Attitudes toward foreign direct investment

Foreign direct investment can basically increase foreign trade volumes and improve the degree of a countrys openness. In recent years, as FDI contributed to the remarkable economic growth, China and Korea both change the attitudes toward FDI.

Since the open-door policy was implemented in 1978, China selectively opened certain areas to the outside world. After accession to WTO in 2001, the opened area and sectors was expanded and restrictions were eased. Since China has become one of the most attractive destinations of FDI and shortage of foreign capital was no longer a big problem in China, the focus of FDI policy in China after 2001 was the quality of foreign investment rather than quantity. Meanwhile, the Chinese government emphasized on a balanced and harmonious investment environment between domestic and foreign enterprises, environment protection and economic development.

Although Korea was opened up in 1962, the government concentrated on control and restrict rather than promote and support. The 1997 financial crisis hit made the government question the previous export-oriented strategy. To recover from the crisis, the Korean government shifted the attitude toward FDI from " passive liberalization" to accelerated liberalization. The government not only promoted FDI but also provided professional support, resolved cultural issues, created a positive perception and improved a credible and favourable environment for foreign investors.

The essay is divided into three main parts to analyse the change of the Chinese and Korean governments' attitudes. The first part will discuss the Chinese government attitude toward FDI after WTO accession. The second part will demonstrate the Korean government attitude toward FDI after the 1997 crisis. The final part will compare them from objectives, approaches and attitudes perspective to encourage governments to change FDI policy consistent with changed situation.

2. The Chinese government and FDI after WTO Accession

China eventually joined WTO in 2001 after 15 years' preparation and negotiation. The government realized the degree of FDI liberalization after the open-door policy in 1979 was not sufficient to join WTO. China made more extensive commitments to WTO than other developed industrial countries made. The service sector that had been prohibited from 1979 was gradually opened, like financial and banking sectors. In regard to commitment involved in service sector, Tseng and Rodlauer stressed (2003, p79), " these involve eliminating geographic and other restrictions in key sectors (such as motor vehicles) and increasing foreign ownership limits in telecommunications (to 50% by 2002), life insurance (to 50% on accession), distribution and retailing, and securities (to 49% by 2003), and giving full national treatment to foreign banks (by 2005)." The liberalization of foreign capital from only export-oriented manufacture at the beginning to service sector witnessed a big step the government made on FDI policy. In the open-up policy, only joint venture was encouraged into Chinese economy (Grub and Lin, 1991), however, wholly foreign-owned enterprises played a dominant role in economic development since they were encouraged. The procedures concerning the registration of foreign-owned enterprises were also simplified to improve the effectiveness. (Fung et al., 2002)

The geographical limits were also eased. Special economic zones and opened coastal cities were not the only destinations of foreign investment. As testing fields, the success of certain areas in promoting FDI encouraged FDI into inland cities to narrow the regional inequality, especially central and western part in China. These under-developed cities also enjoyed the same special conditions and privileges (i. e. low tax and tariffs), which provided incentives for foreign investors. (Hale and Long, 2012)

According to the 11th five year plan in 2006, the policy more emphasized domestic development. The New Enterprise Income Tax Law was issued in 2007 to equalize corporate tax rate for local and foreign enterprises. Some performance requirement especially for foreign enterprises was removed. (Nicolas, 2008) The New Law, to some extent, quieted down the sentiment from domestic enterprises while foreign enterprises received more preferential treatment. The Catalogue for the Guidance of foreign-invested enterprises was revised in 2007 to shift FDI policy from quantity-oriented to quality-oriented. (Nicolas, 2008) Meanwhile, the priority of promoting FDI was given to the technology-transferred, environmental friendly and high-level of effective utilization of resources and energies investment.

Although the number of encouraged sectors in the Catalogue in 2007 was much more than that in 2004, especially industrial sectors as the government attempted to upgrade the industrial structure, some sectors concerning national economic security were still restricted to joint ventures, like petroleum and gas. (Nicolas, 2008) Some export-oriented and traditional sectors were shifted from encouraged catalogue to restricted catalogue to avoid excessive outflow of advanced technology, managerial skills and high productivity capacity.

FDI in China has roared dramatically from nearly zero in 1979 to $74. 77 billion in 2007. (Wei et. al., 2009) The objective of recent policies was to promote the high level of the quality of FDI and competitive investment environment in China. The new policies conducted FDI towards a more balanced and harmonious direction. The balance between domestic and foreign enterprises and between environment protection and economic development stimulated FDI to improve under a more healthy and harmonious condition.

3. The Korean Government and FDI after the 1997 Crisis

Before the 1997 crisis, the presence of FDI in Korean economy was comparatively smaller and weaker than the Korean domestic economy. (Turner and Kim, 2004) The turning point, the 1997 financial crisis, brought in a fundamental change. Before the crisis, the government was pursuing the interests of giant enterprises, like Chaebol, so the temporary and unbalanced economic growth was not able to overcome the crisis. At the same time, the previous export-oriented FDI policy was questioned by the government. (Kim, 2003)

The Foreign Investment Promotion Act (FIPA) was enacted in 1998 to shift the government’s attitude toward FDI from “ passive liberalization” to accelerated liberalization. (Cherry, 2006) After revised several times, the new Act extended sectors which enjoyed tax reduction or exemption to service sector though it was already opened after the 1988 Seoul Olympic

Games. (Lim, ?) In the first FIPA in 1960, only light manufacture was allowed for the inflow of FDI and other protected sectors were prohibited. (Cherry, 2006) In the 1970s, heavy manufacture, chemical industry and leading banks were subsequently opened in the form of joint venture. (Sachwald, ?) The government also permitted to operate hostile M&A and eliminate the upper limits on foreign equity ownership in the stock market. After that, the foreign land ownership was completely liberalized. (Sachwald, ?)

The government established some institutions to provide a sustainable assistance and support for foreign investors. The government set up the Korea Investment Service Centre in 1998 to provide one-stop service to offer consultant and assistance to investors and potential ones. The government also established the Office of the Investment Ombudsman in 1999 to solve any problem foreign investor encountered no matter it was about business or daily lives. The government streamlined the investment procedures, for example, no requirement to report the introduction of foreign capital and only four or five documents were needed to submit. (Cherry, 2007) The procedures of notification and certification were simplified to improve the efficiency of promoting FDI. (Kim, 2003)

One of the most important changes of the government’s attitude towards FDI was to focus on “ software” while improving “ hardware”. To transform Korea into a financial and business hub for Northeast Asia, the government took further step to promote FDI and create a favourable investment environment. In 2003, with the sharply decrease of the FDI inflows, the government revamped the national investment promotion agency to help foreign investors resolve the intangible barriers. The agency provided project managers with one-on-one support to build a positive image of doing business in Korea. The government provided seminars about Korean culture, conventions and Korean business culture to those expatriates and their families. (Cherry, 2006) In addition to the improvement of the perception, the government tried to promote the education, living and health standard provided to those expatriates and their spouses.

With the huge inflow of FDI, the Korean government was offering incentives to attract high quality investment. Despite tax reduction, exemptions from leasing costs and other economic incentives provided, some non-business-related issues were remained. To avoid the discrimination against foreign companies, the government attempted to improve the transparency of information and regulations, eliminate corruption and bureaucracy, establish the labour-management relationship and increase the credibility in governance and management system.

4. Comparison

Compared to Korea, China has a relatively shorter history of inward FDI as opened to the outside world since 1978. There are three main differences in promoting FDI between China and Korea.

Different Objectives

As lack of capital, the Chinese government had to open the door to the outside world to gain capital, advanced technology and managerial skills. After the accession to WTO, the government changed attitude towards the domestic development while continuously promoting FDI. The government tried to create more balanced and harmonious environment for foreign investment. The balance of domestic and foreign enterprises, and environment protection and economic development will be a long-term strategy for inward FDI.

Before the crisis, the government also had to attract investment under the pressure of insufficient capital, advanced technology and know-how. However, to overcome the financial crisis, the government deregulated and liberalized FDI to restructure economy because the previous FDI policy did not gain returns as expected. (Kim, 2003) The government attempted to attract high quality investment and improve the credible and favourable environment for foreign investors.

Different Approaches

China adopted a selective and prudent approach to inward FDI. As a socialist state, the government thought capitalists exploit labours and labours' residual values. (Lei, 1997) For avoiding big mistakes and economic even social chaos, the state conservatively chose certain areas as experimental fields to create a relatively liberal economic environment for foreign investors. The feasibility and viability of the policy released the government's worries. The remarkable success of testing fields enhanced the government's confidence to the effectiveness of the policy. According to the Catalogue of Foreign Direct Investment Guidance from the Ministry of Commerce, all sectors in China were classified into encouraged sectors, restricted sectors and prohibited sectors. Each sector had its own FDI policy lined up with the Catalogue. (Li and Cheong, 2008)

However, the Korean government adopted outright encouragement. Korean government actively and confidently promoted FDI without taking any regions as testing fields. After the 1997 financial crisis, when facing the need of transformation and recovery from the crisis, Korean government spared no efforts to promote and support FDI, especially in the aspect of " software". Korean government committed itself to the construction of " software" in promoting FDI, addressing culture issues, improving the perception to Korea and creating a fair and favourable investment environment for expatriates and their families.

Different Attitudes

The Chinese set up a broad array of regulations and institutions to mainly govern foreign investment. Due to the Chinese unique characteristic and the nature of socialist state, the government had to control and govern foreign investment in a bid to avoid occupying the dominant role in the domestic economy. (Wei et. al., 2009)

While the objectives of regulations and institutions the Korean government established were to support and facilitate FDI in Korea. (Kim, 2003) The convenient, efficient and favourable FDI system created a perfect investment environment in Korea.

5. Conclusion

Both the Chinese and Korean governments have made efforts to promote foreign investment as actively as possible. The participation in WTO brought an opportunity to China, while the 1997 financial crisis was a big challenge to Korea. Both these two countries seized the chance or the challenge to amend FDI strategy. Although the strategies China and Korea chose had different objectives, approaches and attitudes, they selected an appropriate strategy consistent with their own unique economic, political and cultural characteristics. It was doubted that whether the current FDI policies would be suitable for the future development.

The globalization is emerged as an inevitable trend. All countries in the world are mutually influenced by each other. It was noted that in 2001, actual inflows of FDI in Korea dropped dramatically from $10, 172. 1 million in the last year to $4, 856. 1 million. (Kim, 2003) The sharply decrease of FDI did not result from the government policy because the government was still actively encouraging and promoting FDI in Korea. Actually, as the participation in WTO in 2001, China has become a threat to Korea with absorbing the investment and influenced the amount of FDI in Korea to a great degree.

Consequently, a totally unchanged FDI policy will not help a country to stand at the frontier of a competitive world. Faced with a more competitive investment environment under globalization than before, it will be advisable to change FDI policy with a changed situation to maintain the competitive and comparative advantages.