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Foreign investment opportunities in the Republic of Korea

Johng Un Kim

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FOREIGN INVESTMENT OPPORTUNITIES
IN THE REPUBLIC OF KOREA

By
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B.S., Utah State University

Presented in partial fulfillment of the requirements for the degree of
Master of Business Administration
UNIVERSITY OF MONTANA
1971

Approved by:

[Signatures]

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CHAPTER I

EFFECTS OF FOREIGN CAPITAL ON THE KOREAN ECONOMY

Introduction

The climate in the Republic of Korea for investment by foreign nationals has improved greatly in recent years. The Korean government has provided legislation designed to offer distinct advantages to foreign investors. In addition, the progress of the Korean economy over the several years might have provided any such investors with increasing profits. On the other hand, foreign investment has assisted the Korean economy with much needed capital and reduced its chronic unemployment problem.

A major purpose in preparing this report is to provide potential investors with the objectives and goals of the Korean government, pertinent legislation, and the type of socio-economic information necessary to an understanding of the Korean business climate.

Primary and secondary research were conducted in order to determine the goals, plans, and programs of the government sector of the Korean economy for increasing private foreign investment. In addition to identifying the goals of the government, an attempt was made to ascertain its problems in achieving its goals. Through personal interviews with government officials and persons from economic institutions, a general picture of the Korean economy was
developed. However, most of the information for this paper was obtained from a review of newspapers, economic journals, and government publications issued mainly by the Economic Planning Board.

Foreign capital consists of public loans, commercial loans, foreigner's direct investment, and technological development. Public loans are usually used for social overhead capital and to finance public service facilities. Since public loans are not for the purpose of earning profits, they will be omitted from this discussion. Commercial loans consist of cash loans and capital goods investment, the latter being divided into project loans and non-project loans or program loans. Project loans are for building industrial facilities and program loans are made for buying raw materials. Cash loans are used for domestic payment of imported industrial products and facilities.

Foreign investors are allowed to invest directly and to participate in management. They can invest with any of the following items: foreign means of payment or domestic means of payment accrued from direct exchange, profits accrued from the stocks or shares acquired under this law, capital goods, and industrial property rights or other technology as deemed necessary by the Minister of the Economic Planning Board.

In Chapter Two, policies used to attract foreign capital are discussed. Included are the laws and regulations applicable to foreign investment. They are reviewed in detail to illustrate favorable treatment, government guarantees, and restrictions on foreign investment. Comparative foreign investments are treated in
Chapter Three, while in Chapter Four, the various problems created by foreign investment are identified and discussed. In Chapter Five, legislative solutions to the problems are proposed. Conclusions are drawn in Chapter Six.

**Historical Development of Foreign Aid to Korea**

The Republic of Korea (hereafter called Korea) was one of the countries which had received large amounts of American aid. It had received more than $4.37 billion in grants during the 24-year period from 1945 through 1968.¹

These relatively large amounts of dollars have been considered by some persons to be wasted. Within the United States, a major debate has resulted. Nevertheless, American aid has had a great effect on the Korean economy and has played an important role in restoring the economy. For example:

American aid relieved some of the Korean government's financial difficulties. Since personal income in Korea was at a very low level, revenues from taxes were far less than the government's needs. In the 1950's, 40 to 50 percent of the governmental budget was comprised of counterpart funds, which are the revenues received from the sale of merchandise given as aid.²

Until 1960, American aid had accounted for more than 16 percent of the gross national product for each of the previous 15

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years. Goods and services imported as a part of aid packages relieved the shortage of the necessities of life; they helped the Korean economy out of its shortage of foreign exchange. If there had not been American aid, Koreans would have had to buy the daily necessities with scarce foreign exchange, which could have put the economy in a more difficult financial position.

Annual revenues of 20 to 30 billion won ($1.305 equals one won) from the sales of goods and services helped to prevent inflation by withdrawing the notes in circulation and permitted economic growth. On the other hand, counterpart funds became the main source of financing for industry. This replenished the national savings, increased the rate of investment, and played an important role in continuous economic development.

After World War II, the United States provided large amounts of aid to countries all over the world. The aid rescued disease-stricken and hungry people, rehabilitated war-torn nations, and helped economic development in developing countries. Besides these humanitarian and economic aspects, aid was an important measure in maintaining security of countries fighting Communism. It was for these purposes that the United States contributed most of its aid under liberal repayment conditions. However, because of the increasingly unfavorable international balance of payments condition, which began in 1957, the United States has reduced the magnitude of aid, and its foreign aid policy has been changed. Grants-in-aid

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3 Ibid., Table 6, p. 9.
4 Ibid., Table 8, p. 10.
assistance was shifted to development loans. Accordingly, Korea had a reduction in the amount in grants as loans were increased. Foreign aid declined from $352.1 million in 1956 to $109.0 million in 1967. In 1968, it increased to $147.0 million. However, the increase was largely caused by the increase in Development Loan Funds and imports of grain surplus due to the failure of crops in 1967 and 1968. Foreign grants are expected to be discontinued during the 1970's. Financial pressure resulted from the reduced foreign aid, and Korea's balance of payments became unfavorable since most of the daily necessities and raw materials had to be bought with Korean foreign exchange. The gap between savings and investment became greater as the amount of foreign aid declined. The situation further deteriorated because of a series of Five-Year Economic Development Plans started in 1961. In addition, the amount of investable savings was small because of the low level of income. Any economic development plans would have to be financed through foreign loans.

Foreign aid has played an important role in the development of the Korean economy. However, grant aid has been less effective than foreign loans because grants have been controlled by the contributors whereas foreign loans have been used as the borrowers' needs dictated. From the point of view of efficiency, therefore, the conversion from grants to loans has actually brought a great boost to the Korean economy.

After this major turning point in the 1960's, the Korean government implemented a policy to make a type of "artificial" progress with foreign and domestic savings rather than expecting self-generated economic growth provided by grant aid. This effort began in the First Five-Year Economic Development Plan started during 1962. It was the first step of a comprehensive development plan designed to attain a self-supporting economy. As a long-range plan, the Korean government intends to set up a series of five-year economic development plans. These plans will require large sums of capital beyond Korea's internal capacity for generation. Accordingly, policies designed to attract foreign capital for economic growth and development will receive high priority.

Effects of Foreign Capital on Korea

It may be helpful in understanding the significance of foreign capital to demonstrate how such capital contributes to the economy of a developing country.

Grant aid often is not considered by receiving countries as being either sufficient in amount, or of the proper composition, or being received at the most appropriate time. Grant aid is generally extended and controlled in accordance with the economic and political situation of the aiding country. In recent years, a donor country's foreign aid policy has been closely related to its export policy. On the other hand, most foreign capital import policies are formulated by the importing country. They plan how to use foreign capital so as to maximize its effects.
Generally, developing countries face various problems at the time they set economic development plans. The major problems are: the low level of capital accumulation, low productivity, low individual income, low level of investment resulting from the small amount of capital accumulated, underexploitation of resources, lack of technical skills, and a relatively large population combined with an expanding or high birth rate. The function of foreign capital is to fill the gap between needs and availability of capital for investment in a developing country. In other words, foreign capital has the direct effect of bringing a faster rate of development by providing capital and technology to a developing country.

The direct effects discussed previously are only short-term effects to relieve bottlenecks to production. They also have a long-run effect on production. When applied to production, they increase income and effective demand. This increases investment again and will induce the "multiplier effect." The multiplier is determined by the degree of marginal propensity to consume. The consumer index in Korea shows that the average MPC from 1962 through 1967 was 88 percent. By applying the MPC of .88 to the multiplier formula, the following multiplier can be obtained:

\[
k = \frac{1}{1 - .88} = 8.33
\]

Thus, a million dollars of foreign capital to be invested in the Korean economy may increase the gross national product by $8.33 million. Of course, this effect is a description of the

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simultaneous multiplier effect. It will take a relatively long time to see the full multiplier effect and continuous investment will be necessary every year to get a continuous multiplier effect of 8.33 thereafter.

Theoretically, some extent of acceleration will occur when effective demand is increased by foreign capital. However, the Korean economy is not in a position to produce capital goods in response to increases in effective demand. Capital formation can be realized mainly through additional transfusion of foreign capital. Therefore, any acceleration effect may be negligible.

Expecting the full effects described above, the Korean government is making strenuous efforts to attract foreign capital. However, not all foreign capital helps economic progress. Some types do nothing but accelerate the consumption rate. Other types help the economy progress faster. Taking these situations into account, the Korean government has established certain criteria for attracting more effective types and greater quantities of foreign capital. The government has several objectives to achieve through its policies and programs.

First, it wants to maintain a high level of capital formation and attain continuous progress toward a higher level of economic activity. The economy maintained a 9.1 percent average economic growth rate through the First Five-Year Economic Development Plan and achieved higher rates of growth (13.4 percent, 8.9 percent, and 13.1 percent) from 1966 through 1968, respectively. In 1969, the

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government boasted the world's highest rate of economic growth at 15.9 percent. The growth was primarily attributable to the high rate of capital formation which has resulted largely from an influx of foreign capital. The contribution rate of foreign capital to total capital formation increased from 2.6 percent in 1962 to 26.8 percent in 1967.

Second, the government wants to modernize industry. The First Five-Year Economic Development Plan provided the impetus for the industrialization of the Korean economy. Due to the foreign capital which has been used to develop the second and third industries, the industrial structure was greatly improved along with a quantitative expansion of the economy. Proportions of GNP for the primary, second, and third industries have changed from 41.4, 15.1, and 43.5 percent, respectively, in 1960 to 28.0, 21.4, and 50.6 percent in 1968. Intensive investment was made to overcome the shortage of social overhead capital. The main concern of the government is to develop industry, where the social overhead capital is an indispensable factor for industrialization.

Third, the Korean government wants to improve the balance of payments. Foreign capital is important not only for its function as a fund for development but also as a mechanism to improve the


\(^{10}\)Division of Foreign Exchange, Foreign Exchange Bank, \textit{The Present Situation and Problems of Foreign Capital Inducement}, (Seoul, 1969).

international balance of payments. According to a 1968 survey financed by foreign investors, 45 companies created a $350 million import substitution effect and exported $78 million. Also of importance were changes in the composition of exports due to foreign capital. In 1960, the export of industrial goods was less than 17 percent. Most of the exports consisted of raw materials or agricultural products. After eight years, industrial goods now account for 76 percent of exports. This reflects the Korean government's desire to improve the international balance of payments through the exportation of industrial products.  

Fourth, the government is attempting to cultivate entrepreneurship and scientific management. One of the most important economic effects of foreign capital is the changed attitudes of businessmen. Korea has trained many entrepreneurs. Their attitudes toward making profits through scientific management have brought about a revolution in Korean management. Even though there is not much direct investment as yet, foreign investors have introduced modern management techniques to local businessmen. As an inevitable consequence, local businessmen no longer expect to operate a company for windfall profits, but rather they are trying to find new products, new methods of production, new markets, and new forms of organization. 

Finally, the government wants to increase employment and technical development. Foreign capital is used to build factories and to create employment opportunities for local people. As industrialization progresses, it absorbs the unemployed and potential unemployed

\[\text{12 \text{Ibid.}}\]
in agricultural districts. On the other hand, foreign investors introduced new techniques and equipment which help to increase productivity.

The preceding chapter has dealt with the various effects of foreign capital on the Korean economy. The next chapter will be concerned with the role of government and governmental policies toward the overall development of the country. These policies will be examined from the standpoints of flexibility, effectiveness, and timeliness.
CHAPTER II
FOREIGN CAPITAL INDUCEMENT LAWS AND REGULATIONS

The Foreign Capital Inducement Law

Foreign capital inducement in Korea is provided for by legislation through the Foreign Capital Inducement Law. Foreign investors, while receiving considerate treatment, are restricted and supervised according to the law. The law is a guide for government officials to control foreign capital. The law, however, does not guarantee the same treatment for all forms of foreign capital. Those types of capital considered "harmful" are discouraged through administrative measures and less urgent types are restricted by applying complicated conditions for their entry. On the other hand, if foreign capital is considered indispensable to the development of the economy, the government treats it with special consideration.

The foreign capital inducement policy has changed in accordance with the economic policy of the nation. Since economic policy is outlined in the Long-Range Economic Development Plan, it is easier to understand the far reaching economic policy if the targets and directions of the government's long-range economic development plan are known.

A series of Five-Year Plans will be implemented until an adequately high level of economic development has been attained.
The third, fourth, and fifth plans are currently under consideration and plans are being made to introduce foreign capital based upon the urgency and necessity of such capital for the successful accomplishment of economic plans. Even though the emphasis will be placed in different areas as conditions dictate, the basic elements of the long-range strategy and objectives will not be changed significantly throughout the plans. The objectives are stipulated in the Second Plan. The basic objectives of long-range strategy are to expand exports, increase capital, and improve efficient manpower utilization.

The promotion of industrialization through the expansion of exports is an inevitable path for the economy to follow. A relatively unfavorable endowment of natural resources imposes on the economy the necessity of being an open economy. It would also be difficult to offer the domestic market alone as the foundation for expanded industrial production in view of the size of the economy. Another reason exports are emphasized is the low level of capital accumulation. Because of this, and for more efficient development, foreign borrowing is inevitable. However, foreign loans, themselves, may not be available without the foundation of a large export capacity.

Foreign loans, per se, are not enough to develop the economy appropriately. Usually foreign capital is used for importing machinery. To build a factory, land is necessary. To operate the plant, operating capital must be provided. It is very important for the economy to provide these funds while at the same time avoiding inflation. For these reasons, developing the capital
market, especially the stock market, is one of the government's major concerns.

It is often said in Korea that the greatest resource of Korea is its people. Large numbers of well-educated people and highly-skilled workers are willing to work for relatively low wages and salaries. Korea has a low rate of illiteracy of less than 10 percent of its population. Most of the workers, except for farmers, have acquired at least a high school education. The people are diligent and fast learners. However, there are not enough jobs to put all of these laborers to work. It is therefore mandatory that any economic measure fully utilize the human resources. It is essential that development plans give emphasis to those industries which are labor-intensive and those which require high productivity per worker. The electronics and textile industries are representative of such labor-intensive production.

It is also important to develop industries which will stimulate the growth of related industries as well as labor intensive industries in order to increase the levels of employment and income. Furthermore, it is necessary to construct key industries such as chemicals, iron and steel, and machinery manufacturing in order to establish the foundation for heavy industry which will, in turn, provide for the balanced development of industry in the future. Such industrial development should bring about a diversification of commodities and increase effective demand through subsequent development in related industries. Furthermore, it should increase the GNP and strengthen Korea's international competitive position. The government is now planning for the
construction of new plants and the expansion of existing facilities for the production of industrial machinery, heavy agricultural equipment and machinery, communication equipment, automobiles, ships, and transportation equipment.¹

One of the most severe problems facing the Korean economy lies in the differences in income between city and rural districts. District differences between urban communities and rural districts can be seen vividly. People leave the rural areas and seek jobs in the cities, especially in Seoul, the capital of Korea. Mobility leaves the countryside deserted and underdeveloped in many areas. Professor Chin-whan Park of Seoul Agricultural College pointed out that "Korean agriculture fell into a snare of low level of balance of sluggish demand and limited supply," which seems to imply that a low level of demand for Korean grain has resulted from foreign grain imports and limited supply caused by low productivity have prevented rural districts from developing.²

The failure of the farming community has suppressed economic progress in general. First, the farmers' relatively low income levels have restricted the market for goods and services produced and prevented the economy from taking advantage of mass production, which further resulted in higher unit production costs. In addition, farmers could not provide abundant raw materials which then must be imported at higher prices. As a result, the cost of products has risen and weakened Korea's competitive standing in the

²The Dong-A Daily, June 26, 1969, p. 4.
world markets. On the other hand, the drain of foreign exchange resulted from raw material imports aggravated the international balance of payments. To cope with these difficulties in the agricultural field, a concerted effort by the government is expected to be initiated soon. Agricultural development policy will be aimed toward self-support in food production, saving foreign exchange, and increasing farmers' incomes through dairy production and the marketing of other by-products.3

As the economy grows and as its proportion of industry becomes larger, it will be necessary to transfer some farm labor to factories. To prepare for this end, mechanization of agriculture is proceeding. Also, a heavy agricultural equipment and machinery development plan is under consideration.

Development of techniques for production is no less important than the accumulation of capital as regards the process of development. This has been demonstrated by the more advanced countries. J. A. Schumpeter considers such techniques as an independent factor of economic development, and he has contended that economic development cannot be realized without developing new products, new means of production, new markets, new raw materials, and new forms of management organization. According to Schumpeter, advanced countries develop their economies through continuous invention by inventors and innovations for production by businessmen, and so should developing countries through imitating such innovations. The most important strategy for developing the economy of

a developing country is to follow the example of an advanced country, i.e., to introduce their proven techniques. Growth of the Japanese economy is a typical case of economic success through introducing highly advanced techniques from some other more advanced country. 4

The Korean economy accomplished a high rate of growth through the First and the Second Economic Development Plans. However, the expanded exports and domestic and foreign savings were mainly responsible for this fast growth. The growth has not been led by technical development as in more advanced countries. This is partly due to a failure to introduce new techniques. Although late to act on this problem, the government has now begun to pay more attention to technological inducement by preparing "Plans for Authorization of Technological Inducement" through the Foreign Capital Inducement Law.

As the Second Plan nears its end, the Economic Planning Board of Korea has disclosed an outline of its Third Plan scheduled to begin in 1972. There is not much change in direction and contents of economic policies from that of the Second Plan. Rather, the direction of the policy for attracting capital seems to follow that of the Second Plan. In the Third Plan, the need to export is more strongly emphasized and steady economic growth is called for rather than a high rate of economic growth. In May, 1969, the Economic Planning Board released the outline of the Third Plan setting an annual growth rate for the GNP at 10 percent and an export goal for

the last year of the plan at $2.8 billion. The board revised the
guide and released the final draft on November 27, 1969. In this
revision, the annual growth rate of GNP was decreased from 10 per­
cent to 8.5 percent, and the target export figure for the Third
Plan was increased to $3.5 billion.

To attain the established target figures, the following
strategies were outlined in the Third Plan:

1. To mechanize agriculture to attain self-support of food­
stuffs, and to increase the incomes of farmers and fishermen.

2. To accelerate industrialization through facilitating de­
velopment of heavy industry.

3. To maximize employment and promote productivity through
the rapid improvement of scientific technology and the reinforce­
ment of technical training.

4. To balance the development of social overhead capital in
all fields: electricity, transportation, storage, loading and un­
loading facilities, communications, and so forth.

5. To develop collective factory sites for use by import in­
dustries.

Additional Laws and Regulations on Foreign Investment

The main controlling factor for foreign capital entering
Korea is the Foreign Capital Inducement Law of 1966. From the

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5 The Dong-A Daily, May 6, 1969, p. 2.
7 Ibid.
date of passage of the law, many articles and clauses have been added, rescinded, and revised. To facilitate understanding the law, processes and reasons for the changes are described below.

For the purpose of attracting foreign capital, the government enacted the Foreign Investment Encouragement Law on January 1, 1960. This law was reinforced with others, namely, the Basic Policy for Controlling Foreign Capital, established in December, 1961, and the Program of Foreign Investment Promotion for Non-Project Loans, passed in June, 1962. These laws were passed because difficulties were found in the area of commercial loans on long-term deferred payments. Through these laws, the government stressed the benefits to be derived by foreign investors. 8

To confirm the preferential treatment to be given foreign investors, the government proclaimed two rules on July 31, 1962: the Law on Payment Guarantee of Loans and Special Measures Law on Inducement of Capital Goods under Long-Term Settlement Basis. The former defined government guarantees for redemption of foreign capital invested, and, the latter embodied the long-term deferred payment. 9

The policy for attracting foreign capital was changed to a restrictive direction when the balance of payments situation deteriorated from bad to worse toward the end of 1962. In February,


1963, the Administration of Application for Non-Project Loans was published. It gave priority to public loans and restricted private commercial loans.\footnote{Ibid., p. 23.}

In March, 1964, the Economic Ministers Committee passed their Policy for Private Commercial Loan Promotion, which broadened the contents and objectives defined in the above administrative policy.\footnote{Ibid., p. 24.}

In February, 1965, the Korean-American Joint Investment Committee was established for the purpose of jointly evaluating the terms of loans and degree of urgency of commercial loans. Short-term and high interest loans were restricted while long-term and low interest public loans as well as direct investment were encouraged.\footnote{Ibid.}

Through a series of revising and adding to the volume-oriented old laws and rules, the government passed the Foreign Capital Inducement Law of 1966. At the same time, the government permitted banks to guarantee foreign capital against repatriation in order to assure the smooth inflow of foreign investment.\footnote{Ibid., Economic Planning Board, Economic Survey, 1968, (Economic Planning Board Press, 1968), p. 2.}

After the new law was enacted, the restrictive policy was continued for the purpose of carefully selecting loans on the basis of technical and economic appropriateness. However, foreign loans
increased rapidly. Though these loans contributed to rapid economic growth, they also created problems. Foreign debts had increased rapidly. Foreign exchange increased the amount of currency and inflation increased. The balanced development between various industries was checked. To solve these problems, the government announced a Comprehensive Policy for Rationalization of Foreign Capital Inducement. This policy which was announced in December, 1967, was enacted to control capital inducement so as to import only appropriate foreign capital which would assist in achieving the economic development plan.\(^1^4\)

The Foreign Investment Encouragement Law, the Law on Payment Guarantee of Loans, and the Special Measures Law on Inducement of Capital Goods under Long-Term Settlement Basis were abrogated on the effective date of the Foreign Capital Inducement Law.\(^1^5\)

The laws and rules concerning foreign capital were changeable until after the Foreign Capital Inducement Law was passed. Since the economic society was unsettled, and the supply and demand for foreign exchange fluctuated so much, these laws were short-lived and suffered frequent changes. Some small changes in present laws and rules are expected; however, the transitional period seems to be passed and the economy is stabilizing.

Present laws and rules provide generous treatment and guarantees to attract certain types of foreign capital. However, not all

\(^{1^4}\)Ibid.

foreign capital enjoys the same treatment. The government would rather ban those forms which are not conducive to economic development. The present investment laws can be categorized into three major areas: favorable treatment, guarantees, and restrictions.

Favorable treatment. According to the Foreign Capital Inducement Law of 1966, direct investors can enjoy such favorable treatment as tax exemptions, full foreign ownership, reinvestment of dividends and repatriation of capital.

1. The income tax on unincorporated enterprises, the corporation tax on incorporated enterprises, and the property tax and property acquisition tax on foreign invested enterprises shall be exempt in total or part as follows: First, income tax, corporation tax, and property tax shall not be assessed for five years from the first taxable dates under respective laws, and property acquisition tax shall not be assessed for five years from the date of registration of title transfer or asset revaluation. Second, for all these taxes, fifty percent of the tax amount computed under pertinent tax laws shall be exempt for three years following the expiration of the period stated in the preceding statement.16

Taxes to be imposed upon dividends and surplus distribution accruing from the stocks or shares subscribed to under this law by a foreign investor shall be exempt in total or part as follows: Taxes shall not be assessed for five years from the date on which

16Ibid., p. 8.
the enterprise concerned commenced its business operations. Fifty percent of the tax amount computed under the Income Tax Law shall be exempt for three years following expiration of the period stated previously.17

Exemptions are made according to the proportion of the stocks or shares owned by the foreign investors to the total outstanding stocks of the enterprises. That is, in cases of joint investment, tax exemptions are made only for the part owned by the foreign investors.

Customs duty and commodity taxes on capital goods imported under the authorization of the law shall not be assessed.18 Since the law defines as capital goods those parts, accessories to be used in industrial facilities, raw materials, and other reserves necessary for an initial six months, customs duty and commodity taxes are exempt like other machinery and equipment.19 Even after the tax exemption period, accessories of facilities, parts, supplies, and industrial facilities are treated as special imports when the Minister of Commerce and Industry recognizes that they are necessary.20 As in other developing countries, rates of customs duties and commodity taxes in Korea are very high. It is, therefore, of considerable benefit to escape these taxes.

17 Ibid., p. 9.
18 Ibid.
For export enterprises, the total business tax is exempt, fifty percent of all income and corporate taxes are exempt, and the trade rebate system is enforced as well. Therefore, if a foreign company is engaging in the export business, it can enjoy the above exemptions even after the expiration date of the other tax exemptions.

Tax exemptions referred to above may be withheld if the foreign investor or foreign invested enterprise so requests. This clause is provided in order to avoid the double imposition of the tax when tax agreements are reached with the investing countries.

Besides these exemptions, and exemption from customs duty on imports of equipment was also introduced. If an enterprise with foreign investment engages in the electronic appliances industry within a bonded area, duty is exempt on the supplies when the Minister of Commerce and Industry so recommends.

2. Foreign enterprises and foreign investors shall, unless otherwise specifically prescribed by law, receive the same treatment as nationals of Korea in all activities including business management. Most developing countries do not recognize more than fifty percent ownership of stock by foreigners for fear that they might control the economy as a whole. But the Korean government allows unlimited ownership of shares for foreign investors. In other words, a business organization can be established with

23_Foreign Capital Inducement Law, p. 9.
entirely foreign capital investment. In the case of joint ventures, it is a basic policy of the government to let questions of the ratio of shares be deliberated and settled between each partner of the respective joint venture. When a foreign investor possesses more than fifty-one percent ownership, he can manage the business and is free to utilize the profits from such business activities as he wishes.

3. A foreign investor may reinvest dividends accrued from stocks or shares owned by him in the same or other foreign invested enterprises up to the amount of his original investment.

4. The Foreign Exchange Management Law provides that foreign capital may be released if the beneficiary so desires after the business has been established as scheduled and has been running smoothly. Foreign investors are, thus, released from restrictions set by the laws concerning foreign capital.

In addition to the foregoing investment benefits granted to direct investors, preferential treatment is also given to project foreign creditors, i.e., those who contract with local investors.

For example, income tax on unincorporated enterprises or corporation tax on incorporated enterprises are not assessed upon the interest or other income accruing to lenders from cash loan contracts or capital goods investment contracts. The above taxes

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24 Economic Planning Board, Questions and Answers for Your Investment in Korea, p. 5.
25 Foreign Capital Inducement Law, pp. 5-6.
imposed upon remuneration paid to a person or corporate entity providing technology under a technological investment contract shall be exempt, in total or in part as follows: Such taxes shall not be assessed for five years from the date on which technology is introduced. Also, fifty percent of the tax amount computed under the pertinent tax law shall be exempt for three years following the expiration date of the above period. These tax exemptions may be withheld also in part or in whole if a lender providing technology so requests.

Guarantees

As another means of attracting foreign capital, the Korean government provides various guarantees to foreign creditors. Generally, these guarantees involve the government's backing of credit transactions with its own assets and taxing powers. They are similar to general obligation liabilities of the states, counties, or municipal corporations in the United States. In some cases, the government acts through the Korean Foreign Exchange Bank and, in others, through commercial banks to make guarantees. The most common types of guarantees are: guarantees on property invested by foreigners, repatriation of capital subscriptions, remittance of dividends, and repayment guarantees on loans and capital goods investments. Each of these guarantees is discussed below:

1. According to Article 14 of the Foreign Capital Investment Law of 1966, all property of foreign invested enterprises shall be

27 Foreign Capital Inducement Law, p. 11.
guaranteed in accordance with the various laws and decrees.\(^{28}\) Accordingly, the properties are guaranteed in accordance with the Requisition Law, the Law of Compensation for Requisition, and the Law of Expropriation of Land. The Foreign Capital Inducement Law is interpreted to observe international treaties concluded and promulgated by Korea.\(^ {29}\) On November 7, 1957, a Treaty of Comity, Commerce and Navigation, was concluded between the United States and Korea. On February 19, 1960, an Investment Security Treaty was signed between the two countries. According to the terms of the latter treaty, the United States government is to provide compensation for investment losses due to war. It is to give compensation to American investors and take over the claims. According to the terms of the former treaty, people and properties of both countries are continuously protected, especially patents and trade marks are under protection by the "national treatment" clause and the "most favored nation" clause.\(^ {30}\)

Further guarantees are available through the United States Agency for International Development. The Specific Risk Investment Guarantee Program of AID insures new investment in Korea by providing entire coverage against loss due to expropriation, nationalization, or confiscation by the foreign government. It also provides coverage against damage to tangible property as a

\(^{28}\) Ibid., p. 8.  
\(^{29}\) Ibid., p. 20.  
result of war, revolution, or insurrection. The Extended Risk Guarantee Program of AID can cover up to 75 percent of investments in foreign private projects against losses due to all types of risks with the exception of fraud or misconduct by the investors. At the option of investors, the portion of the investment not covered by the Extended Risk Guarantee may be insured against political risk under the Specific Risk Guarantee Program.\(^{31}\)

2. A foreign investor may sell stocks or shares owned by him. The overseas remittance of sales proceeds shall be guaranteed up to 20 percent of the capital subscription amount every year after two years from the date on which the enterprise concerned commences its business operations. However, this restriction is not applicable in cases where the remittance overseas of proceeds resulting from the liquidation of the enterprise is permitted by the Minister of the Economic Planning Board.\(^{32}\) Therefore, foreign investors, if they desire, can recover their whole investment in five years.

3. The remittance overseas of profit dividends accrued from the stock or shares owned by foreign investors is guaranteed in accordance with a presidential decree.\(^{33}\) Further guarantees are also available through AID. The Specific Insurance Guarantee Program of AID provides entire coverage against the inability to

\(^{31}\)Economic Planning Board, *Questions and Answers for Your Investment in Korea*, p. 10.

\(^{32}\)Foreign Capital Inducement Law, p. 8.

\(^{33}\)Ibid., p. 7.
convert actual profits, earnings, or the return of original capital into dollars.  

4. There is no more secure guarantee than a governmental guarantee. The government, to facilitate inducement of foreign capital for industries, may guarantee repayments for overseas obligations incurring from cash loan contracts or capital goods inducement contracts for projects coming under any of the following areas: projects belonging to "key industry" sectors, projects belonging to agricultural or fishing sectors, or projects producing commodities or services, including transportation, essential for national living.  

The remittance abroad of the principal and interest under a cash loan contract, interest under a capital goods inducement contract, or similar values under a technological inducement contract shall be guaranteed according to the contents of the authorization concerned. The sum of the annual repayment allowable (deducting advance payments, if any) from a cash loan contract or a capital goods investment contract shall be decided by dividing the amount of repayment yet to be made by the number of remaining years (deducting grace periods, if any). Most of these remittances, except those guaranteed by the government, are guaranteed by commercial banks. However, since all commercial bank guarantees are

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34 Questions and Answers for Your Investment in Korea, p. 10.
35 Foreign Capital Inducement Law, p. 12.
36 Ibid., p. 10.
made through a government-owned bank, the Korea Exchange Bank, they enjoy double guarantees.

**Restrictions**

Most developing countries have been concerned about economic control by other countries since they have been under colonial policies for long periods of time. Economists try to attract foreign capital but they hope the local businessmen control enterprises and foreigners share profits.

Some foreign capital only increases consumption and has a negative effect on saving, both of which undermine capital accumulation. This situation also causes a deterioration in the international balance of payments since foreign exchange is used for imports of consumer goods.

Restrictions are established to regulate these undesirable types of capital inflow. The restrictions placed by the Korean government are a little different from those of other developing countries. The government does not care who manages the firm as long as it contributes to economic development and a favorable balance of payments. This attitude is demonstrated by the government by allowing complete ownership by foreign investors. In other countries, restrictions may be placed on the type of business operated, the amount of investment, overseas remittance of profits, and use of foreign employees. Other countries indicate the proportion of locally produced parts to be used for production.  

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The most common restrictions instituted by the Korean government are: restrictions on the objectives of investors, restrictions on the repatriation of capital subscriptions, restrictions on the disposition of foreign capital, scope of applications of foreign capital, restrictions on the ownership of real estate, responsibilities to open the company to the public, and suspension of operations during periods of emergency. Each of these restrictions is discussed below:

1. To prevent unwanted foreign capital, the investment made by foreigners is limited to foreign means of payment or domestic means of payment accrued from direct exchange thereof, profits accrued, capital goods, and industrial property rights or other technology as deemed necessary.39

2. Except in the case of the liquidation of an enterprise, the sale proceeds of stocks or shares owned by foreign investors cannot be remitted before two years from the date on which the enterprise commences its business operations, and even after that, only 20 percent of the capital subscription amount can be sent home every year. This measure is taken to provide for sufficient funds which might be needed if foreign investors simultaneously withdrew their investments.

3. If a foreign investor wants to use his capital for purposes other than those authorized, he must obtain prior permission from the Minister of the Economic Planning Board.40 Some

39Foreign Capital Investment Law, p. 6.
40Ibid., p. 8.
investors want to transfer their capital to businesses other than those authorized, while still enjoying privileges afforded to foreign capital. Local businessmen may be subjected to unfair competition if this condition is allowed to exist. At the same time, the government has the responsibility to prevent funds from being diverted to an unwanted form of investment or to an industry promoting consumption only.

4. Trade with communist countries is prohibited. Based on this regulation, Korea is not allowed to attract foreign capital from a national or country which does not maintain normal diplomatic relations with the Republic of Korea, except when a project is considered particularly necessary for the development of the national economy.\(^{41}\)

5. Foreign investors are allowed to acquire real estate, including land. However, in the case of land acquisition in his own personal name, the investor should have prior approval from relevant authorities under a specific law governing land acquisition for foreigners.\(^{42}\)

6. Government-guaranteed enterprises are required to open the companies to the general public after five years from the date of commencing operations.\(^{43}\) A foreign loan enterprise or foreign invested company is considered to have higher credit than the other

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\(^{41}\text{Ibid.}, \ p. \ 3.\)

\(^{42}\text{Questions and Answers for Your Investment in Korea, } p. \ 5.\)

domestic companies. It is the government's intention to foster capital markets by listing the stocks of those companies.

7. According to Article 7 of the Foreign Exchange Law, the Minister of Finance can order the suspension of a foreign exchange payment when an emergency arises at home or abroad. The order is interpreted as being able to stop the remittance of foreign capital and profits. However, it is only a temporary ban. Normalization will be restored as soon as the emergency is ended.

In this chapter, it has been shown that in order to attain rapid economic growth, the Korean government has opened the economy to foreign investors and has provided them with various favors and guarantees. However, the government has placed some restrictions in order to utilize foreign capital more efficiently and to maximize the contribution rate of the capital to economic development by allocating it to industries most urgently needing funds.

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CHAPTER III

COMPARATIVE FOREIGN INVESTMENTS IN KOREA

Public and Private Loans

Despite the current policies of the Korean government which stress a more moderate growth, the amount of foreign capital introduced has increased rapidly from 1959 through 1969. Especially with regard to private loans, amounts have increased from $1.9 million in 1962 to $623.7 million in 1969.\(^1\) The increase is largely the result of an improved investment climate in Korea which helped to win the confidence of foreign investors. Tables 1 through 4, pages 35-38 provide data about the sources and amounts of foreign investment in Korea.

The United States had the largest investment in Korea with $970.0 million, or 39 percent of total foreign capital investment through 1970; Japan was second with $519.5 million, 21 percent; West Germany was third with $226.9, 9 percent; and all other countries invested $739.3 million, 31 percent.

An analysis shows the major characteristics of the foreign capital attracted to Korea. For example, the government now tries to introduce more direct investment since these do not force repatriation of principal and interest during difficult financial times. However, direct investment represents only 5.7 percent of

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of All Countries</th>
<th>United States</th>
<th>Japan</th>
<th>West Germany</th>
<th>Other</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
</tr>
<tr>
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<td>4</td>
<td>12,346</td>
<td></td>
</tr>
<tr>
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<td>5,000</td>
<td>1</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>1961</td>
<td>1</td>
<td>3,130</td>
<td>1</td>
<td>3,100</td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>5</td>
<td>53,081</td>
<td>3</td>
<td>29,518</td>
<td>1</td>
</tr>
<tr>
<td>1963</td>
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<td>9,200</td>
<td>1</td>
<td>9,200</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>6</td>
<td>35,479</td>
<td>4</td>
<td>29,875</td>
<td>1</td>
</tr>
<tr>
<td>1965</td>
<td>6</td>
<td>76,703</td>
<td>5</td>
<td>71,512</td>
<td>1</td>
</tr>
<tr>
<td>1966</td>
<td>20</td>
<td>154,041</td>
<td>11</td>
<td>95,520</td>
<td>6</td>
</tr>
<tr>
<td>1967</td>
<td>15</td>
<td>88,336</td>
<td>4</td>
<td>36,131</td>
<td>8</td>
</tr>
<tr>
<td>1968</td>
<td>14</td>
<td>82,628</td>
<td>7</td>
<td>48,715</td>
<td>4</td>
</tr>
<tr>
<td>1969</td>
<td>20</td>
<td>236,112</td>
<td>8</td>
<td>117,900</td>
<td>5</td>
</tr>
<tr>
<td>1970**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>93</td>
<td>756,056</td>
<td>49</td>
<td>458,847</td>
<td>23</td>
</tr>
</tbody>
</table>


*Public loans are based upon agreements between the Korean government and foreign governments or international financial institutions.

**Not available.
### TABLE 2

PRIVATE LOANS BY NATIONS FROM 1962 TO 1970*  
(In Thousands of United States Dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of All Countries</th>
<th>United States</th>
<th>Japan</th>
<th>West Germany</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
</tr>
<tr>
<td>1962</td>
<td>2</td>
<td>1,851</td>
<td>7</td>
<td>33,796</td>
<td>1</td>
</tr>
<tr>
<td>1963</td>
<td>15</td>
<td>55,281</td>
<td>5</td>
<td>16,607</td>
<td>3</td>
</tr>
<tr>
<td>1964</td>
<td>10</td>
<td>63,268</td>
<td>2</td>
<td>6,298</td>
<td>1</td>
</tr>
<tr>
<td>1965</td>
<td>13</td>
<td>78,127</td>
<td>4</td>
<td>3,281</td>
<td>7</td>
</tr>
<tr>
<td>1966</td>
<td>32</td>
<td>105,158</td>
<td>7</td>
<td>3,391</td>
<td>14</td>
</tr>
<tr>
<td>1967</td>
<td>47</td>
<td>146,372</td>
<td>14</td>
<td>16,846</td>
<td>10</td>
</tr>
<tr>
<td>1968</td>
<td>91</td>
<td>465,839</td>
<td>36</td>
<td>135,640</td>
<td>23</td>
</tr>
<tr>
<td>1969</td>
<td>130</td>
<td>623,700</td>
<td>55</td>
<td>218,358</td>
<td>17</td>
</tr>
<tr>
<td>1970</td>
<td>4</td>
<td>20,500</td>
<td>3</td>
<td>16,500</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>344</td>
<td>1,560,096</td>
<td>128</td>
<td>434,110</td>
<td>73</td>
</tr>
</tbody>
</table>

*Private loans are based on the issue of letters of guarantee and export licenses which are issued.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of All Countries</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Loans</td>
<td>Amount</td>
</tr>
<tr>
<td>1962</td>
<td>2</td>
<td>2,120</td>
</tr>
<tr>
<td>1963</td>
<td>3</td>
<td>5,442</td>
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<tr>
<td>1964</td>
<td>5</td>
<td>757</td>
</tr>
<tr>
<td>1965</td>
<td>11</td>
<td>22,281</td>
</tr>
<tr>
<td>1966</td>
<td>12</td>
<td>2,462</td>
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<td>1967</td>
<td>25</td>
<td>29,362</td>
</tr>
<tr>
<td>1968</td>
<td>50</td>
<td>29,310</td>
</tr>
<tr>
<td>1969</td>
<td>50</td>
<td>46,867</td>
</tr>
<tr>
<td>1970</td>
<td>4</td>
<td>881</td>
</tr>
<tr>
<td>Total</td>
<td>162</td>
<td>139,482</td>
</tr>
</tbody>
</table>

*Direct investments are based upon Korean governmental authorization.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of All Countries</th>
<th>United States</th>
<th>Japan</th>
<th>West Germany</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
<td>Amount</td>
<td>No. of Loans</td>
</tr>
<tr>
<td>1959</td>
<td>4</td>
<td>12,346</td>
<td>4</td>
<td>12,346</td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>1</td>
<td>5,000</td>
<td>1</td>
<td>5,000</td>
<td></td>
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<td>1961</td>
<td>1</td>
<td>3,130</td>
<td>1</td>
<td>3,130</td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>9</td>
<td>57,052</td>
<td>5</td>
<td>31,638</td>
<td>2</td>
</tr>
<tr>
<td>1963</td>
<td>19</td>
<td>69,923</td>
<td>10</td>
<td>48,134</td>
<td>5</td>
</tr>
<tr>
<td>1964</td>
<td>21</td>
<td>99,504</td>
<td>9</td>
<td>36,487</td>
<td>1</td>
</tr>
<tr>
<td>1965</td>
<td>30</td>
<td>177,111</td>
<td>17</td>
<td>95,830</td>
<td>9</td>
</tr>
<tr>
<td>1966</td>
<td>64</td>
<td>261,661</td>
<td>28</td>
<td>101,220</td>
<td>20</td>
</tr>
<tr>
<td>1967</td>
<td>87</td>
<td>264,070</td>
<td>32</td>
<td>72,989</td>
<td>27</td>
</tr>
<tr>
<td>1968</td>
<td>155</td>
<td>577,777</td>
<td>61</td>
<td>196,356</td>
<td>54</td>
</tr>
<tr>
<td>1969</td>
<td>200</td>
<td>906,679</td>
<td>81</td>
<td>350,067</td>
<td>50</td>
</tr>
<tr>
<td>1970</td>
<td>8</td>
<td>21,381</td>
<td>4</td>
<td>16,750</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>599</td>
<td>2,455,634</td>
<td>253</td>
<td>969,947</td>
<td>164</td>
</tr>
</tbody>
</table>

Source: Summary of data from tables 1 through 3.
the total foreign capital in Korea. In addition, most public loans, 60.7 percent, are from the United States. Japan ranked first in commercial loans until 1968. In January, 1970, United States' loans to Korea surpassed those of the Japanese. The United States has dominated direct investment with 55 percent of the total; however, Japan's direct investments have increased rapidly since 1967.

In the earlier period, public loans were the major source of foreign capital, but commercial loans exceed public loans now. Total investments through public loans and commercial loans were $72.7 million and $3.9 million, respectively, until 1962. By January, 1970, the latter increased to a total of $1.6 billion for the period 1962-1970 while the former had a total of $756.1 million from 1959-1970. Some of the causes for the rapid increase of private loans are the rapid economic growth policy of the government which intends to finance and supplement scarce capital in the local economy without aggravating inflation, more attractive terms in foreign countries (e.g., lower interest rates and longer payment periods), small local markets enable foreign capital to enjoy a monopoly (firms may be able to charge monopolistic prices on goods and services produced by foreign-financed enterprises), and the enhanced business environment gives foreign investors confidence in investments in Korea.

The amount of foreign investment varies significantly from industry to industry. Table 5, page 40, illustrates where investments were made during 1968.

---

### TABLE 5

PUBLIC AND PRIVATE LOAN PROJECTS BY INDUSTRY, DECEMBER 31, 1968  
(In Millions of United States Dollars)

<table>
<thead>
<tr>
<th>Project Sectors</th>
<th>Type of Loan</th>
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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Public Loan</td>
<td>Private Loan</td>
<td>Direct Investment</td>
<td></td>
</tr>
<tr>
<td><strong>Primary Industry</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>0.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fishery</td>
<td></td>
<td>53.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Primary Industry Sub-Total</strong></td>
<td>0.4</td>
<td>53.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Secondary Industry</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Manufacturing)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foodstuff</td>
<td></td>
<td>10.6</td>
<td>116.8</td>
<td>0.1</td>
</tr>
<tr>
<td>Textile</td>
<td></td>
<td>48.6</td>
<td>49.9</td>
<td>22.4</td>
</tr>
<tr>
<td>Chemical fertilizer</td>
<td></td>
<td>5.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemical products</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petroleum</td>
<td></td>
<td></td>
<td>59.0</td>
<td>7.7</td>
</tr>
<tr>
<td>Electronic appliance</td>
<td></td>
<td>9.1</td>
<td>66.8</td>
<td></td>
</tr>
<tr>
<td>Cement</td>
<td></td>
<td>1.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Steel and metal</td>
<td></td>
<td></td>
<td>25.7</td>
<td></td>
</tr>
<tr>
<td>Transportation equipment</td>
<td></td>
<td>12.9</td>
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<td></td>
</tr>
<tr>
<td>Other</td>
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<td>46.1</td>
<td>9.4</td>
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</tr>
<tr>
<td><strong>Secondary Industry Sub-Total</strong></td>
<td>75.0</td>
<td>377.1</td>
<td>49.2</td>
<td></td>
</tr>
<tr>
<td><strong>Third Industry</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Social Overhead and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>9.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electric power</td>
<td></td>
<td>47.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water supply</td>
<td></td>
<td>4.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transportation</td>
<td></td>
<td></td>
<td>90.7</td>
<td></td>
</tr>
<tr>
<td>Transportation and sightseeing</td>
<td></td>
<td></td>
<td></td>
<td>2.7</td>
</tr>
<tr>
<td>Communication, transportation, and electric power</td>
<td></td>
<td></td>
<td></td>
<td>111.1</td>
</tr>
<tr>
<td>Communication</td>
<td></td>
<td>25.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>64.9</td>
<td>30.7</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Third Industry Sub-Total</strong></td>
<td>243.2</td>
<td>141.8</td>
<td>4.1</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>318.6</td>
<td>572.8</td>
<td>53.3</td>
<td></td>
</tr>
</tbody>
</table>

Source: Economic Planning Board, Economic Survey, 1969, p. 141, Table 6-4; p. 145, Table 6-7; and p. 147, Table 6-9.

Public loans are invested in social overhead capital which has a long recovery period. Examples of social capital uses include...
electric power, transportation, communication, and water supply. Since public loans have relatively easy terms on interest and redemption, they are well suited to long-term investment in which private companies tend to be unwilling to invest. Instead, commercial loans and foreigners' investments may be put into profitable industries such as textile, synthetic fibre, chemical fertilizer, cement, petroleum chemistry, chemical products, and electrical machinery and equipment.

Until 1966, most commercial loans had been guaranteed by the government. Commercial bank guaranteed loans increased rapidly from $101.3 million in 1967 to $405.6 million in 1968. The investment environment and confidence has apparently improved enough to import capital equipment without government guarantees. The government is attempting to diversify the debt guarantee of the Industrial Bank of Korea.

Loan policies in foreign countries are becoming more stringent as the amount of foreign capital increases. Loans of a low interest (5.5 percent to 6.0 percent) have decreased while high-interest loans (6.5 percent to 8.0 percent) have increased. See Table 6, page 42.

One of the trends in attracting foreign capital is that the unit of commercial loan is getting larger and more centralized. Eleven loans by large companies in 1968 and 1969 accounted for $287 million, which is 29 percent of total commercial loans in the period.

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4The Dong-A Daily, July 19, 1969, 2.
TABLE 6
TREND IN KOREAN INTEREST RATES ON COMMERCIAL LOANS, 1966-1968

<table>
<thead>
<tr>
<th>Interest Rates</th>
<th>1966</th>
<th>1967</th>
<th>1968</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Loans</td>
<td>Percent</td>
<td>No. of Loans</td>
</tr>
<tr>
<td>4.50 to 5.49 percent</td>
<td>1</td>
<td>3.0</td>
<td>2</td>
</tr>
<tr>
<td>5.50 to 6.49 percent</td>
<td>26</td>
<td>81.8</td>
<td>29</td>
</tr>
<tr>
<td>6.50 to 7.99 percent</td>
<td>5</td>
<td>15.2</td>
<td>11</td>
</tr>
<tr>
<td>8.00 percent and over</td>
<td>1</td>
<td>2.3</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>32</td>
<td>100.0</td>
<td>43</td>
</tr>
</tbody>
</table>


The Present State of Technology Inducement Contracts

After the Korean government started to attract technology in 1962 when the First Five-Year Economic Development Plan began, attraction of professional technicians increased rapidly. Following a diplomatic normalization between Korea and Japan, Japanese technological personnel arrived in Korea. By the end of 1969, 104 contracts involving various numbers of technical personnel had been entered into. See Table 7, page 43, for the number and sources of technology advisory contracts.

Table 8 on the following page illustrates the industries in which the technology advisory contracts were made during the period of 1962-1968. Electronic appliances and the machinery industries had the largest number of technology advisory contracts closely followed by chemistry products.
TABLE 7
NUMBER OF TECHNOLOGY ADVISORY CONTRACTS BY NATION, 1962-1968

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of All Countries</th>
<th>United States</th>
<th>Japan</th>
<th>West Germany</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>7</td>
<td>4</td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>1963</td>
<td>2</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>4</td>
<td>3</td>
<td>8</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>1966</td>
<td>15</td>
<td>5</td>
<td>25</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>1967</td>
<td>33</td>
<td>7</td>
<td>31</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>1968</td>
<td>42</td>
<td>6</td>
<td>64</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>104</strong></td>
<td><strong>28</strong></td>
<td><strong>64</strong></td>
<td><strong>4</strong></td>
<td><strong>8</strong></td>
</tr>
</tbody>
</table>


TABLE 8
TECHNOLOGY ADVISORY CONTRACTS BY INDUSTRY THROUGH DECEMBER 31, 1968

<table>
<thead>
<tr>
<th>Industries</th>
<th>Number of Contracts</th>
<th>Industries</th>
<th>Number of Contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic appliances</td>
<td>26</td>
<td>Foodstuff</td>
<td>3</td>
</tr>
<tr>
<td>Machinery</td>
<td>20</td>
<td>Ceramics</td>
<td>2</td>
</tr>
<tr>
<td>Chemistry products</td>
<td>17</td>
<td>Construction</td>
<td>2</td>
</tr>
<tr>
<td>Communication</td>
<td>10</td>
<td>Pulp and paper</td>
<td>2</td>
</tr>
<tr>
<td>Textile</td>
<td>6</td>
<td>Oil refinery</td>
<td>1</td>
</tr>
<tr>
<td>Steel and iron</td>
<td>5</td>
<td>Livestock</td>
<td>1</td>
</tr>
<tr>
<td>Synthetic fiber</td>
<td>4</td>
<td>Others</td>
<td>2</td>
</tr>
<tr>
<td>Electric power</td>
<td>3</td>
<td>Total of all industries</td>
<td>104</td>
</tr>
</tbody>
</table>


Direct Investment

The first direct investment in Korea was made in June, 1962, by Eisenberg, Incorporated, of the United States. It entered into
a partnership with Asia Automobile Company, Limited. Direct investments have increased every year. By March, 1969, 107 direct investments were completed. The government's interest in direct foreign investment arose out of severe public criticism of commercial loans because commercial loans carried high interest rates and did not provide any guarantee for capital investment. Furthermore, prior commercial loan agreements were falling due and required scarce foreign exchange for payment. Because of the advantages of foreign capital to local finance, some businessmen committed the mistake of believing that acquiring foreign capital was an easy method to become wealthy. They imported even "unfavorable" capital without considering their repayment abilities. Many foreign financed enterprises turned out to be unable to repay principal and interest and went under the control of banks. The cumulative increase in installment payments of principal and interest on foreign capital caused the international balance of payments to deteriorate. Expecting that repayment was increasing, the government began to make more restrictions on foreign capital. The government turned its attention from commercial loans to direct investment. Direct investment has more advantages than commercial loans, such as:

1. It does not force repayment when there is no profit and the foreign investor is responsible for its management.

2. It helps to not only tide over difficulties of international payments, but it also enables fulfillment of economic development plans without creating inflation. Direct investments eliminate the risk of inflation.
3. Foreign direct investment makes it possible to save expenditures for loans, lowers local interest rates, and increases the income of local employees, which in turn creates new effective demand and stimulates domestic investment. As investment increases, businessmen can take advantage of mass production and produce goods and services at lower costs.

4. Direct investors try to participate in management by sending their own staff members. Their management expertise contributes to improved entrepreneurship in the host country.

5. New techniques imported with direct investment help to improve local techniques.

6. Through direct investment, businessmen can get information about new products, new fashions and designs popular in foreign markets, and other information important to the export industry.

The classification in Table 9, page 46, shows that most direct investments were made for the manufacturing industries. Seventy-nine percent of the total direct investment was concentrated in the manufacturing industries, 19 percent was in social overhead capital and the construction industries, and only two percent was in the agriculture and fishery industries. This investment relationship supports the opinion that direct investments are profit-oriented. Further analysis of investments by category of business shows that they have invested mainly in highly profitable industries and labor intensive industries. According to Table 9, the following dollar amounts and percentage relationships existed in direct investments:
TABLE 9
DIRECT INVESTMENT BY INDUSTRY THROUGH DECEMBER 31, 1968

<table>
<thead>
<tr>
<th>Type of Industries</th>
<th>Companies</th>
<th>Investments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Dollars</td>
</tr>
<tr>
<td></td>
<td>Percent</td>
<td>Percent</td>
</tr>
<tr>
<td><strong>Primary Industry</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>10</td>
<td>1,426,919</td>
</tr>
<tr>
<td>Fishery</td>
<td>2</td>
<td>600,122</td>
</tr>
<tr>
<td><strong>Primary Industry Sub-Total</strong></td>
<td>12</td>
<td>2,027,041</td>
</tr>
<tr>
<td><strong>Secondary Industry (Manufacturing)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pulp and paper</td>
<td>2</td>
<td>2,287,587</td>
</tr>
<tr>
<td>Foodstuff</td>
<td>2</td>
<td>202,888</td>
</tr>
<tr>
<td>Textile</td>
<td>12</td>
<td>3,920,758</td>
</tr>
<tr>
<td>Synthetic fibre</td>
<td>3</td>
<td>7,650,516</td>
</tr>
<tr>
<td>Chemical fertilizer</td>
<td>5</td>
<td>22,600,000</td>
</tr>
<tr>
<td>Ceramics, cement, and glass</td>
<td>4</td>
<td>3,768,453</td>
</tr>
<tr>
<td>Oil refinery</td>
<td>3</td>
<td>7,676,900</td>
</tr>
<tr>
<td>Chemical products</td>
<td>14</td>
<td>4,230,029</td>
</tr>
<tr>
<td>Steel and metal</td>
<td>7</td>
<td>1,746,067</td>
</tr>
<tr>
<td>Electronic appliance</td>
<td>17</td>
<td>12,118,403</td>
</tr>
<tr>
<td>Machinery and transportation equipment</td>
<td>6</td>
<td>2,625,401</td>
</tr>
<tr>
<td>Other</td>
<td>14</td>
<td>2,580,765</td>
</tr>
<tr>
<td><strong>Secondary Industry Sub-Total</strong></td>
<td>89</td>
<td>71,412,745</td>
</tr>
<tr>
<td><strong>Third Industry (Social Overhead and Construction)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electric power</td>
<td>1</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>3</td>
<td>1,370,340</td>
</tr>
<tr>
<td>Construction</td>
<td>6</td>
<td>10,974,300</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>776,475</td>
</tr>
<tr>
<td><strong>Third Industry Sub-Total</strong></td>
<td>12</td>
<td>18,121,115</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>113</td>
<td>91,561,501</td>
</tr>
</tbody>
</table>


fertilizer, $22.6 million (24.5 percent); electronic appliances, $12.1 million (13.2 percent); textiles, including synthetic fibre, $11.6 million (12.7 percent); and oil refineries, $7.7 million.

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(8.4 percent). In some industrialized nations, their electronic appliances industries face difficulties arising from labor shortages and high wages; the Korean economy is in a favorable situation with relatively cheaper labor. It is expected that more direct investments will be made in this industry.

Ratios of Foreign Investments to Korean Investments

The amount of total investments owned equally by local and foreign investors represents approximately one-half of all investments. The ratio of investment has a relationship to types of industries. Key industries, such as fertilizer, oil refining, and electric power have relatively even ratios of ownership because of governmental policy that tries to avoid giving sole ownership of key industries to foreign investors. On the other hand, 100 percent foreign ownership is found in the electronic appliance industry, which is highly profitable and requires a high degree of skill. The majority of joint investments are those enterprises in which foreign investors own less than half of all stocks or shares. This situation indicates that the foreigners' investment motives center around profits rather than management participation. See Table 10, page 48, for the proportionate distribution of ownership in firms having foreign investments.

Foreign Investors' Investment Objectives

Direct investment in a foreign country is a type of capital flow between nations for purposes of earning profits. Entering the 1960's, economies of advanced countries have progressed to the
TABLE 10
RATIO OF OWNERSHIP BY FOREIGN INVESTORS THROUGH MARCH 31, 1969
(In Thousands of United States Dollars)

<table>
<thead>
<tr>
<th>Percent of Foreign Ownership</th>
<th>Total Foreign Investments</th>
<th>Amount Invested By Foreign Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
</tr>
<tr>
<td>Less than 50 percent</td>
<td>44</td>
<td>37.6</td>
</tr>
<tr>
<td>50 percent</td>
<td>24</td>
<td>20.5</td>
</tr>
<tr>
<td>Over 50 percent but less than 100 percent</td>
<td>26</td>
<td>22.2</td>
</tr>
<tr>
<td>100 percent</td>
<td>23</td>
<td>19.7</td>
</tr>
<tr>
<td>Total</td>
<td>117</td>
<td>100.0</td>
</tr>
</tbody>
</table>


point that the coefficient of capital (output/capital) is decreasing. On the other hand, since capital accumulation is low in developing countries but there are still good opportunities for investment, the capital coefficient in such countries is still very high. It is natural that capital flows from the advanced countries to the developing countries. However, the pattern of investment and types of businesses to be invested in depend on the degree of investment security, economic environment, level of economic development, and profitability. Generally, objectives for investing in foreign countries are as follows:

1. Investors search for a field of business expected to yield a high rate of return on their investments. In a developing country, it is often found that present productivity is very low because of lack of capital or a technical bottleneck. Productivity
may be increased significantly with comparatively little capital and technical assistance. Especially, when the target investment country offers favorable treatment to foreign investors, the investment motivation should become stronger.

2. An abundant supply of relatively inexpensive skilled or trainable labor in the invested country can be a strong motivation. This motive is closely related to obtaining a high rate of return. However, foreign investors frequently want to utilize labor in labor-intensive industries which are declining in their own countries because of increasing wages.

3. Another objective is to develop raw materials. Development of synthetic raw materials has replaced many natural raw materials and weakened this motive. However, foreign investments are still made for the purpose of obtaining raw material.

4. Another objective is to find a foreign market in which to sell. Investment is made not only to secure foreign markets, but also to maintain such markets when local governments try to protect local industries through international trade policies or foreign exchange policies. Investment is also desired to advance to another country using the invested country as a base of operation.

In addition to these objectives, investments are made in a foreign country to protect trademarks and patents, take advantage of favorable tax treatments, or take advantage of mass production through the development of foreign markets.

In summary, the Korean economy is poorly endowed with natural resources; therefore, not much investment has been made for the purpose of developing raw materials nor is such investment expected
for the future. Some investments have been made in oil refineries, and petroleum chemistry is being developed for local markets. However, local markets are small and cannot be considered very important until personal incomes increase. The Korean government tries to acquire foreign investment in the strategic industries such as those which are labor-intensive, those having a high multiplier effect, or key industries providing industrial development. Electronic appliances, machinery, textiles, and precision machine industries will continued to hold top investment priorities.
CHAPTER IV

PROBLEMS CREATED BY FOREIGN INVESTMENT

Two sets of problems arise out of foreign investment in Korea. The first group includes problems affecting the Korean economy and society. Problems encountered by foreign investors comprise the second group. The nature and implications of these problems are treated in the remainder of this chapter.

Major National Economic and Social Problems

The Korean economy has attained remarkable growth with the assistance of foreign capital. During 1969, GNP increased by 15.5 percent over the previous year. The investment rate was 29 percent. Approximately 40 percent of the GNP increase is attributable to foreign investment.¹ The growth rate may be too large. Members of the International Economic Consultative Organization for Korea pointed out at its third general meeting that the growth rate was excessive and depended too much on foreign capital. They listed the following problems in their report to the International Monetary Fund and questioned certain policies for attracting foreign capital:

1. There is too much dependency on foreign savings.

2. Some of the foreign capital is merely for a "demonstration" effect. It encourages consumption and reduces savings.

¹The Seoul Kyunje, December 5, 1969, p. 1.
3. Short-term and intermediate-term cash loans are increasing. Some of these loans are used for purposes other than production or business management and are wasteful of foreign capital.

4. There is an inconsistency in giving priority to attracting foreign capital. The government has set up rules of priority according to the importance of various types of economic development. However, the rules are often broken because of external factors rather than economic ones.

5. Lower priority capital has been introduced and the repayment ability is uncertain. This situation occurs because of severe competition among local borrowers.²

Because of the inconsistencies in the foreign investment policies, the economy was both aided and injured by such capital. Economic development has led to increased foreign capital investment and increased imports. The marginal propensity to import (increase in imports/decrease in GNP) rose from 67 percent in 1966 to 87 percent in 1967; it was 83 percent in 1968.³

The International Monetary Fund in its report on the "High Rate of Economic Growth in Korea," pointed out the vicious inflation caused by rapidly increasing wages, rising prices, and rapid increase in liquidity exchanged with the cash loans.⁴

The Federation of Korean Industries contended that the effective use of foreign capital is impeded by a shortage of domestic

²The Dong-A Daily, April 22, 1969, p. 1.
³Ibid., September 11, 1969, p. 2.
capital, imperfect market research, small scales of production, and a lack of management skills.\textsuperscript{5}

Dependence on foreign capital. Since the number of foreign investors and the amount of investment have been so small, there has been a deficit of trade in Korea. Most of the deficits have been covered with grants from the United States. However, the Korean government has had to seek a method for paying off the deficits when the United States changed its foreign aid policy and when revenues from sales to the military forces of the United States were reduced by a "buy American" policy. The need for foreign exchange became greater when the government implemented the First Five-Year Economic Development Plan in 1961. Realizing that attracting foreign capital was the only way to raise funds, the government started to take a more positive attitude toward foreign capital. As a result, $2.5 billion of foreign capital had been invested as of January, 1970.\textsuperscript{6} Some of the foreign investments have reached the end of the unredeemable period during 1970, and repayment of the principal and interest started in 1971. The amount of redemption will be increasing each year for the next several years. The repayment problem will become more serious as time passes. According to the repayment schedule, the following amounts of capital are to be repayed: $167 million in 1970, $198 million in


1971, $239 million in 1972, $254 million in 1973, $258 million in 1974, and $293 million in 1975. The main causes of the trend of increasing repayment burdens are the increasing dependency on commercial loans, financing working capital from foreign countries, repayment fees, and the importation of raw materials for foreign-financed projects.

A result of research conducted on 45 foreign-financed enterprises shows that the average rate of dependency on imported materials is over 80 percent. The dependence upon imported raw materials is highest in oil refining with 100 percent, iron and steel with 99.7 percent, fertilizer with 97.3 percent, and textiles with 88.4 percent. Most of Korea's key industries had more than 88 percent of raw materials imported. Only the electronics and machinery industries show a relatively low dependency of only 23 percent.8 The Japanese Economic Times commented, "Since the growth tempo of the Korean economy is faster than that of domestic productive capacity, she will see a shortage of materials in every field of industry, which should be supplemented with imports and the result will be to increase foreign debts."9

The balance of payments deficits will increase as United States' expenditures decrease for goods supplied to the military forces in Viet Nam, including a decrease in the United States' dollars spent for Korean military forces and technicians in Viet

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7 The Dong-A Daily, December 9, 1969, p. 2.

8 Korea Efficiency Association, Modern Management, September, 1968, p. 76.

Since military forces and technicians were dispatched to Vietnam in June, 1965, total receipts reached $530 million (or 19.8 percent of the total export receipts during the same period), and they contributed 3.2 percent to the economic growth rate. It is expected that the receipts will decrease as the Vietnam war ends. This situation will reduce the level of foreign exchange holdings of Korea.

Importing unfavorable foreign capital. Local businessmen have used foreign investments, at times, in inappropriate ways. Sometimes they are caught in the illusion that the way to become rich is to obtain foreign capital. Some accept extremely unfavorable terms to obtain foreign capital. There are some advantages to direct investment for a joint venture. For example:

1. Local businessmen try to invite foreign investors to solve financial difficulties. They use foreign investments for facilities, services, and raw materials.

2. With the foreign investors' guarantee of credits, they have access to international credit from a capital exporting country or an international finance organization.

3. They receive advanced management and engineering techniques developed in the investors' countries.

4. They obtain a monopoly on the local market by utilizing the patents of the investing company.

5. The trademark of the investing company can be used for a "demonstration" effect in marketing.

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\(^{10}\) The Dong-A Daily, October 24, 1969, p. 2.

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6. In the case of the exporting company, it may provide entry into foreign markets.

The primary attraction of direct investment and commercial loans is the difference of interest rates in the local financial market from those in foreign financial markets. Local industrial finance bonds are being sold at the interest rate of 31.2 percent per annum.11 Discount time deposits for 18 months pay 29.2 percent per annum.12 The interest rates on foreign capital, on the other hand, range from 4.5 percent to 8 percent per annum.13 Moreover, it is difficult to get long-term financing, especially in large amounts, even at a high interest rate. Occasionally, borrowers pay a special commission to finance brokers to get large loans. It is easier to understand why local businessmen are desperate to get foreign capital. The competition is so severe that the terms of foreign capital are becoming unfavorable.14

Yung R. Kim, editorial writer of the Joong-ang Daily, blames the increasing unfavorable investment terms to government policy. Using a loan from Japan as an example, the following events are likely to occur: When the Korean government approves an application for foreign capital of more than the amount that the Japanese

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13 Economic Planning Board, A System for Foreign Capital Induce-
government is willing to offer, the local businessmen who received permission to import foreign capital from Japan start to compete with each other and bid up the price of the capital. These competitors have spent considerable time and effort getting such permission. If one is unsuccessful in the bid, he may suffer a large loss or even go bankrupt. Therefore, he has to "beg" at the doors of the Japanese government authorities. It is not difficult to imagine how unfavorable contracts can arise under this type of circumstances. Korean businessmen must accept undesirable loan terms such as short-term periods, nonredeemable periods, and a high retaining fee. As a result, they have to start repaying principal and interest before the foreign financed plan commences operating.

Cash loans. Local businessmen may attempt to set up enterprises with no capital of their own. They try to establish their facilities through capital goods attraction contracts and operate them with cash loans. Herein lies the factors of their imminent failure. Recognizing that cash loans for working capital, raw materials, facilities, and even for retaining fees disturb the money and banking system, the government has restricted cash loans. However, total cash loans amounted to $160.5 million for 39 loans by November, 1969.

15 Ibid., pp. 68-69.
17 The Dong-A Daily, December 8, 1969, p. 2.
The following are considered to be the main reasons for the increase in cash loans: the capacity of domestic finance has reached its limits and can no longer satisfy the increasing demand for funds; cash loans are more favorable than domestic loans in terms of interest; repayment of foreign capital reduces foreign exchange holdings; and there is no way, in a short period of time, to fill the increasing deficit in the international balance of payments.

The undesirable fact is that cash loans are used for maintaining the present foreign exchange holdings and for repaying principal and interest on existing foreign loans. Another serious problem arises because most borrowers do not have their own capital to back up the loans, thus causing some foreign-financed enterprises to go bankrupt.

Another problem created by foreign cash loans is their tendency to increase inflation. Korean nationals are not allowed to possess foreign exchange currencies. All exchange is pooled into a foreign exchange account. A foreign exchange holder can either leave funds in the custody of an authorized bank or agency. Such activities increase the amount of currency and cause inflation. The resulting inflation has a more harmful effect to the economy than that caused by currency expansion, in the sense that the cash loan is a debt to be repaid in the future. Some of the cash loans are made for raw materials for domestic uses. The result is to

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19 The Dong-A Daily, August 16, 1969, p. 2.
provide a special benefit to foreign-financed enterprises at the expense of the national economy.\textsuperscript{20}

\textbf{Questionable enterprises.} Since the First Five-Year Economic Development Plan started, the policy to reduce excessive economic growth has been enforced. The policy has been successful due to the beneficial management of foreign capital. However, the quantity-oriented policy for foreign capital has resulted in creating problems. The desire to gain windfall profits was responsible for starting some foreign-financed enterprises.\textsuperscript{21} Due to the scarcity of buyers and sellers in the market, businessmen could make an exorbitant profit through obtaining monopoly prices. Some enterprises which are not able to enjoy a monopoly had to discontinue, and the banks who guaranteed repayment had to repay the debt for the bankrupted firms.\textsuperscript{22} Some foreign-financed enterprises have attempted to engage in monopolistic practices. Industries beneficial to the overall national economy were neglected in the process. Scarce foreign capital, thus, was distributed less effectively. Prices rose and weakened Korea's ability to compete internationally. The number of such questionable enterprises was 83 out of 271 cases at the end of March, 1969. It is believed that many of the other loans were disguised enterprises maintained by

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{20}Ibid., July 25, 1969, p. 2.
\item \textsuperscript{21}Foreign Exchange Bank of Korea, Monthly Review, October, 1967, Vol. 1, No. 3, p. 16.
\item \textsuperscript{22}The Dong-A-Daily, April 22, 1969, p. 2.
\end{itemize}
\end{footnotesize}
domestic monopolies. These enterprises are not only frequently unable to repay debt but also increase the burden of international repayment and accelerate imports for consumption.

**Rising prices in foreign-financed companies.** Monopoly pricing practices of many businessmen in foreign-financed firms have resulted in a cost-push effect. Dependency on imported raw materials increases costs. The high cost effect is not limited to foreign-financed projects but extends to other firms' products which use semi-manufactured articles of the foreign-financed company. It has resulted in higher prices than many international commodity prices. The uncompetitive prices are illustrated in Table 11, page 61.

One explanation of the relatively high prices is that plants and facilities of Korean firms with foreign capital are often smaller than optimum economic scale, thus increasing costs and prices.

**Inconsistent applications of policies.** According to the Foreign Capital Inducement Law, priority is to be given to those projects which contribute to the improvement of the international balance of payments, development of key industries or public enterprises, and projects included in the economic development plans.

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23 Ibid.


<table>
<thead>
<tr>
<th>Types of Products</th>
<th>Units</th>
<th>Cost of Products</th>
<th>Domestic Retail Prices</th>
<th>International Retail Prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nylon yarn</td>
<td>Pound</td>
<td>.85</td>
<td>1.47</td>
<td>.75</td>
</tr>
<tr>
<td>Exlan yarn</td>
<td>Pound</td>
<td>1.43</td>
<td>1.28</td>
<td>.62</td>
</tr>
<tr>
<td>Cashimilon</td>
<td>Pound</td>
<td>1.32</td>
<td>1.28</td>
<td>.62</td>
</tr>
<tr>
<td>Cement</td>
<td>Sack</td>
<td>.72</td>
<td>.82</td>
<td>.93</td>
</tr>
<tr>
<td>Plain tile</td>
<td>Foot</td>
<td>1.14</td>
<td>2.00</td>
<td>3.25</td>
</tr>
<tr>
<td>Phosphureted fertilizer</td>
<td>Ton</td>
<td>27.03</td>
<td>47.09</td>
<td>51.50</td>
</tr>
<tr>
<td>Urea fertilizer</td>
<td>Ton</td>
<td>73.22</td>
<td>73.22</td>
<td>84.00</td>
</tr>
<tr>
<td>Newsprint paper</td>
<td>Ton</td>
<td>194.98</td>
<td>206.05</td>
<td>150.00</td>
</tr>
<tr>
<td>Silicon iron</td>
<td>Ton</td>
<td>260.00</td>
<td>173.00</td>
<td>170.00</td>
</tr>
<tr>
<td>Electric wire</td>
<td>Ton</td>
<td>3,095.50</td>
<td>3,449.20</td>
<td>2,920.00</td>
</tr>
<tr>
<td>Binoculars</td>
<td>Item</td>
<td>18.66</td>
<td></td>
<td>6.50</td>
</tr>
<tr>
<td>Gasoline</td>
<td>Barrel</td>
<td></td>
<td>4.41</td>
<td>5.36</td>
</tr>
<tr>
<td>PVC</td>
<td>Ton</td>
<td>459.36</td>
<td>511.63</td>
<td>240.00</td>
</tr>
<tr>
<td>Caustic soda</td>
<td>Ton</td>
<td>55.17</td>
<td>55.17</td>
<td>80.00</td>
</tr>
</tbody>
</table>

*Costs, sale prices, and international prices are calculated by dividing Won, the basic unit of Korean money, by 279.50, the basic exchange rate of the Bank of Korea on September 30, 1968.

Source: Korea Efficiency Association, Modern Management, September, 1968, p. 75, Table 3.

The priority policy, however, is not always followed. For example, the government allowed foreign capital to be invested in the soft drinks industry. 27

Demonstration effect. Foreign capital all too frequently is attracted to create a "demonstration" effect. This is often found in technological development contracts. The technology itself may not be worth importing, but local businessmen try to use the name of a world famous company for marketing purposes. The technology does not improve the quality of goods and services but merely promotes consumption and misallocates foreign capital.\textsuperscript{28}

Problems Encountered By Foreign Investors in Korea

So far, problems facing the Korean economy as a whole have been reviewed. In this section, specific problems confronting foreign-financed firms are discussed. In addition, those activities which businessmen want the Korean government to engage in are discussed. Several studies have provided the data which follows. The Korean Chamber of Commerce and Industries conducted a survey on foreign investment in May, 1969. The Federation of Korean Industries released "Inducement Factors and Obstructive Factors Reflected in the Eyes of Foreign Investors in Korea," in September, 1968. The Korea Productivity Center published, "Foreign Capital Inducement and Actual Condition of Foreign-Invested Enterprises," in May, 1966.\textsuperscript{29}


\textsuperscript{29}The Korean Chamber of Commerce and Industries distributed 104 questionnaires to foreign-invested enterprises and collected 58 answers, or a 55.8 percent reply. The Federation of Korean Industries conducted its survey on 90 firms chosen from foreign-financed enterprises, agencies, branches, banks, service agencies, and applicants for business permits. Twenty-five firms were personally interviewed and 65 were sent mail questionnaires. The Productivity Center interviewed 54 enterprises, 28 of which replied.
The Chamber of Commerce and Industries listed 13 problems considered to cause the companies difficulties. It asked officials to select the five most severe problems. According to Table 12, below, 27 firms, or 15 percent, mentioned the "shortage of working capital." This is a problem common to almost all firms in Korea. The number of firms mentioning "financial difficulties" and "high interest rates" were 19 and 12, respectively. These problems have a close relationship to the first one. The second highest frequency was "difficulty in developing a market," with 20 firms and

<table>
<thead>
<tr>
<th>Types of Problems</th>
<th>Number of Firms</th>
<th>Percent of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shortage of raw materials</td>
<td>16</td>
<td>8.9</td>
</tr>
<tr>
<td>Shortage of working capital</td>
<td>27</td>
<td>15.0</td>
</tr>
<tr>
<td>Financial difficulty</td>
<td>19</td>
<td>10.6</td>
</tr>
<tr>
<td>High interest rate</td>
<td>12</td>
<td>6.7</td>
</tr>
<tr>
<td>Shortage of facilities</td>
<td>15</td>
<td>8.3</td>
</tr>
<tr>
<td>Shortage of electricity</td>
<td>9</td>
<td>5.0</td>
</tr>
<tr>
<td>Transportation difficulties</td>
<td>15</td>
<td>8.3</td>
</tr>
<tr>
<td>Inadequate harbor facilities</td>
<td>5</td>
<td>2.8</td>
</tr>
<tr>
<td>Technical problems</td>
<td>15</td>
<td>8.3</td>
</tr>
<tr>
<td>High wages</td>
<td>9</td>
<td>5.0</td>
</tr>
<tr>
<td>High taxes</td>
<td>11</td>
<td>6.1</td>
</tr>
<tr>
<td>Difficulties in developing markets</td>
<td>20</td>
<td>11.1</td>
</tr>
<tr>
<td>Other reasons</td>
<td>7</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>180</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

11.1 percent of the total. Since national income still remains at a relatively low level and purchasing power is concentrated in several urban areas, the domestic market is very small. However, as national income increases and active advancement into foreign markets are made, this problem will gradually be solved.

The Korea Productivity Center obtained similar results from its survey conducted in March, 1966. "Shortage of working capital" took first place with 29.7 percent of the firms mentioning it; "difficulty in securing markets," 16.2 percent; "high interest rates," 13.6 percent; "shortage of raw materials," 10.8 percent; and "shortage of facilities," 10.8 percent. The characteristics of problems hampering foreign-financed companies have not changed since 1966. They tend not to be problems with easy solutions quickly solved. Especially, financial problems will not be eased until a larger domestic capital base is developed.

So far, internal management problems have been investigated. Next, the disadvantages arising out of government administration will be examined. The Korean Chamber of Commerce and Industries surveyed firms asking: "What are the serious encumbrances you encounter when trying to invest in Korea?" Respondents were asked to rank the five major problems in declining order. See Table 13, page 65, for the investment problems firms encountered.

Forty-three firms, or 22.5 percent, stated that administrative procedures were too complicated; 18.1 percent of the firms experienced inconveniences arising from differences in social and

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30 Korea Productivity Center, Survey on Foreign Loan and Investments, Productivity Research Series No. 59, (Seoul: March, 1966), p. 69, Table 53.
### TABLE 13
FOREIGN INVESTMENT PROBLEMS IN KOREA

<table>
<thead>
<tr>
<th>Investment Problems</th>
<th>Number of Firms</th>
<th>Percent of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complicated administrative procedures</td>
<td>43</td>
<td>22.3</td>
</tr>
<tr>
<td>Inconveniences arising from differences in social and economic systems and customs</td>
<td>35</td>
<td>18.1</td>
</tr>
<tr>
<td>Poor service of government agencies</td>
<td>29</td>
<td>15.0</td>
</tr>
<tr>
<td>Shortage of social overhead capital</td>
<td>27</td>
<td>14.0</td>
</tr>
<tr>
<td>High tax rates</td>
<td>19</td>
<td>9.8</td>
</tr>
<tr>
<td>Low productivity</td>
<td>11</td>
<td>5.7</td>
</tr>
<tr>
<td>Shortage of natural resources and specialists</td>
<td>10</td>
<td>5.2</td>
</tr>
<tr>
<td>Labor disputes</td>
<td>4</td>
<td>2.1</td>
</tr>
<tr>
<td>Costs of fringe benefits</td>
<td>3</td>
<td>1.6</td>
</tr>
<tr>
<td>No answer</td>
<td>12</td>
<td>6.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>193</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>


Economic systems and customs; 15.0 percent complained about poor service of government agencies; 14.0 percent said social overhead capital was insufficient; 9.8 percent complained about high tax rates; 5.7 percent mentioned low worker productivity; and 5.2 percent stated a shortage of natural resources and specialists created problems.

Similar answers were collected by the Federation of Korean Industries. According to its report, 76.9 percent of those surveyed complained that applications and interpretations of the Foreign Capital Inducement Law and related regulations were not clear and
that coordination between different governments was inadequate; 53.8 percent of the firms said that government policies and regulations were so unstable that it was hard to prepare for changes. "Complaints about the high tax rates" was cited by 46.2 percent of the total. The other obstacles pointed out were "inadequate social development," "economic instability," "housing shortages," inconvenient living conditions," "neglecting commercial contracts," and "rapid increases in wages."

**Ambiguity of law and regulations.** Both surveys revealed that the most serious obstructions to foreign investors were ambiguous laws and administrative red tape. Since the laws and regulations are not clearly defined, some regulations can be interpreted differently by the various agencies. For example, Paragraph 1, Article 4, of the Foreign Capital Inducement Law gives the standard upon which authorizations or approvals of applications for importing foreign capital are made, namely, the extent of expected contribution of the capital to the improvement of the international balance of payments or the development of key industries or public enterprises. Here, the "extent" can become a matter of a subjective judgment. Approval depends absolutely upon the opinion of the government agency concerned. Applicants have no way of proving that their projects are suitable to meeting the standard. One agency might evaluate an application highly and another could evaluate it in an opposite manner. Even the same agency may evaluate the same application differently.
Red tape in administrative procedures. In order to give careful consideration to attracting foreign capital, the government set up several checking stages to evaluate applications before final approval. First, foreign investors must go to the Minister of the Economic Planning Board. The Minister examines the applications for compatibility of the project by using the following factors as defined in Article 3 of the Enforcement Decree of the Foreign Inducement Law:

1. Amount of foreign capital required
2. Cost of commodities to be imported
3. Applicability of Article 44 of the Law (feasibility of domestic supply of the commodities to be imported)
4. Terms of the proposed contract
5. Production capacity, production cost, and production schedule
6. Production schedules considered in terms of domestic and international marketability
7. Production processes and other technical matters
8. Raw material procurement plans
9. Plant site conditions and construction plans
10. Amount of domestic capital required (classified by facilities sector, plant operation sector, and other funds)
11. Feasibility of procuring domestic capital required (based upon the amount determined in the preceding paragraph)
12. Feasibility of repaying principal and interest in terms of profitability
13. Confirmation as to whether domestically manufactured capital goods substituted for foreign capital goods will be more than 50 percent of the contract price.

14. Financial ability of the borrower based upon his ability to maintain a capital account on the balance sheet to over 20 percent of foreign capital acquired until the termination of repayment of principal and interest.

15. Borrower's plans for and his ability to furnish collateral\textsuperscript{31}

On receiving the application, the Minister of the Economic Planning Board presents the necessary documents to the appropriate Minister and receives his opinion. The Minister, when submitting his opinion, examines the pertinent matters in connection with the subscription of stocks or shares, cash loan contract, capital goods inducement contract, or technological inducement contract provided for in Article 3 of the Enforcement Decree and sends his opinion to the Minister of the Economic Planning Board within 50 days from the date of receipt of the documents. Before drawing his opinion, the Minister asks the opinion of appropriate banking institutions about a cash loan contract. He also gets the opinion of the Minister of Construction about the location of the plant for capital goods inducement contracts. It takes a relatively long time to obtain a final decision from the Economic Planning Board.

\textbf{Frequent changes in regulations and government policies.} The Korean economy has functioned under the capitalistic system for a

brief period of time. The government established economic development planning in 1962. However, it could not make a comprehensive plan partly because of insufficient statistical data and partly because of a lack of experience in long-range planning. The government has depended upon trial-and-error methods. It has modified the comprehensive plan from time to time. Excess achievements beyond the original growth objectives during the First and the Second Economic Development Plans are largely the result of an underestimation of the expected rate of economic growth during the period. Since the level of foreign exchange holdings has been very low, the government has not been able to adopt a steady policy but has made changes according to the situation of foreign exchange holdings. Laws and regulations, including the Foreign Capital Inducement Law prepared under this situation, also have had to be changed. It is anticipated that it will take a long time to achieve a sound economy, stable policy, and more perfect laws and regulations.

Differences in social and economic systems and customs. The social and economic systems and customs developed in various countries are different from each other. Korean customs involve more emotion than Western societies. It is interesting to observe that Western business contracts are made in the office after evaluating the benefits, whereas, Korean businessmen make preliminary contracts, if they are important ones, at restaurants, tea rooms, or while enjoying themselves at Korean-style bars. It is not unusual that a compromise is effected on the basis of emotion rather than reason.
Services of administrative agencies. Even though little may be done about uncontrollable factors such as the lack of natural resources, it is a very serious issue to see that so many firms indicate problems arising from "red tape" and "poor services of government officials" and, as a result, corrective actions are being taken to correct these situations.

High tax rates. Since aid from the United States started in 1945, grants-in-aid have accounted for more than 10 percent of the Korean GNP until 1960. This aid had relieved material shortages and had been an important source of government revenue. The proportion of the counterpart funds, or revenues from sales of grant aid materials, ranged from 40 percent to 50 percent in the 1950's. But the proportion has decreased since 1960 to 11.8 percent in 1968. Moreover, the government has had to raise funds for economic development plans. In order to finance economic development through compulsory savings, the government revised 13 tax laws and established two new taxes. The proportion of tax collected to GNP has risen sharply from 8.6 percent in 1965 to 16.0 percent in 1968. The rate is expected to continue to increase.

Lack of social overhead capital. While Korea's economy, overall, grows rapidly, social overhead capital has been unable to keep

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33 Korea Chamber of Commerce and Industries, Economy Prospect and Problems in the New Year, January, 1968, p. 217.
34 Ibid., p. 116.

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pace. Since social overhead capital needs require a large amount of investment and the rate of return on this type of investment is low, private enterprises do not provide adequate sums of social capital. It is necessary to develop transportation facilities, electricity, water for industry, and reduce the fees for these facilities. It is encouraging that a modern highway is being built across the nation for truck transportation. Also, construction of hydroelectricity and thermal electricity plants is being undertaken.
CHAPTER V

MEASURES TO SOLVE FOREIGN INVESTMENT PROBLEMS

A number of solutions to many of the major foreign investment problems are presented in this chapter. Emphasis is placed upon the values accruing to the Korean people by solving their economic development problems. In various instances, it is demonstrated that Korea benefits in the long-run by reducing the conflicts encountered by foreign investors.

Supplementing Domestic Working Capital

As rapid economic growth continues, the shortages of working capital increase each year. Enterprises are making new investments in facilities to increase their productive capacity in order to catch up with their competitors' expansions. However, these expansions have been made through debt. Capital has been acquired from foreign investors for facilities and working capital has been obtained from the domestic financial markets at high interest rates.

In an advanced capitalistic economy, where the corporate form of business organizations and the securities markets are highly developed, available resources for investment tend to be mobilized more efficiently through the capital markets. In contrast, Korean banking institutions have been playing a key role in the mobilization of resources. Eventually, the heavy dependence on direct financing through banking institutions restricts investment
decisions, especially in the private sector. Moreover, the re-
sources of banking institutions tend to be more limited.

The securities market is usually the financial market for
long-term capital needs. Banking institutions are supposed to
provide business enterprises with short-term operation funds. How-
ever, Korean banks have to provide long-term capital as well as
short-term loans. For the purpose of restoring the functions of
banking institutions and securing long-term capital through direct
financing channels, the Capital Market Fostering Law was proposed.
On November 8, 1968, the National Assembly passed the law and re-
vised the laws affecting corporation and personal income taxes.

Under the provisions of these laws, the government guarantees
at least minimum dividends to the owners of securities listed on
the stock market. Dividends are tax deductible. Certain corpora-
tions are requested to make stock available to the general public.
This practice is needed because one of the impediments to stock
market development is that stocks are often owned by one family
and, therefore, are not available to the public. 1

The Korea Investment Development Corporation was established
to direct plans for increasing public investment in stocks. The
law also permits banking institutions to establish syndicates for
underwriting stocks. It was hoped when passing the law that the
various functions of the stock market would be strengthened and a
financial channel developed between the public and businesses. 2

No. 1, p. 36.

2 Ibid.
Regulations for listing stocks were drastically relaxed to facilitate listing and to let banks establish departments of securities to help channel small amounts of funds into capital investments.  

With the Capital Market Fostering Law, the government provided penalties against foreign-financed firms which did not list their securities. The purposes are to open such firms to public ownership, to diversify listed stocks, and to give the public a variety of choices when participating in the capital market.

Reducing Red Tape

Recognizing that red tape is a great obstruction to attracting foreign capital, the Ministry of Commerce and Industry reduced the amount and complexity of procedures for the electronic appliance industry. The following changes were made:

1. The procedures of receiving and sending documents were simplified.

2. The verification of materials, approval of exports and imports, and recommendations for custom tax exemptions were decided at the supervisory level.

3. According to Article 44 of the Foreign Capital Inducement Law, certain commodity items cannot be imported. The policy is limited in its application only to the electronic appliance industry. It is expected to be extended to other major industries.

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5Ibid., pp. 55-56.
The government has arranged bonding measures for foreign investors. If a foreign-invested firm is registered under the Foreign Capital Inducement Law, and if the products are completely exported, it can arrange to bond its imported materials. The bonding measure provides highly simplified procedures, thus saving time in obtaining import and export licenses and custom clearances.

**Improving the Service of Administrative Agencies**

The government has attempted to improve its efficiency and services through training programs. According to Article 8 of the Foreign Exchange Management Law, a loss may be compensated upon request if suffered from willful neglect of duty by an agency or a person in charge of foreign capital. The Minister of the Economic Planning Board can order compensation.

Part of the problems with administrative procedures and services that cause inconveniences to foreign investors arise from the differences in social and administrative orders and customs. In order to solve these problems, the Ministry of the Economic Planning Board set up the Office of Investment Promotion to provide assistance and advice to foreign investors in solving various problems related to the establishment and operation of foreign-invested enterprises in Korea.

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Enhancing Social Overhead Capital

The expansion of the Korean economy requires the simultaneous expansion of social overhead capital and public services. Shortages of transportation and electricity and an urgent demand for more communication facilities have recently appeared. In a developing country, emphasis is usually placed on developing scarce resources and achieving rapid growth through rapid industrialization. Social overhead capital needs often are neglected because they require large sums of capital and they require a long repayment period. Therefore, an imbalance is apt to result between manufacturing industries and needs for social overhead capital.

Transportation difficulties arose in 1965 as economic development continued to advance. Lack of adequate transportation has become a chronic obstacle to economic development. Because of a railroad-oriented transportation policy of the government, investment has been mainly in railroad transportation. By the early 1968 period, railroads were transporting 75.9 percent of total freight in Korea. To ease the burden on railroads and provide more balance in economic development over the entire nation, the Ministry of Construction planned to complete by 1976 eleven new highways extending 1,125 miles. A 250 mile highway connecting Seoul and Inchon and another between Seoul and Pusan has already been completed. A 187.5 mile highway between Tae-Jun and Sun-Chun and 146.3 mile highway between Seoul and Kang-Nung were started in

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1970. A ground-breaking ceremony is scheduled in 1972 for the remaining highway to be constructed.\textsuperscript{10}

With the completion of these projects, the entire nation will be within the range of a one-day's drive. Transportation difficulties will be eased, and a great contribution will be made toward industrial development.

The national economy faced an electricity shortage beginning in late 1966. Suddenly, it was necessary to provide limited transmission of electricity to homes, factories, and even to street lamps. The shortage started as a result of a long drought which slowed down the turbines generating hydroelectricity. However, due to the active participation of the government in developing electricity, supply and demand were in close balance after 1968.\textsuperscript{11}

The total capacity of power plants has increased from 771,645 kilowatts in 1966 to 917,245 in 1967. Capacity reached 1,124,245 kilowatts in August, 1968.\textsuperscript{12} A plan was set up for the development of sources of electric power. The goal is 6,169,000 kilowatts by 1974.\textsuperscript{13} Another measure, in 1968, to find a solution to the power problem was to have private companies develop electrical power. The Korea Electric Power Company, partly owned by the government, had been the only developer of electric power up to that time. Two

\begin{footnotes}
\item[12]\textit{Ibid.}, p. 117, Table 3.
\end{footnotes}
private companies have begun building a large-scale facility in Korea.  

**Developing Farming Villages**

Since the advent of rapid economic growth, emphasis was placed mainly on manufacturing and social overhead capital. The primary industries of agriculture, fishing, and forestry, which account for an annual average of 34 percent of value added, have been neglected. These industries have an annual growth rate of only 4.0 percent. The stagnant agriculture industry has not been able to provide a self-sufficiency of food for Korea. The nation has had to import an annual average of 7,850,000 metric tons of foreign grain during the period from 1958 to 1968. Grain imports amount to approximately 12.5 percent of the total demand for grains. The relatively low productivity of farming and fishery villages has resulted in low incomes to farmers and fishermen. Markets for their products have been limited to urban areas. Furthermore, the development of raw materials has been reduced as a result of stagnant farming and fishing methods. A large amount of foreign exchange has been spent for importing raw materials. In order to attain a self-sufficiency of food, increase the purchasing power of rural communities, expand markets for goods and services produced, and accelerate the development of raw materials for industry, the government enacted the Farm Industrialization Promotion Law. It has 11 projects underway to increase incomes for farmers and

14 *Economic Movement in 1968 and Prospect of New Year*, p. 121.
fishermen. Under the agricultural law of September 3, 1969, a long-range project will be established to industrialize the rural communities. The government will assist in the following ways:

1. Subsidize or pay the rent for factory sites
2. Build roads
3. Give priority for access to foreign capital
4. Make special arrangements for transmission of electricity
5. Make loans at low interest rates
6. Guarantee the presence of raw materials
7. Find markets for investors
8. Exempt taxes on accumulated profits for reinvestment.

These taxes include corporation, business, and commodity taxes.\(^{16}\)

**Reduction of Labor Disputes for Foreign Investors**

Under the influences of rapid economic growth and inflation, entrepreneurs encountered rapid increases in wages. Considering that the primary asset of the Korean economy is its abundant labor supply at low wages, some of the recent labor disputes demanding higher wages could be a problem to foreign investors who have invested in Korea in order to utilize the less expensive labor. In order to prevent such disputes and provide foreign investors with favorable labor costs, the Ministry of Economic Planning intends to regulate labor to resolve disputes.\(^{17}\)

\(^{16}\)The Dong-A Daily, September 3, 1969, p. 2.

\(^{17}\)The Dong-A Daily, November 24, 1969, p. 2.
Reduction of Foreign Exchange Waste

Foreign capital has helped Korea attain a high rate of economic growth. However, there may be a balance of payments problem after 1971 when the repayment of principal and interest on foreign loans begins. Due to the facilities established with foreign capital, exports have increased every year during recent years, but such a large quantity of raw materials is imported that the net receipt from export is very little. Therefore, the government has to reconsider rapid economic growth attained through high rates of investment, import, and consumption.

In order to control foreign capital at the proper level on a more steady basis, the Ministry of the Economic Planning Board prepared a Plan for Improving the Administration of Foreign Capital Inducement. Foreign capital is allowed to be imported according to a yearly quota based on the Third Five-Year Economic Development Plan and the plan's total capital budget. Also, standards such as check lists provided by the International Bank for Reconstruction and Development and the Agency for International Development for qualified projects were established to tighten controls on attracting foreign capital.¹⁸ Strict quotas will be assigned to short-term commercial loans which affect the international balance of payments.¹⁹

The National Assembly may revise the Foreign Capital Inducement Law to prevent disorders caused by commercial loans. If the

law is passed, all commercial loans for projects over $10 million in the areas of fertilizer, electric power, cement, iron and steel, shipbuilding, petroleum, electronic appliance and machinery industries must receive approval from the National Assembly.\textsuperscript{20}

The government has established the Third Secretarial Office and delegated the authority to handle foreign investments. The application for introducing foreign capital should seek approval from the Office of the President on recommendation from the Third Secretarial Office, in addition to the approval by the Foreign Capital Inducement Deliberation Committee.\textsuperscript{21}

Recognizing the necessity of improving management of some enterprises, the Third Secretarial Office closed the firms or amalgamated them with other companies. Firms would be closed or consolidated if they:

1. Discontinued or slowed down production because of overproduction caused by foreign investments

2. Had long delays in construction or completion of facilities because of insufficient capital

3. Accumulated deferred payments over $333,333

4. A bank which guaranteed a loan had to repay the principal and interest for the indebted company, or such payments were expected.

5. Accumulated losses for more than two fiscal years.\textsuperscript{22}

\textsuperscript{20}The Dong-A Daily, June 20, 1969, p. 2.
\textsuperscript{21}The Dong-A Daily, September 3, 1969, p. 2.
\textsuperscript{22}Ibid.
Restricting Unfavorable Foreign Capital

As described earlier in the paper, the terms sought by foreign investors are getting more unfavorable for Koreans each year. With some administrative backing, the government has tried to improve this situation through the following measures:

1. The Economic Planning Board Ministry has decreed that foreign capital lenders should consult with governmental agencies about the terms of capital and should seek advice and cooperation from consulate generals in the investing country before commencing negotiations.23

2. The government has introduced a subletting system to utilize line credits or blanket loans issued through foreign underwriters for loans of less than $500,000 per project. The government expects to take advantage of economies of scale by combining individual negotiations on those projects requiring less than $500,000.24

3. To date, foreign capital has been imported mainly from the United States and Japan, but a new source is the Euro-Bond market. By diversifying capital sources, more favorable terms can be obtained while reducing the dependency for capital from just one or two countries.25 Another reason for the action is that favorable capital is more difficult to attract from the United States and

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Japan since they have reached their investing limits. Finally, the economic recession within the United States has slowed investments.

4. Importing technology is very important to a developing country. However, in some cases, pseudo-technology has been imported under the disguise of technical development. A technical assistance agreement is generally entered into, in this case, for its demonstration effect alone. These contracts are made not to develop local technological capacities but rather to import raw materials, goods-in-process, or to assemble goods prohibited from import. An application for a technical contract is not approved if it is considered to be for any of these purposes. Also, an application must not contain any conditions that restrict exporting products produced with imported technology or dealing with competitive products that are produced by the contracted technology.

5. An objective of American investors in Korea is to increase their profits by utilizing less expensive labor and a favorable investment environment. The objectives of Japanese investors are to increase the Koreans' propensity to consume; increase the dependency on the Japanese economy for consumer goods, raw materials, and facilities; and create a sales decline in domestic consumer

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goods industries. Because of these objectives, the government has strictly regulated all Japanese investments. By the end of March, 1969, Japanese investments accounted for 17 loans or 14.5 percent of the total of 117 loans, whereas American investments consisted of 57 loans or 48.7 percent of the total. Considering the amount of investment, the United States businessmen had invested about 67 percent while Japan accounted for only 7.2 percent. Considering geographic proximity of Korea to Japan and the similarities of their social and economic systems, the Japanese have potential profitable opportunities for investing in Korea. However, they seldom get such chances due to administrative controls which discourage Japanese investment.29

**Taxes for Interest Equalization**

Interest rates on foreign loans range from 6 percent to 8 percent but domestic interest rates are in the 22.8 percent to 31.2 percent per annum range.31 To prevent undue financial risks, the government established an "Interest Equalization Tax" which is effective for five years and applicable to commercial and cash loans. The difference in interest between domestic loans and foreign loans will be absorbed by this tax. The rate is to be set at 30 percent of the difference.32

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30 Ibid., p. 19.


CHAPTER VI

CONCLUSIONS

The preceding chapters have presented a history of how one Asian country has structured its economic development within a framework of a constantly changing international business environment. The purpose of this investigation has been to give the potential foreign investor some insight as to why Korea should be considered as a repository for his capital. Only through an understanding of how the Korean government's development philosophy has fluctuated in reaction to economic trends can a foreign investor make such important decisions with a minimum of risk and a maximum return on his capital invested.

The evolution of Korea from a war-ravaged and divided nation into a member of the international business community has not been an easy transition. It has, rather, been the result of extensive government planning and unilateral intervention into what would have been normal economic relationships between Korea and potential investors throughout the free world. In the beginning, planning was nonexistent. United States foreign aid was responsible for a steady, if not dramatic, increase in economic growth and personal income. When foreign aid was reduced, the dream of "natural" growth was shattered, and key government officials were forced to make serious planning efforts aimed at generating national capital from other sources.
Realizing that it could no longer rely on a self-generated national product based on injections of foreign aid, the government turned its attention to foreign investors. This interest was manifested in a series of five-year plans designed to attract industry which would, in turn, provide a base from which an orderly economy could develop.

It became readily apparent that any long-range planning efforts would have to be flexible enough to react to changing economic conditions both in Korea and around the world. In fact, this element of instability became a key ingredient in the measures adopted with the first five-year plan. Laws and regulations were prepared which provided foreign investors with preferential treatment not available in many nations; laws included guarantees against capital confiscation, low interest loans backed by the faith and credit of the Korean government, and the opportunity for repatriation of investments. While such measures did stimulate the flow of exchange into national accounts, they also carried with them a risk of exploitation through their liberal approach to investment. A small amount of "unwanted" industry was tolerated in these early stages of development; however, as foreign holdings grew, planners gained the confidence and experience to build a degree of selectivity into subsequent import guidelines. Regulations were formulated which required that all investments be carefully screened and assessed as to their potential effects, both social and economic. This selectivity has progressed over the duration of the current five-year plan to the extent that in order for an investor in 1971 to receive favorable treatment afforded him in 1961, he must be able
to convince administration officials that his long-range objectives involve capital accumulation, permanent industrialization, and intensive use of Korean labor.

As Korea moves into its third five-year plan scheduled to begin in 1972, it appears that national priorities are turning inward toward the enhancement of the nation's social and cultural environment. This emphasis is demonstrated in proposals for improvements in transportation, housing, and utilities. All such investments in social overhead capital add to the attractiveness of Korea to foreign investors, but in addition, the years from 1972 through 1977 will also see the development of Korea as a market for industry as well as merely a point of manufacture for export. With this added dimension, future studies such as this will deal with the Korean investment climate in a much different manner.

Aside from the capital import and GNP data presented in the body of this paper, the ideal conclusion to a study of the Korean government's efforts to attract foreign capital would be to examine the role of such investment in Korea today. The mere fact that such major companies as International Business Machines, Motorola, Fairchild, and Gulf have established themselves in Korea is testimony to the effectiveness of the government's inducement efforts. An even more critical consideration, however, is how potential investors view the country. Temporary success is meaningless unless obstacles to investment can be identified and overcome. Such an assessment of investor's views was outlined in the surveys reported previously.
Many of the problems noted by investors are being acted upon at the present time, such as shortages of raw materials, high utility expenses, and transportation difficulties. Others, including high tax and interest rates, are inherent to the country's current economic status and, as such, are more difficult to correct. The shortage of technical knowledge found by some investors should end as more technicians teach their skills to Korean nationals and as the educational system in Korea becomes more sophisticated.

Problems which the surveys show to arise out of the Korean government's administration of capital import regulations may continue well into the third five-year plan. Such obstacles as complicated procedures, discourteous officials, and ambiguous regulation terminology are the by-products of a growing bureaucracy which shows no signs of abatement. It can only be hoped that a more educated electorate will eventually provide a stable political framework wherein an effective import policy for foreign investment may operate without unnecessary red tape.

For all the problems experienced by investors, the general picture appears to be one of increasing optimism. The investment environment and the attitudes of the Korean people toward investors are viewed as generally favorable. The availability of abundant skilled labor at low prices is and will continue to be a major advantage in competing for international investment dollars. On the whole, it would seem that government efforts at attracting and controlling the import of foreign capital has succeeded in making Korea's presence felt within the international business community.
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