UNCTAD/ITE/IIT/ 29

VOLUME II NUMBER 1 APRIL 2002

TRANSNATIONAL CORPORATIONS

William A. Stoever

Attempting to resolve the attraction-aversion dilemma: a study of FDI policy in the Republic of Korea

United Nations
United Nations Conference on Trade and Development
Division on Investment, Technology and Enterprise Development

Attempting to resolve the attraction-aversion dilemma: a study of FDI policy in the Republic of Korea

William A. Stoever *

The Republic of Korea is an almost textbook example of a developing-country pattern of alternately courting and restricting foreign direct investment (FDI).[1] It has sought the capital, technology, management skills and organizational capabilities that transnational corporations (TNCs) can bring, even as it tried to preserve large segments of its domestic market for home-grown companies. But there has been a striking divergence between official pronouncements of opening wider to FDI and the practical experiences of many prospective investors, especially in the 1980s and 1990s. This article sets out a framework for analyzing the degree of liberalization of a country's FDI policy. Then it briefly describes the FDI policies of the Republic of Korea from 1960 to 2000 and evaluates and charts their degree of openness. Finally it draws conclusions and policy implications. The policy swings have been more pronounced (or at least more public) in the Republic of Korea than in many other developing countries, but similar attraction-aversion patterns are seen in many such countries. Thus, policy makers and scholars from many countries should find the analysis useful. It should also be helpful to foreign business executives who need to understand the internal debate underlying the apparently unpredictable swings in FDI policy in the Republic of Korea and similar countries.

Introduction: reflections on "openness"

A developing country that desires to attract FDI, especially in manufacturing, will most likely have to allow transnational corporations (TNCs) a high degree of independence in managing their investments, which means it will have to reduce the requirements

* Professor, Stillman School of Business, Seton Hall University, South Orange, New Jersey, United States.

[1] The Republic of Korea would have been classified clearly as a developing country when it first began seeking FDI in the early 1960s. Most researchers were labeling it a newly-industrializing (or newly-industrialized) economy by the 1980s (when it was included as one of the four East Asian "tigers" or "dragons").

and restrictions it imposes on such investments. Robert E. Lipsey (2000, p. 67) found that:

> "The strongest influence on foreign direct investment inflows ... was the openness of an economy, crudely represented by the ratio of trade to output. ... [T]he ratio of foreign direct investment inflow to GDP [was] the most consistent positive influence on subsequent growth rates."

The ultimate case would be where a country abolished all controls and relied on market forces and competition to shape investment and prevent abuses, but this scenario is neither possible nor desirable. A developing country government may, however, reduce the regulations and administrative burdens it imposes on TNCs, in which case such corporations are likely to perceive that the costs, delays, risks and hassles of investing there are decreased (Bergsman and Shen, 1995). Hence, they may require lower rates of return and fewer guarantees, subsidies, etc. from the host government, which in turn means greater value added to the host economy. This argument is summarized in the following flowchart:

Reduce burdens and restrictions → **Lower costs and risks to foreign investors** → **Investors require fewer incentives and lower return** → **FDI has lower costs and brings more benefits to host country.**

Aradhna Aggarwal (1997) makes a similar argument, although in different terminology. Somewhat analogously, Kirt C. Butler and Domingo Castelo Joaquin (1998) found that the cost of capital to a foreign investor is higher when the prospect of adverse political changes is greater.

Table 1 lists some steps governments can take to reduce the burdens, restrictions, costs and risks of investing in their country. Many of these actions, however, may also reduce a government's ability to control the domestic economy and guide the country's development. Governments may perceive the actions as opening their countries to rent-seeking and other abuses by TNCs (Buckley, 1996). David Conklin and Donald Lecraw (1997) examine other reasons for which a government may impose restrictions on foreign ownership and be reluctant to give them up. More broadly, many developing countries are not confident that FDI contributes to their development goals if the requirements and restrictions on foreign investors are reduced and TNCs are given too free a rein. Policy makers may believe their countries have not achieved an adequate degree of economic stability, or their markets do not function well enough to allow competitive forces to control foreign (as well as domestic) business operations (the market-failure argument – see Stiglitz, 1989). They may also be concerned about the appearance of losing national control of foreign entities in their midst. Hence, they may be averse to implementing a policy that liberalizes FDI entry.

Table 1. Some elements of opening a country's FDI regime

<u>Reduce market distortions</u>
• Relax currency controls and increase convertibility of currency
• Reduce tariffs, quotas and other restrictions on imports
• Eliminate price controls on most goods and services
• Allow market conditions to determine interest rates
• Reduce burdensome and counterproductive labour regulations
<u>Improve competitive conditions</u>
• End favored treatment of state-owned enterprises, or privatize them
• Ease government buy-local policies
<u>Improve legal framework</u>
• Adopt laws and regulations to clarify foreign investors' rights and obligations
• Improve fairness and efficiency of judicial system
<u>Improve regulatory procedures</u>
• Make screening of investment proposals more efficient and less costly and delay-prone
• Reduce number of ministries and government agencies that review proposals
• Create true "one-stop" application office
• Eliminate approval requirement: grant national treatment to foreign investors
• Base screening on economic merits, not political concerns
• Reduce and rationalize government regulation of FDI in place
<u>Improve substantive rules</u>
• Fewer restrictions:
- Increase industries open to FDI and reduce number of industries closed to FDI
- Ease limits on dividend remittances
- Ease restrictions on land ownership
• Reduce requirements regarding:
- local majority/minority ownership
- level of technology
- diffusion of technology
- local research and development
- local procurement quotas
- employment creation
- export requirements

Source: Stoever (2001).

A country's degree of openness is clearly a matter of degree; it is not an all-or-nothing proposition. The true test of openness is not in a government's pronouncements, but in the practical effects. For example, a government may announce that it has streamlined its process for approving FDI proposals, but officials from various ministries may continue to interfere in the approval process (Wells and Wint, 1993). The practical effect may be to create delays, uncertainties and bureaucratic obstacles that discourage investors.

The extent of its welcome to FDI cannot be judged solely from statistics on the number or value of foreign investment applications or arrivals. Many factors influence companies' investment decisions, including economic conditions in the investors' home countries and in the world in general, competition from other developing (and developed) countries seeking similar investment, the anticipated growth or stagnation of the market for the company's products, the internal strategy and politics of investing companies, a host country's political stability and so on.[2] While these factors may influence the amount and kind of investment made in a host country, the focus of this article is on the influence of policy factors, specifically, the effect of a host government's policies (its openness) towards FDI.[3]

Methodology

There are immense problems in trying to assess the degree of a country's openness to FDI. Some aspects may be quantifiable – for example, the percentage of industries open to FDI or the monetary value of investment incentives (in countries that compile such statistics). Another possibility would be to examine figures on investment approvals or inflows, and indeed table 2 gives the number and total value of FDI approvals in the Republic of Korea from 1962 to 2000. These figures give a broad outline of the country's degree of receptivity to FDI, but they are far from a perfect indicator because (as noted above) the number and value of investment applications is influenced by many factors. The country also publishes statistics on investment inflows ("arrivals"), but these are even less reliable as indicators of openness, partly because of problems of definition and timing, as well as numerous externalities. Hence, an assessment of a country's degree of openness must necessarily be based largely on qualitative judgment (Stoever, 1989).

[2] Jun and Singh (1996) is one of many articles examining the factors affecting the flow of FDI.

[3] UNCTAD (1999) discusses at length the importance of host-government policies.

Table 2. FDI approvals, 1962-2000

Years	Projects (number)	Amount (millions of dollars)
1962	1	0.58
1963	1	0.30
1964	2	0.33
1965	5	20.7
1966	6	1.1
1967	12	6.3
1968	20	8.4
1969	25	15.6
1970	50	13.6
1971	57	25.8
1972	107	93.1
1973	194	156.6
1974	85	74.0
1975	29	169.4
1976	35	72.2
1977	37	65.9
1978	41	128.4
1979	50	107.3
1980	36	140.8
1981	41	145.3
1982	55	187.8
1983	75	267.8
1984	103	419.0
1985	..	531.7
1986	203/205	345.0
1987	317/373	1 060.0
1988	352	1 282.0
1989	336/349	1 090.0
1990	482	803.0
1991	482	1 390.0
1992	444	894.6
1993	458	1 044.3
1994	646	1 316.5
1995	872	1 941.4
1996	968	3 202.6
1997	920	5 899.9
1998	..	5 540.0
1999	..	15 541.0
2000	..	15 690.0
Total through 1997	**7 352 / 7 423**	
Total through 2000		**59 692.0**

Sources: *Korea Annual,* various issues; *Korea Times*, 18 January 2001.

Note: Two dots (..) indicate that data are not available.

The core methodology of this article is the examination and evaluation of relevant historical documents (Dunning, 1994, uses a somewhat-similar methodology). Year-by-year evaluations of the FDI policies of the Republic of Korea were made, based on articles from the business press and scholarly journals. Some of the articles came from Korean sources, but the majority were from the United States and British sources, because these latter would have the greatest influence on the perceptions of English-speaking businesspersons of the country's welcome to FDI. Pronouncements of the Government were included in the evaluations, but were weighted less heavily because the study was concerned not with the official line, but with how the policies actually worked in practice; unofficial sources were considered more reliable for assessing investors' actual experiences. The policies and yearly policy changes are briefly summarized in table 3. (Caves, 1998, discusses the problem of isolating the effects of policy choices, along with many other problems of research on FDI.)

Based on these sources, the country's degree of openness to FDI each year was assessed on a scale of 0 to 10, with 0 being the least open. The ratings are largely subjective, which is consistent with the fact that the perceptions of TNCs on the country's openness to FDI would also be relatively subjective. Also, investors' characterizations of how the regulations and procedures actually work in practice would be based largely on their own company's experiences and on reports of other companies' experiences, which would also be mostly subjective. Furthermore, even if the reader might question the exact numerical assessments of openness in specific years, the general trend concerning a greater and lesser desire to attract FDI is still captured by the swings in the numbers.

The degree of openness of a country's policy at any given time varies from industry to industry, so the evaluations must be taken as averages or generalizations, and are not necessarily equally applicable in every industry. In a few cases, there may have been significant variations in the Republic of Korea's approach within a given year, but the changes were usually gradual and incremental rather than abrupt and revolutionary. Hence, yearly evaluations were considered frequent enough to portray the investment environment accurately. Indeed, in some cases the same numerical rating was carried over from one year to the next when no information was available to indicate that the Government's policies had changed significantly.

The ratings are similar to the evaluations of political risk made by a number of investment and financial companies, such as the Business Environment Risk Index (BERI),[4] Business International,[5] and the international accounting-consulting firms of PriceWaterhouseCoopers and The PRS [Political Risk Services] Group.[6] However, these firms' evaluations cover a greater variety of political risks, whereas the present article focuses specifically on the country's degree of openness to FDI. (While there is a lot of overlap between political risk and openness, the two are not exactly the same.)

Observations and comments

Table 3 summarizes the major developments in the FDI policies of the Republic of Korea and evaluates the country's degree of openness to FDI from 1953 to 2000. Figure 1 shows the yearly ratings (starting in 1960) in graphical form; it vividly illustrates the country's alternating periods of attraction and aversion to FDI. Along with table 3, it yields some useful generalizations:

Table 3. Openness of the Republic of Korea to FDI 1953-2000: brief summary of developments in FDI policy

Year	Development in FDI policy	Openness rating
1953-1960	Recovery from 1950-1953 Korean War; political chaos and corruption; essentially no FDI.	0
1960	Some political and economic stability; passed Foreign Capital Inducement Act (FCIA) → allowed 75 per cent foreign equity.	2.0
1961	Military revolution; first five-year plan; start of export drive.	2.2
1962	FCIA amended → allowed foreign firms tax holidays, equal treatment with national firms; Economic Planning Board (EPB) created.	3.0
1963	Limited foreign capital inflow, mostly loans at concessionary rates.	3.1
1964	Monetary reform stabilized currency → allowed firms to repatriate up to 20 per cent of invested capital (Frank, Kim and Westphal, 1975).	3.5
1965	Normalized relations with Japan → allowed Japanese investment.	3.7

/...

[4] Business Environment Risk Index, Ltd., P.O. Box 4697, Newark, Delaware 19711, United States.

[5] Formerly an independent corporation, now affiliated with the Economist Intelligence Unit of *The Economist* newsmagazine (United Kingdom).

[6] http://www.prsgroup.com.

(Table 3, continued)

Year	Development in FDI policy	Openness rating
1966	FCIA modified to allow 100 per cent foreign ownership and more generous tax concessions.	5.0
1967-68	Joined International Centre for the Settlement of Investment Disputes (ICSID); expanded role of FDI in second five-year plan; created Office of Investment Promotion (OIP).	5.2
1970	Entered treaty with Japan to eliminate double taxation; further sweetened incentives; passed labor law forbidding strikes in foreign-managed firms.	6.0
Early 1970s	Vast increase in FDI, especially Japanese companies seeking cheap labour for simple manufactures.	
1972	"One-stop service office" set up à reduced time and red tape to get investment approval (Republic of Korea, EPB, 1972).	7.0
1973	In response to Japanese low-technology cottage industries, EPB began rethinking liberalization policies; devised new regulations that encouraged joint ventures (Republic of Korea, EPB, 1973).	5.5
1974	Changing priorities favoured large or high-technology projects; list distinguished "favourable" versus "unfavourable" industries for FDI; set different percentage foreign equity in different industries (Republic of Korea, EPB, 1978).	3.5
1977	Ministries disagreed on revisions to FCIA; EPB set two categories of manufacturing FDI: "top level" = essential to development → got full incentives; and "second level" = no special incentives, but allowed to compete in domestic consumer market; $500,000 minimum set for all new investment (Pearlstine, 1979; Business International Corporation, 1981, p. 9).	2.5
1978	Corruption and delays in approval process discouraged many investors; country sought to diversify by attracting more European investment (Business International Corporation, 1981, pp. 3-5)	2.0
1979	President Park assassinated → political instability; inflation → Government restricted economic growth; more industries opened to FDI, but high-tech and skill-intensive industries favoured (Business International Corporation, 1981, p. 5).	2.1
1980-1981	Government made new FDI a priority again: took steps to reduce red tape; relaxed local-ownership requirements for high-technology, export-oriented, diversifying or non-tax-privileged investment; reduced minimum size to $100,000; announced a relaxation in the Alien Land Law to allow foreign ownership (Korea Exchange Bank, 1982).	4.0

/...

(**Table 3, continued**)

Year	Development in FDI policy	Openness rating
1982	FDI fell off drastically, due partly to world recession and partly to ongoing problems of inefficiency, corruption and paperwork (*Christian Science Monitor*, 1982).	3.9
1983	Significant efforts to simplify administrative procedures and enlarge businesses open to FDI, but FDI applications fell another 60 per cent (United States, Department of Commerce, 1984a, p. 9; Jeong, 1983, p. 9).	4.3
1984	Approval procedures and remittance restrictions relaxed further; more foreign majority ownership allowed; approval responsibility transferred from EPB to Ministry of Finance; foreign-owned businesses treated less differently from domestically owned; consumers began pressing for greater openness to foreign products (United States, Department of Commerce, 1984b, p. 10).	5.0
1985	"Positive list" (allowing FDI in specific sectors) replaced by "negative list" (allowing FDI in all sectors except where specifically prohibited) → substantially increased number of industries open to FDI; move towards "national treatment" in tax regime for FDI (*Euromoney*, 1985; United States, Department of Commerce, 1986, p. 8).	6.0
1987	New laws to combat piracy of intellectual property adopted, partly to further efforts to join OECD; more industries opened to FDI (97 per cent of manufacturing sectors claimed open) (Davis, 1989, p. 5).	6.2
1988	Insurance opened to FDI; advertising and maritime opened partly (United States, Department of Commerce, 1988, p. 6).	6.3
1989	Approval procedures claimed further facilitated, although foreign companies complained about delays and favouritism of the "case-by-case" approval process (Davis, 1989, p. 9).	6.4
1990	Government announced programmes to liberalize foreign exchange and open advertising, pharmaceuticals, travel agencies etc. to FDI over 2-3 years; allowed automatic approval of foreign minority investment up to $100 million; however, some capital controls remained (Davis, 1989, p. 9; United States, Department of Commerce, 1990, p. 6).	6.5
1991	High inflation and interest rates, rapidly climbing wages → Government announced it would open retail and financial industries to FDI; re-stated intention to ease restrictions on land ownership by foreigners (Nakarmi, 1991; United States, Department of Commerce, 1991, p. 6).	6.7

/...

(Table 3, continued)

Year	Development in FDI policy	Openness rating
1992	Worldwide economic slowdown plus ongoing protectionism and investment barriers in the Republic of Korea → FDI fell off; first truly democratic election → Kim Young Sam elected as President (Paisley, 1992, p. 31).	6.7
1993	Government announced plans to liberalize financial industry; revised FCIA to allow simple notification (versus approval) of many investments; pushed plans to further reduce red tape → FDI in services soared; but much regulation, bureaucracy and harassment of FDI remained, especially among lower-level bureaucrats; foreign-minority joint ventures still favoured over foreign-majority (Paisley, 1993, p. 40; Cheesman, 1993; Economic Intelligence Unit, 1993; *Economist*, 1993).	6.9
1994	Government eased policies on approvals, technology regulation, land ownership by foreigners etc., but foreign companies still complained of high costs and of bureaucratic procedures and controls (*Business Korea*, 1994; *East Asian Executive Reports*, 1994).	7.2
1995	Government created incentives in tax, capital access, land ownership, subsidized factory sites etc., especially for high-tech investments; pledged to "raise transparency" in approvals and economic regulation; but foreign observers noted unfavourable labour conditions and the bureaucracy's tendency not to carry out official liberalizations (*East Asian Executive Reports*, 1995; *Business Korea*, 1995; Kim and Crick, 1996).	7.4
1996	Foreign Direct Investment Promotion Act adopted: set timetable for liberalization, notification rather than approval for most investments; but theft of confidential information continued, domestic companies (*chaebol*) resisted foreign competition, and bureaucrats continued to delay and encumber investment applications (Economic Intelligence Unit, 1996).	7.7
1997	Government tried another one-stop service centre, added further incentives and guarantees for FDI, allowed friendly foreign mergers and acquisitions of Korean companies, claimed more industries opened; however, the Asian financial crisis caused some foreign companies to cancel or postpone investment; Kim Dae Jung elected as President in November (Joo, 1998; Ryou, 1998).	8.0

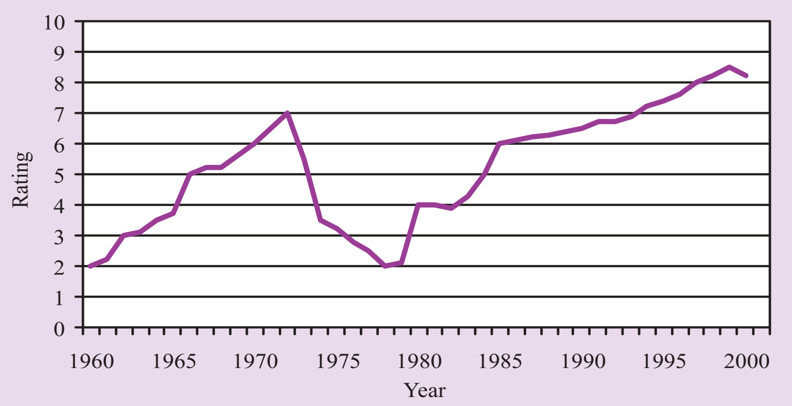
/...

(Table 3, concluded)

Year	Development in FDI policy	Openness rating
1998	Financial crisis → Government announced programme to restructure economy, especially debt-ridden banks and money-losing *chaebol*; introduced new tax incentives and reduced land prices offered to new FDI, especially in high technology; opened financial industry wider to foreign investment and takeovers; foreign interests purchased domestic companies at distress prices, raising fears of nationalistic reaction (*Business Asia*, 1999; *Business Korea,* 1999a; Jeon and Ahn , 2001).	8.2
1999	Government announced shift from "control and regulation" philosophy to "promotion and support" of FDI; relaxed rules on hostile takeovers of Korean companies; allowed local governments to compete for and approve FDI projects; largest FDI inflow ever in "corporate fire sale", although foreign observers still noted hesitancy in implementing reforms (*Business Korea*, 1999b; *Industry* Week, 2000).	8.5
2000	Government drew back from restructuring programme, hesitating to reform *chaebol* or let banks fail (*Korea Times*, 2000; Larkin, 2000; Lee, 2000; Choi, 2001; *Business Asia*, 2000).	8.2

Sources: Stoever (1986); author's calculations.

Figure 1. Openness of Korean foreign investment policies



Source: author's calculations.

- Many people within the country clearly wanted FDI, but they wanted it on their own terms. They wanted the specific benefits, especially capital (in the early years), technology and managerial skills, that TNCs could bring, but without paying the price in terms of allowing foreign competition in the domestic market (at least until the mid-1990s).
- In bargaining terms, the country was evidently trying to push its partners to the outer limits of their zones of acceptance; the spirit appears to have been somewhat different from the Western idea of striking a balance that both sides could be happy with.
- The Government evidently felt that it could obtain the desired benefits from FDI better than individual Korean companies could (Costello, 1996). It adopted a market-supplementing approach to determining the characteristics of FDI, attempting to use screening, approvals, incentives, regulations and administrative guidance to steer investment into desired industries or to make it take on desired characteristics. This attitude indicates a lack of confidence in the efficacy of the domestic market to control foreign capital. Alice H. Amsden (1989) noted that FDI played a relatively small role in the emergence of the Republic of Korea as an economic power, but its role was crucial in providing technology and industrial know-how. Her central thesis was that the Government achieved a more efficient allocation of investment (including FDI) than would have been obtained through the market alone. Yeomin Yoon (1993) is among the commentators who respond that the Government's approach may have been justified in the early years, but it became increasingly counterproductive as the economy became more developed. Those very approval and regulating processes created costs, delays, corruption, uncertainties and risks for foreign investors, which the Government tried to overcome with incentives such as tax holidays and subsidies. Thus, ironically, the Government had to create incentives to overcome the costs and disincentives of its own policies and regulatory mechanisms. In a sense, the Government created a monster that it later had difficulty reining in (Cho and Kim, 2000).
- The Republic of Korea appears to have gone through a distinct attraction-aversion-attraction cycle in the first 20

years or so after it began consciously formulating an FDI policy. Thereafter its reaction to FDI appears to have been less cyclical and more of a slowly rising (secular) trend (although it may be too soon as of 2001 to make this judgment). This observation obviously cannot be generalized to other developing countries, but it does suggest that any initial cycle may tend to be measured in decades rather than years.[7] It may also suggest that a developing country's first attraction-aversion-attraction cycle may be its most pronounced and obvious; later, as the country grows more economically complex and politically diversified, the effects of the attraction-aversion dilemma may be more diffuse and harder to identify.

Machiavellian motives?

A foreign observer should be cautious about ascribing Machiavellian motives to the swings in the Government's policies; but one could become skeptical about the Government's repeated pronouncements of reforms, easing, liberalizing, and opening wider to FDI, followed by very small changes in actual practices. The question arises whether the country's apparent swings might have been a deliberate tactic, an unspoken agreement, or an opportunistic reaction to changing circumstances. If it was deliberate, there is also a question exactly when the Government started consciously employing such a tactic. Thus:

- Government leaders may have wanted to stimulate the desire of TNCs to invest in the country in order to increase their own bargaining power. Any attempt to use this tactic could well have stemmed from an attitude seen in many other developing countries during the 1960s and 1970s, that TNCs were clamoring to get into the country and that the Government could get better terms by playing them off against each other.[8]
- Starting in the 1980s, the country seemed to want foreign governments and companies to *think* the country had opened up its FDI regime more than it actually had. An outsider might see this as being intended to forestall foreign pressures to open still wider.

[7] Stoever (1995) found a similar pattern in China, for example.

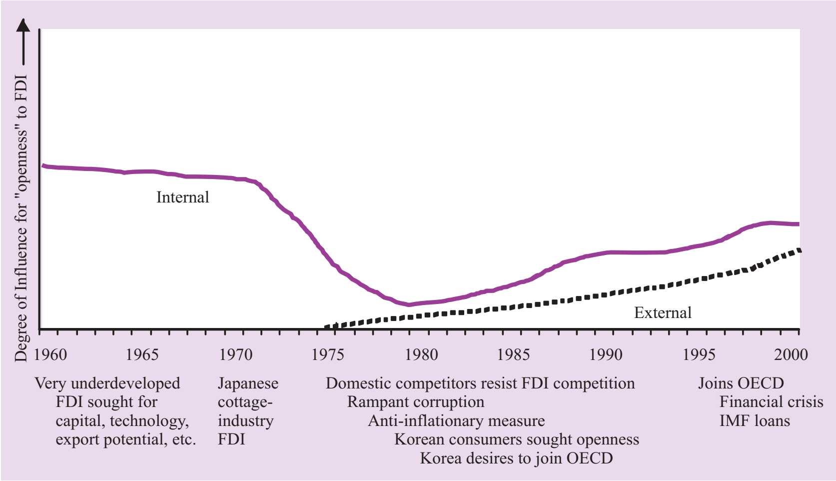
[8] By the late 1980s most developing countries recognized that the balance of bargaining power more often was with TNCs.

- As the 1980s unfolded, some policy makers may have seen opening more rapidly to *FDI* as a way of heading off outsiders' demands to reduce barriers to *trade*.[9]

Internal pressures for and against opening to FDI

The attraction-aversion dilemma of the Republic of Korea is vividly illustrated when one examines how the internal pressures for and against opening wider to FDI varied over time. Figure 2 provides a graphical representation of the strength of various internal pressures, as judged from the above narrative, plus a line representing external pressures on the country. The vertical axis represents the degree of influence for openness; thus an upward-sloping line would indicate increasing pressures to allow more FDI in, while a downward-sloping one would indicate increasing pressures to keep FDI out.[10] The horizontal (time) axis shows some especially significant developments in the country's modern experience with foreign investment; the discussion below is organized according to these periods.

Figure 2. Internal (and external) pressures driving FDI policies of the Republic of Korea, 1960-2000



Source: author's calculations.

[9] Rogowsky (1996) hints at such a tactic.
[10] Note that the line would say nothing about how attractive TNCs found the country to invest in or how open it actually was to FDI.

Very underdeveloped; beginning of the export drive (1960s)

It was relatively easy for Korea to open to FDI in the 1960s, when the country was definitely "less-developed", for several reasons:

- Domestic pressures favoured opening to FDI when the country was still poor and non-industrialized (although there was significant pressure against opening to *imports*, partly to conserve foreign exchange and partly to protect infant industries from foreign competition). The country did not differentiate among various kinds of capital inflows, simply viewing "foreign capital" in a generic sense; such capital was seen as a way to obtain needed resources and expertise, including technology and management skills.
- The United States was seen as a friend and protector because of its leadership and dominant role in the Korean War; so there was little anti-foreign sentiment when the total amount of investment was small and the United States was the major source of FDI.
- External forces brought very little pressure on the country at this time.

Market-seeking FDI; Japanese cottage-industry investment (1970s)

Internal political and economic pressures began to build for more rigorously screening and regulating FDI proposals in the late 1960s and 1970s, for several reasons:

- Some popular reaction against FDI by United States companies began to emerge as the United States came to be seen as exerting too great an influence on domestic business and politics (Costello, 1996).
- Popular aversion to investment by Japanese companies emerged quite strongly, largely attributable to the long history of rivalry between Korea and Japan, its experiences as a Japanese colony for 40 years, and its feelings of having been exploited and mistreated by Japan during World War II. These feelings were intensified because of the low-technology, cottage-industry nature of most Japanese investment in the 1970s; Koreans felt they could run these labour-intensive production facilities themselves.

- The Government came to realize that many TNCs wanted to put in plants to produce products primarily for the domestic market (import-substituting investment) rather than to support the country's export drive. Thus, it began to tighten its restrictions on market-seeking FDI even while expanding export incentives to domestic producers, both foreign- and locally-owned.

External forces began to exert some pressure on the country to open wider to imports, but there was still relatively little pressure to allow in more FDI.

Competitive pressures and reform efforts (late 1970s-1980s)

Internal pressures in favour of opening more rapidly became stronger as the country became more developed and prosperous:

- Some domestic manufacturers found themselves in need of foreign resources in order to enhance their own competitiveness. They sought freer access both to imported technology and components and to local production of critical inputs by foreign suppliers.
- Some policy makers also became more vocal in support of the desirability of introducing more competition into domestic markets, both as a way to obtain the benefits of increased openness predicted by economic theory and as a way to respond to external pressures to open wider to FDI.
- The Government realized that competition for desirable FDI - particularly FDI that produced products for export - was becoming more intense as more developing countries (as well as industrialized ones) created incentives, built subsidized industrial parks, granted longer and longer tax holidays, advertised their attractions to investors, and made other efforts to attract TNCs. The competitive environment created pressures on the Government to relax and streamline its review and regulatory processes.

External pressures to open more rapidly to FDI also began to emerge during this period. Foreign governments and business spokespersons began to view the country's efforts to attract export-oriented FDI while restricting import-substituting FDI as an effort to have its cake and eat it too: to shield domestic producers from foreign competition at home, while promoting their ability to compete in foreign markets.[11] The Republic of Korea could get away with this when it was a small player — an insignificant competitor with a small market - but as it became stronger and wealthier, foreign governments and companies began demanding greater reciprocity.

However, internal pressures to resist further opening were also growing more intense:

- Korean companies developed vested interests in maintaining the privileged positions that the Government had provided in earlier years. In particular, 20-30 large family-run conglomerates (*chaebol)* that the Government was supporting as major domestic manufacturers and export engines wanted to continue the protection they had been given as infant industries. Thus, they fought to keep out foreign businesses that could have provided strong competition in their home market.
- One response by the Government was to try to persuade potential investors to sell or license their technology to Korean companies, rather than putting in a complete investment "package". In view of Korean firms' reputation for intellectual piracy, however, many foreign companies were leery of entrusting their cutting-edge technology to Korean companies without the protection of an equity share.
- The Government's early successes in directing the economy, particularly in selecting industries for Korean companies to compete in, seemed to have made it reluctant to give up its role in guiding investment by foreign as well as domestic companies.
- The very success of the country's export drive apparently made the government reluctant to shift its emphasis towards raising domestic living standards, even though the economy was maturing and the need for export-led development decreasing.
- Some government agencies were reluctant to give up powers and prerogatives they had exercised during the country's emerging years. Some ministries obviously did not want to yield powers to other agencies such as the

[11] Many other developing countries were trying to do the same in the late 1970s and 1980s.

one-stop approval agency the Government tried to set up.

- The growing red tape, delays and corruption in the Government's approval and regulatory agencies also in effect created inertia against change and greater openness.
- Ideology doubtless played a part: civil servants who had been educated to believe that the Government could most effectively plan the country's economy found it difficult to yield their regulatory role to less controllable market forces.

Emergence as economic power (mid 1980s-mid 1990s)

As the country's economy grew and diversified, both external and internal pressures to ease its restrictions on FDI intensified:

- The OECD members demanded that the Republic of Korea substantially reduce its barriers to FDI and foreign imports as a condition for being invited to join.
- As Korean consumers began to learn about world markets and prices, they began to exert a little internal pressure to open wider to foreign companies seeking access to the domestic market.

Financial crisis and recovery (1997-2000)

The financial crisis that hit the country and several other East Asian countries in the latter part of 1997 caused some policy-makers to look to FDI as a possible aid to recovery. For a period of one to two years, there was considerable pressure from the top to accelerate the process of opening up, but as the country began to pull out of the crisis, the old fears of foreign competition and intrusion once again generated a backlash against such opening.

Conclusions and recommendations

Numerous articles contain prescriptions as to how developing countries can attract FDI on terms that are beneficial to both the investor and the host society (e.g. Buckley, 1996; Lall, 1995; Nunnenkamp, 1997; Ramamurti, 2001; Wells, 1998; UNCTAD, 1999). There is no point in repeating these pronouncements; rather, the intention here is to see what new insights can be gained from the experience of the Republic of Korea. Here are some suggestions:

Be aware of the attraction-aversion syndrome

The Republic of Korea never really succeeded in resolving the dilemma of desiring the benefits that foreign investors could bring while wanting to limit the intrusion of foreign entities. One reason for this may have been that Korean policy makers were unaware of how much their policies fluctuated over the years, particularly as seen through the eyes of foreign observers. A variation could be that they did not perceive the swings in policy to be as pronounced as outside observers saw them. They may have been too close to the daily workings of the governmental machinery to see the effects on outsiders. Colloquially, they did not see the forest for the trees. This phenomenon has been observed in many aspects of international economic relations, where policy makers are so involved in domestic political maneuverings that they lose sight of the bigger picture as it presents itself to the outside world (Blake and Walters, 1983). Thus, one of the first steps a developing country government can take to rationalize its FDI policy is simply to be aware of the mixed messages caused by the swings in its treatment of TNCs. If government leaders can make conscious efforts to step back from the daily minutiae of their functions, they may be able to get a broader perspective on the effects of their actions. Specifically, in the context of FDI policy, they may be able to dampen the extreme swings in their own governments' policies.

Develop a clear set of priorities for FDI

The experience of the Republic of Korea suggests that, if the Government could have decided on a clear set of priorities, it might have been better able to formulate policies designed to obtain a specific, limited set of benefits from FDI. Few governments are able to spell out their objectives so clearly, however, and so they end up trying to achieve multiple, often competing, objectives related to FDI. One reason is that policy makers may have different unstated assumptions as to what the country should be seeking from FDI and thus may give inconsistent directives to lower-level personnel who are charged with actually carrying out a policy. This phenomenon may have been one of the underlying causes of the fluctuations in the degree of openness of the Republic of Korea. In such a case, just making the effort to discuss their goals and set them out on paper can be a useful exercise: it can prompt policy makers to recognize and hopefully reconcile hidden differences.

A related problem is the phenomenon of sequential attention to goals, that is, the tendency to emphasize one set of goals for a period of time, and then to emphasize a different, sometimes contradictory, set at a later time. The Government of the Republic of Korea apparently went though such a sequence with respect to its FDI policies. In the 1960s and early 1970s, it sought capital and exports as its primary goals from foreign affiliates, and then it gradually switched emphasis to management know-how and technology. Preserving a significant degree of local control (or at least the appearance of local control) through joint ventures also became an important goal in the 1980s, concomitantly with increasing the inflow of FDI. However, these various goals proved to be somewhat incompatible: TNCs were reluctant to bring in large amounts of capital and technology while concentrating on production for export, and while limiting their ownership to minority positions in joint ventures.

Keep policies current

As a corollary to the above, a country's needs for FDI change over time as its economy evolves and grows. What is appropriate when a country is least developed might be quite different from what is most useful as its economy strengthens and diversifies. In the Republic of Korea, however, there was a noticeable tendency for policies to lag behind economic changes. Hence, one suggestion would be for a host government to make a conscious effort to review its objectives for FDI periodically and revise and update them so as to keep them consonant with its changing needs.

Set an appropriate pace of deregulation

Some regulation of FDI is clearly necessary and desirable, but the crucial question then becomes when, how and how much to regulate — all complex questions. Policy makers must tread carefully as they begin to change and dismantle their countries' laws and policies regulating FDI.[12] Deregulation that is too rapid or poorly

[12] And most other regulatory activities too, for that matter.

planned can have serious, often unintended consequences. On the other hand, policy makers cannot allow bureaucratic inertia to keep them from making changes long after the need becomes apparent. Thus, a government has to find an appropriate pace for deregulation and liberalization.

The Republic of Korea appears to have erred on the side of caution by failing to phase down and simplify its FDI regulation as its economy strengthened and diversified. Starting in the mid-1980s, it could have allowed market forces a much greater role in determining the amount, industries and other characteristics of incoming FDI. To an outside observer, it would appear that time is long overdue for the Government to bite the bullet and drastically reduce its administrative guidance of foreign investment. The burden of paperwork, delays, seeming arbitrariness, opportunities for corruption, and general hassles of the application and regulatory processes are imposing substantial costs on the country in the form of lagging technology, lost opportunities for new markets and products and lack of domestic competition — all elements for which FDI could make a real contribution.

Bridge the gap between rhetoric and reality

One of the ways the Government of the Republic of Korea damaged the country's reputation as an investment site was by its repeated announcements of opening wider, easing restrictions, facilitating procedures and so on, and then failing to carry through on its pronouncements in meaningful ways. This pattern, after numerous repetitions, in effect advertised the country's ambivalence towards FDI and thus created conditions in which TNCs were likely to demand more incentives or higher returns on their investment. It also doubtlessly damaged the Government's bargaining power with prospective investors. Regardless of the domestic factors that may have driven this behaviour, it was a poor face to present to outsiders, and it raised the question whether the on-again, off-again actions were a deliberate attempt to mislead foreigners. Hence one lesson to be learned from the country's experience is to avoid the appearance of duplicity or manipulatory tactics. A corollary would be not to neglect the importance of building a reputation of trustworthiness in the investing community.

Make genuine reforms in regulatory procedures

Reforming the bureaucratic processes proved to be one of the most difficult obstacles to easing the roadblocks to FDI in the Republic of Korea. Its efforts were more than lip service but less than an all-out commitment to remove unnecessary and cumbersome requirements and procedures to FDI approvals and implementation. One major problem was to get lower-level bureaucrats to implement reforms promulgated by top-level ministers and deputies. A particularly notable example was the Government's repeated attempts to implement a one-stop service office for FDI approvals, which lower-level bureaucrats rendered largely ineffective. Here again the question arises whether one could ascribe Machiavellian motives to the Government, i.e. whether the top-level might have anticipated and tacitly approved the lower-level bureaucrats' actions.

Do not overbalance domestic political considerations

The experience of the Republic of Korea suggests that internal factors may have fairly strong influences towards opening wider to FDI when a country is quite poor and underdeveloped, at least to the extent that the country's balance-of-payments position can tolerate import-substituting investment. However, as domestic enterprises begin to produce manufactured goods, they typically seek to protect their local market shares, with the result that internal pressures begin to shift against foreign investors (as well as foreign imports). Conversely, external factors tend to be unimportant when a country is insignificant either as a producer or consumer of manufactures, but they can become important sources of pressure to open wider as the country emerges as both a market and a competitor. The problem arises when a government allows domestic political pressures to continue to weigh too heavily on its decisions long after the country's enterprises have reached a level at which they should be able to compete without special protection.

It is easy for an outside commentator to recommend that a developing country government be prepared to resist domestic political pressures for limitation of, or protection from, foreign competition; the outsider must first attempt to understand the dimensions of the internal struggle. Nonetheless, the Government of the Republic of Korea must recognize that their restrictive policies impose increasingly heavy burdens on the domestic economy in the form of lower welfare, lost efficiency, and bloated, uncompetitive domestic enterprises. Opening an economy wider is a complex process that requires political determination and economic rationality. Fortunately, there are elements in the country that are pushing to open up the economy at a more determined pace. The country has a fairly good record of recognizing when problems exist and of moving to alleviate them in due course. Thus, it is reasonable to hope that the Government will succeed in making its FDI regime more truly effective in the not-too-distant future. ■

References

Aggarwal, Aradhna (1997). "Liberalization, internalization advantages and foreign direct investment: the Indian experience in the 1980s", *Transnational Corporations*, 6 (3), pp. 33-55.

Amsden, Alice H. (1989) *Asia's Next Giant: South Korea and Late Industrialization* (Oxford and New York: Oxford University Press); revised and reissued (paperback) in 1992.

Bergsman, Joel and Xiaofang Shen (1995). "Foreign direct investment in developing countries: progress and problems", *Finance and Development*, 32 (4), pp. 6-8.

Blake, David H. and Robert S. Walters (1983). *The Politics of Global Economic Relations* (Englewood Cliffs, NJ: Prentice-Hall).

Buckley, Peter J. (1996). "Government policy responses to rent-seeking transnational corporations", *Transnational Corporations*, 5 (2), pp. 1-17.

Business Asia (1999). "Economic outlook: South Korea", 29 November, p. 8.

___________ (2000). "Foreigner-friendly?", 16 October, pp. 1-3.

Business International Corporation (1981). *Investing, Licensing and Trading Conditions Abroad: Korea* (June) (New York: Business International Corporation).

Business Korea (1994). “Luring foreign investment”, February, p. 41.

___________ (1995). “Trade and industrial policies for the new economy”, October, pp. 13-15
.

___________ (1999a). “Corporate fire sale peaks in 1999”, October, pp. 39-41.

___________(1999b). “Foreign direct investment in Korea sets new record”, December, p. 87.

Butler, Kirt C. and Domingo Castelo Joaquin (1998). “A note on political risk and the required return on foreign direct investment”, *Journal of International Business Studies*, 29 (3), pp. 599-607.

Caves, Richard E. (1998). “Research on international business: problems and prospects”, *Journal of International Business Studies*, 29 (1), pp. 5-19.

Cheesman, Bruce (1993). “South Korea: investors’ land carrot”, *Asian Business*, 29 (7), p. 12.

Cho, Yong Hyo and Shin Kim (2000). “Administrative and regulatory reform of Korea in a time of national crisis”, *International Journal of Public Administration*, 23 (11), pp. 1197-2016.

Choi, Hae Won (2001). “Facing slump, South Korea eases pressure for reform – in policy it calls temporary, Seoul will help firms refinance maturing debt”, *Wall Street Journal*, 16 January, p. A19.

Christian Science Monitor (1982). “Firms hesitate to invest in Korea” and “South Korea: back to bootstraps after tripping over its own laces”, 11 May, p. B1.

Conklin, David and Donald Lecraw (1997). “Restrictions on foreign ownership during 1984-1994: developments and alternative policies”, *Transnational Corporations*, 6 (1), pp. 1-30.

Costello, Matthew J. (1996). “The Politics of foreign direct investment in South Korea” in Yeomin Yoon and Robert W. McGee (eds.), *Korea’s Turn to Globalization and Korea-U.S. Economic Cooperation* (South Orange, NJ: Seton Hall University Press), pp. 139-153.

Davis, Ian (1989). "Korea opens its doors to U.S. firms," *Business America*, 13 March, pp. 2-9.

Dunning, John H. (1994). "Re-evaluating the benefits of foreign direct investment", *Transnational Corporations*, 3 (1), pp. 23-51.

East Asian Executive Reports (1994). "Executive briefing", February, pp. 4-5.

__________ (1995). "Executive briefing", January, p. 15.

Economic Intelligence Unit (1993). *Investing, Licensing and Trading Conditions Abroad: South Korea* (September) (London: EIU).

__________ (1996). *Investing, Licensing and Trading Conditions Abroad: South Korea* (August) (London: EIU).

Economist (1993). "South Korea: reaching out", 25 December, p. 46.

Euromoney (1985). "Korea seeks to spur foreign investment after record year", Supplement No. 6, October, p. 50.

Frank, Charles R., Kwang Suk Kim and Larry E. Westphal (1975). *Foreign Trade Regimes and Economic Development: South Korea* (New York: National Bureau of Economic Research, distributed by Columbia University Press).

Industry Week (2000). "Valuing Asia's bargains", 10 January, pp. 49-50.

Jeon, Bang Nam and Se Young Ahn (2001). "The changing receptivity towards TNCs in the Republic of Korea: survey results and policy implications", *Transnational Corporations*, 10 (1), pp. 119-137.

Jeong, Gil-Sik (1983). "Direct foreign investment in Korea", *Korea Exchange Bank Monthly Review*, 17 (10), p. 1-12.

Joo, Sangyong (1998). "Opening capital markets", *Korea's Economy 1998* (Washington, D.C.: Korea Economic Institute of America), pp. 33-37.

Jun, Kwang J. and Harinder Singh (1996). "The determinants of foreign direct investment in developing countries", *Transnational Corporations*, 5 (2), pp. 67-105.

Kim, Seung H. and Trevor Crick (1996). "U.S. investment in Korea and Korean investment in the U.S.", in Yoon, Yeomin and Robert W. McGee (eds.), *Korea's Turn to Globalization* (South Orange, NJ: Seton Hall University Press), pp. 129-138.

Korea Exchange Bank (1982). "Administrative procedures concerning foreign investment simplified", *Monthly Review*, 15 (January), p. 57.

Korea Times (2000). "Foreign investment key to Korea's success: Toffler", 31 March, www.law.columbia.edu/course_00S_L9436_001/.

Lall, Sanjaya (1995). "Industrial strategy and policies on foreign direct investment in East Asia", *Transnational Corporations*, 4 (3), pp. 1-26.

Larkin, John (2000). "Lessons unlearned", *Far Eastern Economic Review*, 21 September, pp. 64-66.

Lee, Charles S. (2000). "Work in progress", *Far Eastern Economic Review*, 8 June, pp. 70-71.

Lipsey, Robert E. (2000). "Inward FDI and economic growth in developing countries", *Transnational Corporations*, 9 (1), pp. 67-95.

Nakarmi, Laxmi (1991). "Korea throws open its doors", *Business Week*, 29 July, p. 46.

Nunnenkamp, Peter (1997). "Foreign direct investment in Latin America in the era of globalized production", *Transnational Corporations*, 6 (1), pp. 51-81.

Paisley, Ed (1992). "South Korea trade and investment: time for a new start", *Far Eastern Economic Review*, 13 August, pp. 29-34.

_____ (1993). "South Korea trade and investment: cleaning up the act", *Far Eastern Economic Review*, 27 May, p. 40-44.

Pearlstine, Nathan (1979). "How South Korea surprised the world", *Forbes*, 30 April, pp. 53-54, 60-61.

Ramamurthi, Ravi (2001). "The obsolescing 'bargaining model'? MNC-host country relations revisited", *Journal of International Business Studies*, 32 (1), pp. 23-39.

Republic of Korea, Economic Planning Board (EPB) (1972). *Guide to investment in Korea* (Seoul: Government of the Republic of Korea).

______ (1973). *Foreign Capital Investment Administrative Procedures: Emphasis on Foreign Investment* (Seoul: Government of the Republic of Korea).

______ (1978). *Guide to Investment in Korea* (restated from 1974 version) (Seoul: Government of the Republic of Korea).

Rogowsky, Robert A. (1996). "Trade liberalization and economic reform in Korea: some general equilibrium estimates", in Yeomin Yoon and Robert W. McGee, eds., *Korea's Turn to Globalization and Korea-U.S. Economic Cooperation* (South Orange, NJ: Seton Hall University Press), pp. 111-119.

Ryou, Jai-won (1998). "Foreign direct investment in Korea: trends and prospects", *Korea's Economy 1998*, vol. 14 (Washington, D.C.: Korea Economic Institute of America), pp. 47-52.

Stiglitz, Joseph E. (1989). "Markets, market failures and development", *American Economic Review Papers and Proceedings*, 79 (2), pp. 197-202.

Stoever, William A. (1986). "Foreign investment as an aid in moving from least-developed to newly industrializing: a study in Korea", *The Journal of Developing Areas*, 20 (2), pp. 223-248.

__________ (1989). "Research note: methodological problems in assessing developing country policy toward foreign manufacturing investment", *Management International Review*, 29 (4), pp. 68-77.

__________ (1995). "The gold rush-disillusionment investment cycle in China", *Proceedings of the Fifth Asian Business and Economics Conference* (New York: St. John's University), pp. 16-21.

__________ (2001). "Liberalizing developing country policy toward foreign investment: a framework for analysis", *American Asian Review*, 19 (3), pp. 121-153.

United Nations Conference on Trade and Development (UNCTAD) (1999). "World Investment Report, 1999: foreign direct investment and the challenge of development", *Transnational Corporations*, 8 (3), pp. 55-100.

United States, Department of Commerce (1984a) "Foreign economic trends and their implications for the United States: Korea", March (Seoul: United States Embassy), mimeo.

__________ (1984b). "Foreign economic trends and their implications for the United States: Korea", November (Seoul: United States Embassy), mimeo.

__________ (1986). "Foreign economic trends and their implications for the United States: Korea", January (Seoul: United States Embassy), mimeo.

___________ (1988). "Foreign economic trends and their implications for the United States: Korea", October (Seoul: United States Embassy), mimeo.

__________ (1990). "Foreign economic trends and their implications for the United States: Korea", April (Seoul: United States Embassy), mimeo.

__________ (1991). "Foreign economic trends and their implications for the United States: Korea", February (Seoul: United States Embassy), mimeo.

Wells, L.T., Jr. (1998). "Multinationals and the developing countries", *Journal of International Business Studies*, 29 (1), pp. 101-114.

__________ and Allen G. Wint (1993). "Don't stop with the one-stop shop: foreign investment in a liberalizing third world", *The International Executive*, 35 (5), pp. 367-383.

Yoon, Yeomin (1993). Book review on Alice H. Amsden (1989/1992), *Asia's Next Giant: South Korea and Late Industrialization*, in *American Asian Review*, 11 (1), pp. 196-201.