

International Direct Investment in the ROK (Direct Overseas Investment and Foreign Direct Investment)

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1. Introduction

Policies relating to and the scale of international direct investment (direct overseas investment and foreign direct investment) in the ROK have changed along with changes in awareness regarding international direct investment. Until the mid-1980s, the negative effect of FDI¹ on state sovereignty and domestic enterprises was emphasized, but since then, the positive impacts – in the form of effects on growth and employment, and the efficient allocation of resources – have been played up. In particular, prior to the financial and currency crisis, when external conditions would have facilitated the provision of capital in the form of official loans, etc., the government regulated FDI or implemented passive investment-inducing policies. Since the crisis, however, it has implemented more positive policies, in order to cover the foreign currency reserve deficit and increase external confidence.

Meanwhile, policies relating to direct overseas investment² have either been regulated or liberalized, emphasizing such macroeconomic goals as securing foreign currency reserves or stabilizing prices. Until the mid-1980s, in order to prevent the outflow of foreign currency reserves, which were in short supply, direct overseas investment was only permitted in order to expand the export market or develop resources, but from the late 1980s onward, in order to ease inflationary pressures on the domestic currency due to the trade surplus, the government began to liberalize direct overseas investment and presently, only regulations on payroll guarantees to locally incorporated companies remain.

2. Direct Overseas Investment (Outbound)

1. Prior to the Financial and Currency Crisis

Direct overseas investment by ROK businesses has increased rapidly since the latter half of the 1980s, at a pace exceeding 50% per annum on average, but from 1991 until mid-1993, there was an obvious slowdown in the growth trend and investment remained at approximately \$1.2 billion (Disbursed) annually. After this, it began to grow rapidly again.

¹ In the ROK, direct investment by foreign nationals is defined as when a foreign national obtains shares (or equity) in a domestic enterprise equating to 10% or more of the number of shares authorized (or total equity), with the aim of establishing a sustained economic relationship by means of participation in management; or when they provide a loan with a full term of 5 years or more.

² In the ROK, direct overseas investment is defined as investment which takes place with the aim of participating in the management of a foreign corporation and in which the relocation of capital is accompanied by the transfer of production and management technology (or human resources).

In terms of the configuration of investment, one of the characteristics of direct overseas investment prior to the crisis includes the expansion of large-scale investment in large companies; in terms of the type of industry, investment took place mainly in the heavy and chemical industry and foreign trade sectors; and in terms of region, a large amount of investment focused on North America, while the growth rate of investment in Southeast Asia and Europe increased. The share of foreign direct investment by small and medium-sized companies, which had been increasing rapidly, mostly in Southeast Asia, from the mid-1980s, decreased after reaching a peak in 1993. On the other hand, large-scale foreign direct investment by big companies in the electronics, semiconductor, automobile, and iron and steel sectors mainly in Southeast Asia and Europe increased rapidly from 1993 to 1996.

2. Since the Financial and Currency Crisis

The ROK's direct overseas investment displayed a continuous downward trend from 1997 until 2000. This trend is believed to have been caused by unease with regard to the economic climate in the ROK after the crisis, as well as by a lack of ability on the part of Korean businesses to engage in direct overseas investment, due to sustained structural adjustments. However, the number of cases of direct overseas investment has been increasing, reflecting the fact that, since the crisis, the ROK's direct overseas investment has been undertaken mainly by small and medium-sized companies rather than large ones, on a smaller rather than a larger scale. By region, amid the overall downward trend, direct overseas investment in North America and Asia, which were the main focus of investment by Korean companies, has displayed a remarkable decrease.

Despite this general trend, the broad increase in overseas investment in the communications sector, such as in cable and wireless communications businesses, and in such IT-related services as internet provision services and data processing, and the rise in the number of cases of investment in China and the value thereof can be identified as features of the ROK's direct overseas investment since the economic crisis.

3. Background to the Increase in the ROK's Direct Overseas Investment

While direct overseas investment decreased after the financial and currency crisis, the factors contributing to its rapid growth before then include 1) the liberalization of direct overseas investment; 2) a deterioration in the domestic business environment; and 3) the globalization management strategy and improvements in the overseas financing capability of domestic companies.

- 1) Developments in the liberalization of direct overseas investment: At the beginning of the 1990s, regulations governing direct overseas investment were strengthened temporarily, due to the current account deficit, but as a result of the necessity of

expanding overseas penetration, which is essential for the globalization and internationalization of companies, these were broadly relaxed in September 1992. The government began to scale down the categories of business subject to overseas investment restrictions in December 1993, and in June 1996, it more or less abolished restrictions on business categories. However, it restricted indiscriminate direct overseas investment and, intending to make investment businesses sounder, in October 1995 it reintroduced the Self-Financing Obligation Rule, as well as establishing the new Restrictions on Parent Company's Guarantees to Overseas Subsidiaries for their Local Funding.

- 2) Deterioration in the domestic business environment: Due to rises in wages, land prices and distribution costs, the management environment for domestic businesses deteriorated and the shift of factories overseas has been stepped up. The nominal rate of wage rises in the ROK between 1986 and 1995 was 15.3% per annum on average. The trend towards significant increases in unit labor costs adjusted for rises in labor productivity continued, at 5.6%. The price of lots on industrial estates was between 5 and 25 times that in China and developing countries in Southeast Asia, and 10 to 45 times the price of those in the US and the UK. Distribution costs accounted for 16% of GDP, with sales accounting for 14%, a high level in comparison with the US (GDP and sales correlation 10.5%, 7.0%) and Japan (8.8%, 11.0%).
- 3) The globalization management strategy and improvements in the overseas financing capability of domestic companies: Overseas investment, mostly by major companies, is being promoted in their main business areas, with the aim of exploiting overseas markets and acquiring technology through globalization management strategies that respond to the sudden changes in the global economic environment. The reason for this is an increase in the ability to borrow foreign funds directly due to increased confidence. In particular, as a result of such factors as the easing of foreign exchange restrictions, an expansion in the scale of companies, and the reduction of country risk, the ability of domestic businesses to attract foreign capital to their overseas operations has improved considerably, and the attraction of large-scale direct overseas investment funding has become easier.

Direct Overseas Investment

(US\$1000)

	Japan		China		Russia		Mongolia	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
1980	22	2,482						
1981	6	1,122						

1982	0	233						
1983	3	651						
1984	3	606						
1985	2	324						
1986	6	1,968						
1987	6	1,421						
1988	13	6,473						
1989	21	10,179	7	6,360	2	480		
1990	14	6,967	24	16,174				
1991	21	12,127	69	42,469	5	17,244		
1992	13	28,077	170	141,127	7	3,247		
1993	12	6,014	378	264,047	12	3,042		
1994	16	57,954	841	632,114	20	11,925	2	241
1995	28	105,141	740	823,535	24	30,808	3	4806
1996	22	80,550	729	835,667	12	41,357	2	352
1997	22	63,686	622	633,206	6	8,175	3	1400
1998	17	22,658	242	630,845	5	35,137	1	130
1999	35	48,256	431	307,111	7	714	3	1855
2000	121	60,802	692	307,077	9	3,133	6	1782
2001	85	38,133	690	300,543	6	6,603	3	1573
Total	488	555,824	5,635	4,940,275	115	161,865	23	12139

Notes 1) According to Ministry of Finance and Economy criteria, there is no direct investment in the DPRK
2) General investment base

Source The Export-Import Bank of Korea

Foreign Direct Investment (Inbound)

1. Prior to the Financial and Currency Crisis

Continuous political efforts, such as the 1960 enactment of the Foreign Capital Introduction Promotion Law, have been made to encourage direct investment in the ROK by foreign nationals, in order to attract the foreign capital necessary for promoting economic development, but until the mid-1980s, practical accomplishments remained small. Since the 1962 implementation of the First Five-Year Plan for Economic Development, the ROK's foreign capital introduction policies have focused mainly on loans from banks and the public sector; the main reason for this was a strongly skeptical attitude towards foreign-financed companies on the part of the Korean public. However, at the beginning of the 1980s, the international financial market was destabilized by the repercussions of the foreign debt crisis that hit Central and Southern American states and the question of whether the ROK would suffer a similar crisis became an issue. As a result of the ROK government's active efforts to attract foreign investment from the mid-1980s, the scale of FDI reached \$800 million in the period 1986-1989, which reached 0.5% of nominal GDP. Between

1990 and 1995, the deterioration in the domestic investment environment, due to such factors as a sudden increase in disputes between management and labor unions since the mid-1980s and sharp wage and land price rises, was accompanied by a slowdown in the upward trend in direct investment by foreigners, as a result of which, FDI fell to 0.3% of nominal GDP. However, since the mid-1990s, FDI has begun to grow in earnest, due to the expansion in the sectors in which investment liberalization has taken place and the simplification of investment procedures.

2. Since the Financial and Currency Crisis

Since the economic crisis, despite such issues as the endless labor-management problems and uncertainty relating to the Korean economy, the number of cases and the monetary value of FDI have been increasing, due to across-the-board permission for hostile takeovers of domestic businesses and the easing of restrictions on the acquisition of land. Furthermore, given the growing share of small and medium-scale investment, i.e. investment worth less than \$5 million, it seems that the investment base is expanding. Looking at the situation by region, investment from the USA, which was main investor in the ROK before the crisis, has decreased, but investment from Japan has increased significantly. By industry, the trend towards a preference for investment in the service sector has continued, and in terms of business category, investment in wholesale and retail, the accommodation industry and other service-related businesses has been increasing. In terms of investment patterns, new share acquisitions, such as the establishment of new corporate bodies and participation in capital expansion, have been notable. Furthermore, while large-scale investment has decreased significantly, due to the increase in risk as a result of increased industrial efficiency and the structural adjustment of business finance, additional investment by investing companies and investment accompanying strategic cooperation has increased significantly.

3. New Characteristics of FDI Since the Financial and Currency Crisis

- 1) Rapid increase in FDI by means of the mergers and acquisitions method: Mergers and acquisitions investment through the stock acquisitions and asset acquisition methods has been increasing since the acquisition of Ssangyong Paper Company by the American multinational P&A. Such mergers and acquisitions investment has been vigorously promoted as part of the ROK government's business and financial structural adjustments and this trend seems likely to continue in the future. (Of the 112 cases of large-scale investment, worth more than \$10 million each, which were reported between January and November 1998, 49 (43.8%) were mergers and acquisitions investment; 14 cases, or \$2,345 million of investment by means of the factory acquisition or business unit acquisition methods were registered during that period, along with 207 cases of stock subscriptions, worth \$1,110 million.)

- 2) Increase in the share of manufacturing industry investment: During the period January to November 1998, there were 501 cases of investment by foreign nationals in the manufacturing industry, totaling \$4,402 million and accounting for 63.7% of the total amount invested by foreigners. This is a significant increase on the 33.7% figure for the share of manufacturing industry investment in 1997. The expansion of investment in manufacturing by means of this form of mergers and acquisitions investment could become a new turning point in the development of manufacturing industry.
- 3) Increase in investment from Japan: Investment from Japan is showing an upward trend but, in contrast to Western European states, it is mainly centered around small and medium-scale investment. (Direct investment from Japan was worth \$504 million in 1998, \$1,750 million in 1999, and \$2,448 million in 2000, with the increase in its relative importance overall amounting to 5.7%, 11.3% and 15.6% respectively.)
- 4) Emergence of investment in establishing regional bases: Amid large-scale mergers and acquisitions investment, the inflow of investment aimed at establishing a base in Asia has been increasing. It can be anticipated that such investment in regional bases will provide new momentum for the development of industry in the ROK, and that in the future, expansion investment accompanying the development of regional bases will grow more than new investment.

Foreign Direct Investment

(US\$1000)

	Japan		China		Russia		Mongolia		World	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value	Cases	Value
1962-71	246	98,017							395	264,075
1972-81	871	927,910							1,104	1,545,938
1982-86	276	876,190							565	1,735,287
1987-89	530	1,660,256	1	2,800					1,052	3,306,615
1990	145	235,530	1	100	1	200			305	796,755
1991	113	225,918	3	690	5	711			297	1,380,146
1992	72	155,161	6	1,056	10	1,458			236	886,698
1993	86	286,006	29	6,864	6	903			278	1,041,584
1994	131	428,407	31	6,145	14	1,420			423	1,303,217
1995	170	424,094	45	10,892	9	952			579	1,931,479
1996	155	254,676	56	5,578	10	1,677	1	66	612	3,201,486
1997	132	265,380	66	6,518	10	603			664	6,967,318
1998	177	504,158	87	8,381	17	1,849			826	8,694,606
1999	237	1,749,716	300	26,586	11	671			1,499	15,508,157
2000	413	2,448,222	1,077	76,496	13	702	1	69	3,146	15,654,370
Total	3,754	10,539,641	1,702	152,106	106	11,146	2	135	11,981	64,217,731

- Notes
- 1) According to Ministry of Finance and Economy criteria, there is no direct investment by the DPRK
 - 2) The figures for cases and values of investment by countries throughout the world exclude those for international cooperative frameworks and such institutions as the ADB and IFC
 - 3) The figures for cases and values of investment are on a reported basis
- Source Ministry of Commerce, Industry and Energy