount	170 (-31.7)	392 (130.6)	569 (45.2)	791 (39.0)	1,218 (54.0)	594 (312.5)	8,094 (37.9)
		Number	86 (-34.4)	141 (64.0)	207 (46.8)	299 (44.4)	302 (1.0)	117 (17.0)	3,490 (57.3)
	USA	Amount	379 (28.0)	341 (-10.0)	311 (-8.8)	645 (107.4)	876 (35.8)	1,606 (1100.0)	6,698 (31.4)
		Number	70 (-18.6)	68 (-2.9)	115 (69.1)	161 (40.0)	167 (3.7)	54 (-14.3)	1,521 (26.9)
	Total	Amount	434 (39.1)	344 (-20.7)	323 (-6.1)	666 (106.2)	925 (38.9)	1,628 (1000.0)	7,009 (32.8)
		Number	83 (-8.8)	76 (-8.4)	127 (67.1)	175 (37.8)	182 (4.0)	62 (-3.1)	1,645 (27.5)
Europe	Germany	Amount	120	36	60	45	95	47	768
		Number	13	11	18	22	33	7	225
	UK	Amount	24	71	25	87	79	85	616
		Number	6	8	10	10	17	12	129
	France	Amount	29	40	56	35	90	242	689
		Number	6	7	7	14	8	5	102
	Netherlands	Amount	44	131	67	170	205	713	2,134
		Number	11	10	9	16	13	4	119
	Switzerland	Amount	37	7	11	10	162	52	595
		Number	4	7	9	4	13	3	97
	Total	Amount	282 (-65.8)	307 (8.9)	407 (32.6)	475 (16.7)	1,058 (122.7)	1,465 (490.7)	6,049 (28.3)
		Number	65 (-11.0)	60 (-7.7)	89 (48.3)	103 (15.7)	124 (20.4)	38 (-15.6)	931 (15.2)
	Grand	Amount	894 (-36.0)	1,044 (16.8)	1,317 (26.1)	1,941 (47.4)	3,203 (65.0)	3,687 (586.6)	21,356 (100.0)
		Number	236 (-20.3)	278 (17.8)	424 (52.5)	578 (36.3)	613 (6.1)	218 (4.3)	6,119 (100.0)

Note: Figures in parentheses represent percentage.

Source: MOFE (1997).

Table 2. Outward Foreign Investment from Korea (Amount: Million $)

Region\Year			1992	1993	1994	1995	1996	1997.1-4.	Total
Asia	China	Amount	141	262	631	815	802	266	2,933
		Number	171	376	836	727	687	187	3,084
	Hong Kong	Amount	44	31	47	86	103	13	341
		Number	38	31	35	35	23	10	252
	Japan	Amount	28	6	58	105	80	34	334
		Number	13	12	16	28	21	5	184
	Indonesia	Amount	164	59	68	200	148	49	1,098
		Number	27	18	21	29	37	6	294
	Malaysia	Amount	24	24	20	114	42	3	278
		Number	23	15	16	19	19	5	149
	Vietnam	Amount	17	27	89	178	90	63	439
		Number	8	16	44	34	36	8	143
	Philippine	Amount	20	14	45	57	44	10	267
		Number	31	28	166	70	77	18	420
	Total	Amount	519 (21.3)	485 (-6.6)	1,080 (122.7)	1,643 (52.1)	1,584 (-3.6)	559 (3.5)	6,529 (44.0)
		Number	358 (32.1)	544 (52.0)	1,212 (122.8)	1,011 (-16.6)	1,018 (6.9)	272 (-25.5)	5,066 (72.2)
	USA	Amount	347 (-11.3)	384 (10.7)	531 (38.3)	534 (0.6)	1,549 (190.1)	255 (-73.2)	4,302 (29.0)
		Number	63 (-20.3)	54 (-14.3)	127 (135.2)	126 (-0.8)	179 (42.1)	55 (5.8)	924 (13.2)
	Total	Amount	391 (-14.8)	390 (-0.3)	573 (46.9)	546 (-4.7)	1,567 (187.0)	262 (-72.5)	4,578 (30.8)
		Number	63 (-23.2)	58 (-7.9)	136 (134.5)	133 (-2.2)	186 (39.8)	56 (5.7)	976 (13.9)
Europe	Germany	Amount	32	77	123	66	83	15	386
		Number	6	3	7	12	10	2	78
	UK	Amount	49	27	26	71	217	22	393
		Number	2	5	4	15	13	3	65
	France	Amount	30	35	46	53	9	0.1	176
		Number	4	2	3	4	3	-	24
	Total	Amount	144 (60.0)	190 (31.9)	428 (125.3)	614 (43.5)	640 (4.2)	149 (-45.4)	2,250 (15.2)
		Number	37 (2.8)	33 (-10.8)	56 (69.7)	79 (41.1)	76 (-3.8)	23 (-17.9)	409 (5.8)
Grand		Amount	1,218 (9.2)	1,260 (3.4)	2,305 (82.9)	3,064 (32.9)	4,134 (34.9)	1,192 (-35.6)	14,850 (100.0)
		Number	497 (12.2)	682 (37.2)	1,475 (116.3)	1,289 (-12.6)	1,370 (6.3)	378 (-20.8)	7,016 (100.0)

Note: Figures in parentheses represent percentage.

Source: Bank of Korea (1997).

Korea now ranks second in the world in shipbuilding, third in semiconductor manufacturing, fifth in automotive production and sixth in steel production. Korea's trade relations span the globe, with total trade volume of approximately US$280 billion per year. Korea is the fifth–largest market for U.S. goods and has close ties with the European Union (EU). Excepting EU countries, Korea ranks as Germany's seventh–largest export market (MOTIE, 1996).

In 1996, foreign investment in Korea increased 65.0 percent over previous years, reflecting the success of liberalization policies. Koreas three leading investors are Japan, the United States, and the Netherlands. In terms of the share of total foreign investment, Japan ranks first, followed by the United States, and Netherlands as shown in Table 1. The government has also announced an aggressive timetable to expand investment opportunities, including liberalization of many service businesses.[10] Currently, the manufacturing sector is almost fully liberalized. By the year 2000, nearly all business lines in Korea will be open to foreign investment, with 18 exceptions including medical care insurance and television broadcasting, for example (MOTIE, 1996).

Korea's unique geography provides significant advantage. Equidistant from Tokyo and Beijing, close to both the capital markets and raw materials of greater Asia, Korea is the continent's natural business center.[11] Between 1990 and 1996, Korea invested $2.7 billion in China, or 44 percent of Koreas total investment in Asia for that period as shown in Table 2. Korean investment in Vietnam, India and the Com-

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10) The government announced the Foreign Investment Liberalization Plan (1997–2000) in 1996 thereby increasing the scope of liberalization as specified in the plan. The foreign investment liberalization ratio is expected to increase to 95.1 percent (1996), 97.4 percent (1997), 98.2 percent (1998), 98.3 percent (1999), 98.4 percent (2000), respectively.

11) Korea has several locational advantages as a host country. Research shows that these locational advantages are frequently cited as reasons of inward investment in Korea. Some of these include: supply of human resource; the desire to preserve markets established by exports; an improved Korean political climate; and desire to learn high technology (Buckley & Brooks, 1992). Arpan and Ricks (1979) designed and administered a survey which dealt with local incentives and their influence on the decision of a foreign firm to come to a specific state or locality. The major reason given by the foreign firm to locate in a particular country was proximity to a specific market. Other reasons given, ranked in order of importance, were transportation facilities, labor market factors and tax considerations. In that some of the locational advantages are considered when making the initial decision to invest in the host country, other locational advantages apply when choosing a particular region of the host country. The regionspecific locational advantages include: ① proximity to the relevant markets; ② labor and wage differentials; ③ infrastructure transportation, particularly port facilities; and ④ tax and financial incentives (Gordon & Lees, 1986).

monwealth of Independent States (CIS) is also increasing rapidly. Furthermore, in 1996, Korea exported US$15.8 billion worth of goods to Japan; US$11.4 billion to China; US$4 billion to Taiwan, US$20.2 billion to ASEAN (Association of Southeast Asian Nations) countries, and US$2 billion to Russia, all of which combined total 41.2 percent of Korea's entire export earnings.

Korea offers many advantages in high tech fields. Its work force is relatively well-trained, and its manufacturing sites well-developed.[12] Korean wages are cost-effective compared to those of even low-wage Asian nations, and provide value to investors due to the advanced skills and productivity of Korea's work force. The average manufacturing work week is 49 hours, making Korea one of the world's most productive countries.[13] Hence, the promising areas for foreign enterprises to invest will be in service or value-added related industries, such as information technology, telecommunications, distribution and finance, and in areas in which Korea still lags such as the environmental management and venture business. In addition to well-known successes in semiconductors and electronics, Korean companies are world leaders in fields such as textiles, chemicals and sports equipment.

Korea's success is far from an overnight phenomenon – rather, it is grounded in profound educational and cultural strengths. The country ranks third in the world in per capita education.[14] Korea's 152 colleges and 134 universities graduate more than 350,000 students annually. In 1996, the Ministry of Education began to provide millions of dollars to each of 9 major universities in Seoul to educate graduate students who want to be experts on international trade, commerce, and international studies.

Since the inauguration of the first civilian government in 1993, Korea has pursued global economic integration based on a solid democratic political system. Korean management and labor have entered a new era of cooperation.[15] Arbitrated labor

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12) Although the level of core technology such as basic architecture, software, and core parts and components is rather behind advanced countries, Korea's processing and assembling technologies have reached the level of advanced countries. Also, Korea ranks high by world standards in the automobile, electronics, and shipbuilding industries.

13) According to statistics on average number of working hours per year (IMD, 1996: 556), Korea (2,302 hours) ranks second, following Chile (2,400 hours).

14) The total enrollment of higher education beyond junior college level in Korea is about 4,540 per 100,000 persons, third in the world behind Canada and the United States (MOTIE, 1996).

15) The normal type of labor union in Korea is a company-based trade union. It is also common for enterprise-unit unions to be affiliated with the industrial federations.

issues have dropped dramatically from 1,616 cases in 1989 to 88 cases in 1995 as shown in Table 3. The number of labor disputes which had been so prevalent in the latter half of the 1980s have now decreased to less than one-tenth of that. The factors contributing to the reduction of labor disputes are as follows: (1) certain practices regarding bargaining techniques and procedures have been established, especially in the large companies which had been frequently affected by labor disputes; and (2) both workers and employees generally came to share the view that a cooperative system needed to be build between labor and management. The average rate of wage increases has also declined significantly.

Table 3. Number of Labor Disputes and Wage Increase Rate, 1989-1995

Year	1989	1990	1991	1992	1993	1994	1995
Number of Labor Disputes	1,616	322	234	235	144	121	88
Number of Labor Disputes at Foreign Companies	N/A	N/A	25	22	20	10	16
Rate of Wage Increase (%)	22.1	N/A	17.5	15.2	12.2	12.7	11.2

Note: The number of labor disputes refers only to strikes lasting longer than 8 hours.

Source: MOTIE (1996).

In March, 1997, the government amended its labor laws to strengthen the foundation of participatory, cooperative labor-management relations.[16] By promoting flexibility in the labor market, the amended labor laws have helped too created an environment which is supportive of the managements activities in enterprises. In addition, wage increases have slowed in recent years, making Korea's labor costs more competitive with other Asian nations. South Korean and foreign companies alike are viewing North Korea as a market of opportunity for business. To that end, a number of South Korean companies are investing in joint-ventures with North Korean businesses as well.

16) Based on the discussions of the presidential advisory body "Presidential Commission on Industrial Relations Reform" was established in May 1996 in order to devise comprehensive improvements covering the wide range of labor-management relations including practices, institutions, and culture. At present, many problems between labor and management are resolved through dialogue and mutual compromise in the interest of avoiding physical strikes.

The Korean government has implemented several programs to promote foreign investment. It, in accordance with related laws, not only guarantee equal treatment for foreign investors as domestic entities, but also offers investment incentives for foreign investors which are more advantageous than those for Korean enterprises. Foreign investment, by means of M & A, is also allowed to enable foreigners to make direct investment in promising Korean enterprises.[17]

Under the Korean governments initiative: corporate tax and income tax shall be totally exempted for 5 years starting from the year in which initial profits have occurred (see Table 4). Custom duties, the value-added tax (VAT), and special excise taxes shall be exempted for imported facility goods required in the investment projects. Importation of commercial loans required to import facility goods shall be allowed within the range of invested amounts. The government also plans to rent foreign investors factory sites at a very low rate in cases where more than $ 20 million is invested. Even among general manufactures where the foreigner's investment ratio is greater than 50 percent, the importation of commercial loans to import facility goods shall be allowed (MOTIE, 1996).[18]

Among the various incentives to attract inward foreign investments, the most significant one is tax exemption on highly advanced technological investments. Foreign investments accompanied by highly advanced technologies may be eligible for exemption on corporate income tax for five years and reduction by half for another three years. Also, available is an exemption of customs duties on imports of capital goods necessary in the employment of these advanced technologies.[19]

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17) Seven high-tech industrial areas are targeted for special investment benefits. These industries include electronics, information and electrical; precision machinery and advanced processes; optical and medical equipment; aerospace and transportation; and environment, energy and construction.

18) A notable example being the designation of two "foreign investor industrial parks (FIIPs)" which is exclusively for foreign investors — a 660,000 square meter zone in Kwangju, and a 495,000 square meter zone in Chun-an (Land prices are much lower than those of other areas). Other incentives are: Expediting the approval of property transactions to within 60 days of filing, this includes real estate needed for manufacturing facilities, main offices, warehouses, employee dormitories and employee housing. There is also the opening of the Korea Stock Exchange, including liberalized stock certificate procedures, and the introduction of a foreign exchange deposit system.

19) Foreigners' investment ceiling shall be increased on a gradual basis from the current 23 percent as of May, 1997, with a plan to totally liberalize investment by the end of 2000. In order to liberalize investment, clarify the investment system, and protect investors, Korea plans to actively participate in negotiations to conclude international investment agreements, such as the Multilateral Agreement on Investment (MAI) being pursued by the Organization for Economic Cooperation and Development (OECD).

Table 4. Major Business Incentives in Korea

Tax Incentive	• For the newly established technology–intensive small enterprises, up to 50 percent of income tax and corporate tax shall be exempted for 6 years starting from the year in which first profits are realized. Property tax and composite tax are also exempted up to 50 percent. • Fifteen percent of technology or manpower development expenses shall be deducted from the income tax and corporate tax. • Corporate tax and income tax shall be deducted within the limit of 10 percent of the investments made in research and testing facilities and in new technology commercialization. • Income tax for foreign technicians shall be exempted for 5 years.
Financial Benefit	• Up to 500 million won for facility costs and 200 million won for operation costs shall be financed at more favorable interest rate than market rates, if recommended by local government, when small–medium enterprises are founded. • Financial funds not exceeding 2/3 of technology development expense (1/3 for large enterprises) shall be granted for small–medium enterprises, which are selected as eligible for R&D projects designated by government. • Financial support not exceeding 2 billion won shall be provided for development of prototypes and advanced industrial technology at more favorable interest rate than market rates. • Financial support not exceeding 1 billion won shall be provided for development of environmental facilities and technology to improve environment at more favorable interest rate than market rates.

Source: MOTIE (1997).

In February 1997, the Investing in Korea Service Center (IKSC) expanded from the former Comprehensive Assistant Center for Foreign Investment was newly established to meet the foreign investor's every need as a "one–stop window." Conveniently located in the Korea World Trade Center in southern Seoul, the Service Center is working closely with the Ministry of Trade, Industry and Energy (MOTIE), the Ministry of Finance and Economy (MOFE), the Ministry of Justice (MOJ), the

National Tax Administration (NTA), and Korea Customs Service (KCS).[20] Foreign investors are provided with a wide range of services from general information on foreign investment to assistance in administrative procedures. For example, in order to obtain approval for establishing factories, there is now no need to visit other organizations or local government once the required documents are submitted to IKSC.[21]

Ⅳ. The Emerging Role of Local Governments

Local governments have been and currently are very involved in attracting foreign investment. This is particularly true in Korea since the full realization of local autonomy in 1995. Over the last few years, all Korean provincial and metropolitan city governments established a new office called the "Office of International Cooperation" in a major move toward internationalization and diplomacy. For example, this office recently initiated the building of a sisterhood relationship with many foreign localities for its own government and local economy.

Nowadays, there is increasing concern because of the intense and even cutthroat competition among local governments for foreign investment. Particularly, local economic development departments go to elaborate extremes to present and represent a glowing picture of their cities. Many of these departments are staffed by highly competent marketing personnel who are convincing and persistent. Armed with glossy brochures and video production presentations, their promotional pieces are supported by qualitative as well as quantitative data and analysis. Their roles and expectations are in sharp contrast to the traditional roles and expectations of the local govern-

20) The Korea World Trade Center, managed by the Korea International Trade Association, provides a comprehensive business environment for foreign business investors in Korea.

21) Information and assistance are offered in the following areas: ① handling of all administrative procedures related to obtaining approval for establishing factories and building construction by proxy for foreign investors (Processing will completed within 30 days after consultation with the relevant ministries and local government; ② information and consultation on foreign investment, incentives, factory sites, taxation, and financing; ③ match-making with potential Korean partners for joint ventures; ④ consultation and resolution of difficulties related to foreign investment; ⑤ extension of the sojourn period of foreign investors, their families and employees (MOTIE, 1997).

ment.[22] These public entrepreneurs do more than just provide incentives for development; they provide a positive climate for development. Bellone (1988) refers to an "unconventional role" for entrepreneurial cities; in that they are more active in and in control of their own destiny by directly causing things to happen through innovation, creativity, and change. Seemingly, this is precisely the role that these economic development directors assume as they seek to attract foreign direct investment.[23]

For communities seeking to pursue direct investment opportunities within their jurisdiction, several recommendations can be made to better assure success. The first recommendation is that the effort to attract interested investors must be an organized and cooperative one between national and local officials so that promotional efforts are positive and coordinated. Another important recommendation pertains to the relationship between the public and private sector within the community; cooperation between these two groups at the local and regional level is of the utmost priority. Attention should be paid to community planning needs and possible environmental impacts through the inclusion of both the planning and environmental management departments in local government, as well as the economic development staff, in order to reduce the potential for serious problems in the future. Thorough consideration of all development issues related to the investment should be the overriding

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22) These people are still career civil servants. In the near future, however, contract–based or performance–based employment system, with competitive salary scale, should be introduced to the Korean government.

23) Not only must the locality be attractive for investment, but the macroeconomic conditions of a country and global economic conditions must be advantageous as well. While examining the causes of FDI, it becomes apparent that there is a definite interaction between the initial consideration to invest in a particular country and the later consideration of a region or locality by a foreign firm. Where a foreign firm may consider firmspecific advantages and locational advantages for investment, it would also consider locational advantages offered by different regions and localities in the nation. These motivations by the foreign firm have different bearings based on the stage of the decision process. Although closeness to markets and labor and tax consideration are among the highest priority for prospective foreign firms, port facilities (airport and seaport) are also becoming increasingly important as global investment and trade widens and propagates. Welsher and Righter (1975) in their book, the Exploding City emphasized how great cities such as Calcutta, Bombay, Seoul, Mexico City and Singapore urbanized at almost alarming rates. Inchon is also an example of the tremendous urbanization and city growth that occurs where ports provide an impetus for economic development and commerce. Results of a recent business climate rating and survey ranked Inchon as the most desirable business investment location in Korea. A major reason for this was its port and airport facilities.

factor. Finally, it is imperative that communities recognize the Global Community concept.[24]

Moreover, many cities become more aggressive than ever before utilizing the concept of social marketing. Over time, the philosophy which characterizes the essence of marketing has changed and developed.[25] If at one time it was a product-based philosophy that emphasized the production function over selling and other aspects, the emphasis of the marketing conception and the philosophy of social marketing is now on the needs, desires and interests of the consumer and even of society at large. Today marketing has developed to the point where it touches on the interests of all parties involved--the buyer, the seller and the everyday citizen.

A newly emerging type of marketing is "city marketing," which takes a much broader of view of the way in which the respective territory can be used and which therefore is much more complicated.[26] The term 'city marketing' refers not only to cities, but also other administrative and territorial units, irrespective of their size. City marketing has appeared in a number of developed countries over the last sever-

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24) This concept has two elements, the first of which is that an openness to and awareness of international investment opportunities is a prerequisite to attracting investment. Many communities remain unaware of the opportunity and therefore fail to pursue it. The other critical concern of this element is the need to develop crosscultural sensitivities. When reaching out to people outside of our national borders for financial investment we are faced with differences in cultural norms and values. The combination of differences in culture and the initiation of change within the community brought on by investment projects can create problems. Deliberate attention must be paid to developing strong personal relationships with the potential investor, the establishment of a foundation of mutual trust, and the cultivation of a firm understanding of the needs of the investor and any staff that may be required t locate in the community. The second element requires that the local community thoroughly understand their region and community's unique qualities and strengths, and pursue projects that can make optimal use of those qualities. The community's representatives must be knowledgeable as to where their competitive advantage lies, in order to attract worthwhile investments.

25) The term "marketing" appeared in the economic literature at the turn of the 19th century, and it literally refers to the operations of the market or work within the market. There has never been a single definition of the world 'marketing' that describes the essence of the process in full. A leading marketing theorist, Philip Kotler (1989), has defined marketing as a public process that is aimed at satisfying the needs and desires of an individual or a group via the production and exchange of the product of labor. There are many other definitions of marketing which accent the technical, leadership, economic or social sides of the process.

26) The term city marketing can be used in a narrow and a broad sense. In the narrow sense city marketing is held to mean the establishment of the city's trade and business centers, advertising of retail trade, cultural, and recreational facilities, and so on. In the broader sense city marketing means orienting the city's thinking toward the interests of the business community both in domestic and overseas, bearing in mind the demands for economic and social development of the city.

al years, and it is becoming increasingly popular and widely used. City marketing is used in the elaboration of local economic policies. It one of the newest and most progressive ways to promote a city's economic development, and it is an effective way to stimulate entrepreneurship. Just as there is no single definition of marketing as such, there is also no unified view of the definition of city marketing. In a nation today, territories compete to attract industry and government contracts, as well as to host major events, to offer a home for athletic teams that can contribute to local economic development, etc. The battle involves small towns, cities, states, and regions. Each territory that participates in this process must first answer several questions: (1) why would people want to move here, live here, invest money, start up a business or expand an existing business?; (2) what is found here that people would need or desire?; (3) what are the advantages of this place over others? Locations are no longer competing only with their neighbors or with directly competitive cities. Local, regional and national economies that a short time ago where still relatively independent are now becoming mutually dependent elements in an integrated global economy.[27]

Cities that want to win in this tense competition of locations must think and act like businesses; in other words, they must think about the special goods and services which their specific location offers and the specific clients for whom these goods and services are intended. In order to win in this competition, a location must excel in some sense and be superior to all others.

V. Conclusions and Policy Implications

Since taking office in February 1993, the administration of President Kim Young Sam has been implementing a series of measures to improve the climate of foreign investment in Korea. These measures can be divided into the areas of liberalization, simplification of procedures, expansion of tax benefits and financial assistance, and creation of industrial parks for foreign invested enterprises. There is still, however, a

27) Goods can be produced and services can be offered in almost any location, and that means that educated, trained and mobile labor forces have a new and vast choice of places to live and work. Locations are now fully sensing the effect of the technological and communications revolution. Facsimile machines, small computers and modern telephone communications allow companies to move to new locations where costs are lower an working conditions are more attractive. As they become involved in global competition, cities must rely to an ever greater extent on their own resources and abilities.

long way to go for further development.

It is necessary for the government to provide clearer, more transparent, and more comprehensive information about governmental policies. Better information about the extent and limit of private economic activities encouraged by the government and about the processes and procedures presently applied by the public administration would reduce the frustrations and anxieties experienced by many foreign investors and in turn would considerably improve the country's investment climate. The government has substantially liberalized and decontrolled the economy over the last several years and made it more private sector friendly. Yet much of the positive impact of these measures was lost through the prevailing lack of transparency and the absence of clear information concerning these changes. While promulgation of clear rules and procedures might take some decision making power away from the government bureaucracy, it is vital to restore private sector confidence and willingness to invest. Lack of transparency explains, at least to some extent, the slow response of private investors to the government's policy changes over the last several years.

a. Streamlining

In spite of substantial improvements, there is further room, and indeed need to streamline the system and speed up procedures. The number of ministries and other public services presently involved in approvals of investments, of imports, of transfers, etc., could be reduced without problems and, in fact, should be reduced as a means to cut processing time. The best way to speed up the investment approval process, however, is to make the government a truly one—stop institution. To this end, the authority of the different ministerial representatives needs to be strengthened, so that these representatives can make decisions in the name of their ministers; this would avoid the lengthy back and forth between technical ministries and private investors prevailing today.[28]

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28) One of the main reasons for the still long investment approval process is the lack of decision making power of government agencies. In particular, ministerial representatives, other than those from the Ministry of Finance and Economy (MOFE), often do not have the authority to make immediate decisions, but have to refer the issues back to their respective ministries for review and decision. Often this reporting—back triggers requests for additional information to be supplied by the prospective investor, creating further delays. Requests for additional information from the investor are frequent, while lack of clear guidelines and approval criteria create the impression of uncertainty, arbitrariness, and ad—hoc decision making.

b. Need for More Transparency

One of the private sector's main complaints was lack of clarity and/or transparency. On the one hand, the government has said and done much lately to encourage private investments; on the other hand, it has taken a number of positions that cannot but scare away private investors. Hence, there is an urgent need for the government to define clearly its position vis–a–vis the private sector in general, and to spell out in detail its rules and regulations for investment approval and for the information required from the prospective investors. A clear and explicit declaration by the government on this subject would go a long way to dispel the feeling of uncertainty and ambiguity prevalent among private investors, a feeling that seriously hampers increased private investment. Private investors can live with many regulations and controls as long as they are clearly published, transparent and applied uniformly and equitably. In addition to investment approval, foreign investors usually need approval for the employment of expatriate personnel; requests must be submitted to the Immigration Office. Again, the process is lacking transparency, as the criteria used in making decisions are little known to investors.

c. Customs Procedures

Custom procedures are long and cumbersome. The problem starts with the number of public services involved in approving import tax exemptions. Custom exemptions are a classical case where the government should be allowed to rapidly become a one–stop decision making system. The situation is complicated by the fact that the government's definition of a tax exempt investment good does not always correspond to the customs service's definition of such good. It is imperative that an agreement is achieved on this purely technical point. Currently, even once a decision is made to grant an investor customs–free import privileges, actual clearance of goods at customs is often delayed, as investors do not receive a permanent, global permit to import certain goods tax free.

d. Taxation

Taxation is another issue where more transparency would go a long way to satisfy private investors. Tax rulings of general interest ought to be made public on a regular basis. The need for general tax reform was mentioned by representatives from the Ministry of Finance and Economy (MOFE), as the tax burden on private enterprises is high in an international comparison. Such a reform has to include an assessment of all the many small hidden taxes, for which no tax exemptions are granted to foreign investors.

In summary, Korea managed to turn its initial disadvantages into assets by pursuing a total dedication to exporting in the post-1961 period. Relying first on foreign aid, and later on rapidly increasing savings and external borrowing, and a vigorous pursuit of technology, it was able to capitalize itself. When combined with a talented labor force that worked record hours, it produced a highly productive and rapidly growing economy.[29] To prepare for future growth, and in assuming its role as regional business hub, Korea has targeted more than US$100 billion for massive infrastructure development in the next twenty years.[30] Included in this extraordinary commitment are 27 new ports and a new international airport. Total seaport capacity will double by 2011, reaching 560 million tons of freight per year. Inchon International Airport, for example, about 50 km west of Seoul, will be completed in 2020, and will ranks as North Asia's largest airport.[31] Also under development is a high-speed rail system linking Seoul and Pusan, scheduled for completion by the year 2005. The new "bullet" train and other rail and highway improvements will increase

29) At the center of development was public policy, which aided by technocratic bureaucracies and research institutes prodded the private sector to attain national export objectives. In addition to managing the macro economy, the government created state enterprises when needed; and intervened in credit allocation to promote exports in the first instance. Korea did relatively well on the economic fundamentals; the government pursued sound macroeconomic management, invested in infrastructure and human resources and supported an outward-oriented private sector. When industrial intervention was tried in the 1973-79 period, it always had exporting as sits final objective. Korea has a good record of developing infant industries. What Korea also had in abundance was tight policy implementation, based on strong presidential leadership. Korea is an example in which the government clearly took the lead in development – strategy and implementation – and where it was successful.

30) At present, the per capita ownership of telephones and personal computers in Korea is nearing the level of advanced countries. The Korean government continues to expand investments in the field of information and telecommunications. According to statistics on global comparison of industrial electricity rates (IMD/WEF, 1995), the electricity rates for industrial use in Korea as of 1994 is 5.9 cents per kwh, which is much less expensive than rates in other Asian countries (16.7 cents in Japan, 11.0 cents in Hong Kong, and 7.7 cents in Taiwan).

31) The construction of Korea's new Inchon international Airport, able to serve over 100 million passengers and 7 million tons of cargo annually, will be completed by 2020. After completion of the first stage of construction in 2000, the airport will be able to accommodate 27 million passengers and handle 1.7 million tons of cargo every year (MOTIE, 1996).

Korea's internal logistical support dramatically.[32]

In 1997, 26 new business sectors were opened to foreign investment. In 1998, five more sectors will open, and in 1999 and 2001, an additional four. Included will be legal services, real estate services, insurance, wireless telecommunications, employment services, magazine and newspaper publishing, investment trust, and many other fields. Such new opportunities will build on Korea's vibrant economy. Factors, such as an educated, well-trained workforce; management and labor cooperation; cultural traditions that inspire dedication and pride in performance, will create a good environment for the business investor. While Asia emerges as the world's prime economic driver, Korea's role as regional and global leader will grow.[33]

Recent years have shown the world economy to be moving increasingly toward globalization, the Korean government has come to recognize an increased need for foreign investment to help promote industrial restructuring, developing advanced technology and globalize business firms. The Korean government has, therefore, taken active measures to improve the environment for foreign investors.[34] Liberalization of foreign investment will be nearly completed soon except for the mass media, real estate, energy and some other sectors as is the case in advanced countries. Direct overseas investment by Koreans has also been almost completely deregulated. The principles of national development in the globalization era must be different from those of the past era of industrialization. Government initiative alone will not be sufficient to develop the nation during this age. For this reason, the governments role must undergo a drastic change. Governments need to fulfill their duty

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32) In addition, the government is investing US$ 1 billion in a new, fully-digital "information superhighway" that will interconnect all government agencies, research centers, and higher education institutions by the year 2010. Another US$ 60 billion is targeted to expand this network to the general public by the year 2015.

33) The living environment in Korea is increasingly cosmopolitan. Market liberalization is delivering more variety in goods and services. Korean culture and lifestyles are becoming more "foreigner-friendly." The government also continues to support liberal visa policies, and the system of allowing renewal of a residence permit only twice will be nullified from July 1, this year, thus resulting in the permanent stay.

34) Governmental management must become just as effective and cost-efficient as well-managed business companies in terms of providing public services. A small but cogent government that is intelligent and flexible should be the primary objectives of the administrations efforts toward globalization. At the same time, local autonomy must be firmly entrenched so that local communities can engage in healthy competition with one another and maximize their full potential, and thus be able to successfully cope with the challenges of globalization.

of ensuring fair competition in all sectors and by taking a greater interest in issues related to social development. In conclusion, a nations wealth and overall quality of life will be dependent on the quality and scope of knowledge, information, and technology its citizens possess.

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