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 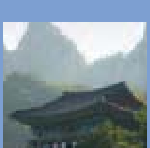  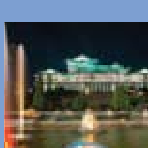 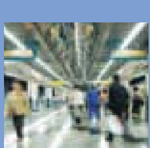

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FDI in Korea: The Permanent Achilles' Heel?

By Andrew Noh

I. INTRODUCTION

The South Korean economy has proven markedly resilient in the face of the global financial crisis that began in 2008, posting positive GDP growth while most economies recorded steep drops. The Korean economy continues its remarkable growth in 2010 with GDP projected to grow 5.5 percent according to Bank of Korea projections. Yet despite the impressive growth and goodwill in Korea in 2010, the Korean economy's Achilles' heel remains foreign direct investment (FDI). In 2009, net FDI hit a 15-year low of $965 million, according to government figures. The Bank of Korea (BOK) announced that the country's net FDI—inflow minus outflow—stood at $965 million from January through November 2009, down 57.6 percent from the same period in 2008. This amount represented Korea's lowest level of FDI since 1994, when net FDI reached $767 million.

When taken at face value, South Korea's low level of FDI is likely because of investors' retreat from all markets during the financial crisis. After all, foreign investment in the global economy tends to rise and fall with the global economy. Imports, foreign firms, and foreign investment are acceptable during times of growth, but subject to xenophobic scapegoating during times of crisis. The period 2008–9 was obviously a time of crisis for the world economy. Global FDI dropped 39 percent in 2009, so it should follow that inbound FDI in Korea would also fall at a similar rate. Unfortunately, this was not the case; Korea's FDI inflows dropped a drastic 57.6 percent. In addition, the 2010 UNCTAD *World Investment Report* found that FDI flows to Asia dropped a modest 17 percent in 2009, making Korea's 57.6 percent drop even more astonishing. The *World Investment Report* also reported that the region now accounts for one-fifth of global FDI inflows. Of that, FDI inflows to Korea accounted for only two percent of the region's inflows. The drop in Korean FDI was so large that Korea fell out of the A.T. Kearney Foreign Direct Investment Confidence Index for 2010, the first time since the index's inception in 1998.

What explains the precipitous drop in foreign confidence in Korea? Why are FDI inflows for Korea so weak in the most economically dynamic region in the world? These questions become even more confounding as Korea continues to improve its institutional and cultural framework for FDI. According to Bernie Bishop's "Barriers to Foreign Direct Investment in Korea and Australia," since the 1997 crisis the Korean government has undertaken a paradigm shift in its economic policy and pursued relentless institutional and structural reforms in compliance with the IMF rescue package. The government has abandoned its policy of protecting domestic industries, pursued the task of restructuring *chaebol* (conglomerates), and liberalized the economy, while opening the Korean market widely to international competition through trade, FDI, and mergers and acquisitions (M&A). These reforms have taken place across Korea's contentious politics; liberal and conservative governments alike have recognized the need to attract further investment in Korea. In addition, many researchers have argued that even Korean society and its people have changed, becoming more amicable to foreign business operations in Korea.

Yet despite the improving institutional and cultural framework for FDI, FDI inflows in Korea continue to diverge against global and regional trends. Research by Arthur Alexander in "Mergers and Acquisitions in Korea: The Leading Edge of Foreign Direct Investment" has shown that while worldwide M&A—a primary indicator of the level of FDI—set new records in 2006 and 2007, Korea's fell in both years. This is most surprising as the world economy reached new levels of prosperity during the same time period. The BOK's announcement of Korea's historically low 2009 FDI numbers paints an even grimmer picture of foreign investor confidence in Korea, and suggests that there is something seriously wrong with Korea as an investment destination. Why have international investors fled one of the most vibrant economies in the world? Does the source of foreign investors' aversion to Korea come from the top level of policymakers or from the bottom level of bureaucrats and civil society? What more needs to be done to increase FDI inflows so that it is comparable on a regional level?

This paper attempts to answer these questions. First, it begins with a brief historical examination of FDI inflows in Korea in an effort to lay out the institutional improvements Korea has made to its FDI framework since the 1960s. The paper will then examine the current Lee Myung-bak administration's efforts to promote FDI; the Lee administration has been the most proactive administration to date, and an examination of current FDI initiatives is necessary to understand the current FDI environment in Korea. The paper will then delve into three case studies—covering a success, a semi-success, and an outright failure—that will provide a sampling of the issues foreign companies encounter when they choose to invest in Korea. The paper will conclude with an assessment of historical factors, case studies, and the current FDI framework to determine what exactly helped contribute a successful or unsuccessful case of FDI. Finally, the paper concludes that despite improvements, FDI in Korea is still at times subject to insufficient regulatory transparency; inconsistent, ad-hoc changes in the interpretation of regulations by lower-level bureaucrats; underdeveloped corporate governance; and the lingering remains of economic domination by the remaining national economic champions, the *chaebol.*

II. BRIEF HISTORY OF FDI IN SOUTH KOREA

The Korean government has long maintained tight control over allocation of financial resources to ensure that investment activity would take place according to its priorities and plans. This has been possible for three important reasons. First, the government had a firm control over domestic finance after nationalizing commercial banks in 1961. Second, the government controlled the use of foreign savings by requiring all foreign loans be authorized by it. Third, the government could control the direction of industrial development by maintaining tight regulations on FDI. Had foreign multinationals established a large presence in Korea, it would not have been easy for the government to maintain its industrial policy.

While Korea relied heavily on foreign borrowing, it largely stayed away from capital inflows in the form of FDI or portfolio investment. Simply put, the Korean government preferred loan-based development to investment-based development. It was not until the Kim Young-sam administration in 1993 that Korea finally placed foreign investment policy high on its economic agenda. The Kim administration entered into power at a time when international economic issues moved to forefront of global and domestic politics. The formation of the North American Free Trade Association, the conclusion of the Uruguay Round, the evolution of the General Agreement on Tariffs and Trade (GATT) into the World Trade Organization (WTO), and the creation of the Asia-Pacific Economic Cooperation (APEC) forum all loomed large, and Korea sought to find its place in the emerging global economic order. Korea's desire to be a part of APEC and the Organisation for Economic Co-operation and Development (OECD) would drive the Kim administration to reverse Korea's long aversion to FDI and move Korea towards more market-friendly, liberalization policies.

Despite these reforms by the Kim administration, inbound FDI in Korea during the 1990–97 period amounted to 0.96 percent of its gross fixed capital formation, while the average for other East Asian economies was 7.4 percent according to the 2002 UNCTAD *World Investment Report*. According to O. Yul Kwon, when it came to attracting foreign investment, the Korean government was passive and restrictive. The 1997 crisis would force Korea to change after it agreed to the IMF's conditions to open its economy to foreign investment.

As a result of the IMF's conditions, the government faithfully carried out the liberalization reforms, including making a full-fledged opening of the financial markets, selling off troubled financial institutions to foreign investors, lifting foreign exchange regulations, and radically liberalizing inward foreign investment, both portfolio and direct. The Foreign Investment Promotion Act (FIPA) codified Korea's commitment to FDI and sought to create a more open and transparent investment regime, and to abolish many of the regulatory restrictions that plagued the country prior to 1998. Structural reforms were launched in four areas: financial, corporate, labor, and public. Old industrial policy placed restrictions on inbound FDI, but the government began actively engaging FDI as a source of not only foreign capital inflows, but also advanced technologies and management practices. The government further established two FDI-promotional agencies, Invest Korea, an agency mandated to offer a "one-stop shop" for attracting FDI, and the Office of the Investment Ombudsman to provide investment aftercare services to foreign companies operating in Korea. For the first time, FDI definitions and requirements were put forward in an explicit and transparent manner for foreign investors.

As mentioned earlier, most of the traditional barriers to FDI were removed following the Asian Financial Crisis and subsequent liberalization of the Korea economy. The traditional barriers of local company promotion—limited foreign ownership, technology poaching, and *chaebol* favoritism—finally ended, primarily as a result of the Asian Financial Crisis. Foreign companies were finally allowed to invest in all but a few, mostly manufacturing, industries. All told, FIPA liberalized Korea's FDI framework to 99.8 percent of business sectors open to FDI, now in line with most OECD practices. The financial crisis would also force the Korean government to implement *chaebol* reforms, thereby dissolving some of the collusive government-*chaebol* relations, and ultimately resulting in improved corporate governance, management transparency, and accountability. The government would also lay the framework to later establish three free economic zones (FEZs), providing a range of investment incentives including tax breaks, tariff-free imports, relaxed labor rules, and improved living conditions for expatriates in areas such as housing, education, and medical services.

Despite the dramatic reorientation of the Korean economy towards foreign investment, old habits die hard, and FDI in Korea reverted to previous levels. Although FDI increased at a rapid rate after 1997 because of the IMF's conditions and foreign M&A of troubled Korean corporations, the flow of foreign capital quickly slowed when the IT bubble burst in 2001. Foreign investment would rise again from 2004 to 2007, but would quickly slow thereafter, bottoming out in 2009 as mentioned earlier. Table 1 shows the rapid rise and fall of FDI in Korea.

Table 1: FDI Levels in South Korea

(Unit: USD, millions)

Year	Notification	Arrival
2001	11,287	5,034
2002	9,095	3,806
2003	6,471	5,138
2004	12,796	9,289
2005	11,566	9,618
2006	11,247	9,123
2007	10,515	7,850
2008	11,711	8,371
2009	11,484	6,668

Source: Invest Korea

Although President Lee Myung-bak came to power as FDI in Korea was falling, the blame cannot be placed solely on his policies. In fact, during his fall 2007 presidential campaign, one of Lee's key promises was to take steps to attract more foreign direct investment in Korea in an attempt to revitalize Korea's economy.

Since taking office in February 2008, President Lee has recognized the forces of globalization and the need to move Korea away from a manufacturing-based economy and towards a knowledge and services-based economy. In a January 2009 speech before the American Chamber of Commerce in Korea and the European Union Chamber of Commerce in Korea, President Lee emphasized Korea's strong potential for overcoming the crisis and reassured foreign investors of his administration's business-friendly policies. In addition, President Lee established the Presidential Council on National Competitiveness to address FDI by inviting foreign business association leaders and foreign CEOs operating in Korea to be regular members on the panel.

President Lee also laid out explicit promises to further promote FDI through corporate tax reductions and a restructuring of Korea's cumbersome corporate tax code. Capital market reforms under the Lee administration have eliminated or raised ceilings on aggregate foreign equity ownership, individual foreign ownership, and foreign investment in the government, corporate, and bond markets. Taxes remain as one of the biggest barriers to FDI, and President Lee further proposed cutting the corporate tax rate and increasing the threshold between high and low tax brackets by the end of 2010, as shown in table 2 below.

Table 2: Corporate Tax Rates in South Korea

Current	Tax Rate	End of 2010	Tax Rate
<₩100 million	13%	<₩200 million	10%
>₩100 million	25%	>₩200 million	20%

Source: Ministry of Strategy and Finance, Republic of Korea

Korea has chosen to pursue a slow evolution of its FDI policy evolution, from openly hostile policies until the 1980s, to hesitant ones in the 1990s, and finally to actively seeking FDI as a critical component of its Korea-as-a-business-hub strategy. Despite the sudden rapacious FDI policy and active recruitment, FDI inflows remain precariously low. The reasoning for this may be deduced from an analysis of successful and failed cases of FDI. In the following section, the paper examines

MetLife, GM Daewoo, and Lone Star Funds in an attempt to identify the factors that are responsible for the lack of achievement despite Korea's activity.

III. CASE STUDY 1 (SUCCESS): METLIFE KOREA

The American insurance giant MetLife began its operations in Korea in 1989 through its subsidiary MetLife Korea, when the Korean insurance market opened to foreign investors. MetLife's operations began when it established a joint venture in Korea with the Kolon Group, a Korean textile manufacturer. The joint venture began as a small operation and captured very little of the Korean insurance market (insurance was sold on an informal basis at the time, usually person-to-person) and would continue that way until 1998, when MetLife was able to acquire Kolon Group's stake in the venture, rename the company, and begin restructuring MetLife Korea.

Once MetLife gained full control of its operations in Korea, it began offering variable insurance products—the first insurance operator to do so in the Korean market. In an effort to upgrade its workforce, MetLife launched the "professional agency force" to convert its informal, person-to-person sales force into the professional force seen today. Long-established domestic firms, whose sales force consisted mostly of women, historically dominated the Korean insurance market; shop-owners and homemakers sold insurance on a part-time basis to make ends meet. This sales channel was dubious at best, as these agents had little or no training, and as a result, the insurance industry was marred by complaints of unprofessionalism and low customer retention. Upon entry, MetLife immediately professionalized the workforce and established a precedent that all insurance companies operating in Korea now follow. This positive externality, both for foreign firms and for MetLife, almost certainly came about because of market needs rather than any government policy or company initiative.

Since then, MetLife has launched telemarketing, bancassurance, and pension products, and is now the fourth-largest variable universal life insurance writer in Korea, capturing approximately three percent of the market. Although small in percentage terms, MetLife's three percent market capitalization represents a large portion of the 18.9 percent market capitalization by foreign insurance firms.

Although MetLife successfully cultivated local talent and increased labor productivity through its professional agency force, the company's cultivation of foreign talent cannot be ignored either. Stuart Solomon, longtime CEO of MetLife Korea, speaks Korean fluently. This skill has no doubt helped his image with the local population and enhanced MetLife's image as the rare responsible foreign company in the eyes of the Korean public.

MetLife's success in Korea stands as a shining example of FDI's potential in Korea. Although the company started small and in a joint venture with a company unrelated to insurance or other financial services, it was able to take advantage of the Asian Financial Crisis and the Korean government's liberalization of financial services to shed the joint venture and strike out on its own. MetLife also successfully cultivated the local population through its "professional agency force" and actuary programs at Seoul National University when it initially arrived. MetLife's cultivation of local talent and its Korean-inclusive corporate governance structure allowed it to engage the Korean government and society at all levels. These actions exhibited its commitment to both the Korean market and the Korean people, as if to portray itself as a Korean company when it was not.

Another factor in MetLife's success is its strategies specifically customized for the Korean market. Korea is a rapidly aging society; 38 percent of the population is expected to be elderly by 2050, putting it in contention with Japan, Italy, and Spain for the oldest country in the world according to the Korea National Statistical Office. MetLife was the first foreign firm to have made inroads into the retirement markets in a systematic way. It hired Korea's top financial planners, while preparing the next generation of insurance actuaries through a dedicated education program on pensions and annuities at Seoul National University. The program is set to produce a total of 2,400 retirement-planning professionals by the end of this year. The firm plans to further improve the program in the near future.

MetLife's success is not a result of its actions alone. Luck has played a significant role in MetLife's success, having benefited from the Asian Financial Crisis and reform of the insurance industry. In 1999, the Korean government established the Financial Supervisory Service (FSS) to regulate the financial services industry, which includes insurance. The FSS is one of the most transparent and effective regulatory agencies in Korea, and provides a comprehensive one-stop shop for all insurance regulations. The FSS immediately joined the International Association of Insurance Supervisors (IAIS), thereby synching Korea's regulatory standards to international norms, which MetLife was already familiar with. MetLife International also never ran into debt issues in any of its operations around the world. Although some may contend that this is a product of proper corporate governance, luck plays an important factor as well.

MetLife's success is a combination of good corporate governance, a high-penetration market, and luck. Regulatory agencies are notoriously difficult in Korea, but the FSS was an internationally recognized agency held to international, not Korean, standards. As such, MetLife was able to avoid the usual pitfalls of FDI implementation and was left to fend for itself according to the market's, not the state's, machinations.

IV. CASE STUDY 2 (PARTIAL SUCCESS): GM DAEWOO

In 1984, the Korean government brokered a deal with Detroit's General Motors and Korea's Daewoo Motors to form a Korean-based 50-50 joint venture (JV). Each company would invest $100 million to form Daewoo Motor Company, and produce the Pontiac LeMans subcompact car. Using technology from Opel, GM's wholly owned German subsidiary, Daewoo Motors would produce the LeMans for the Korean and U.S. markets. The JV was thought to be a smart move for both firms as Daewoo lacked the engineering expertise to design and manufacture a car on par with Western standards, and GM privately doubted that a subcompact car could be profitably produced in the United States. GM took on the responsibility of marketing the LeMans, allowing Daewoo to concentrate solely on adapting the superior engineering skills of GM in its effort to gain market share from its main Korean competitors, including Hyundai.

Despite what looked great on paper, multiple problems began to develop just as production began. Daewoo's union began demanding higher wages and launched a series of strikes that repeatedly halted production. The higher wages demanded by Daewoo's union essentially made it cheaper to produce the automobile in its native Germany, thanks to Germany's higher productivity. The LeMans also suffered from several quality issues. The vehicle routinely experienced problems with its brakes and electrical system. Sales of the LeMans fell dramatically within three years of its initial production. Each partner began to blame the other: Daewoo blamed GM for failing to promote the vehicle in America, and GM blamed Daewoo for quality and structural problems. Daewoo wanted to invest aggressively outside the initial target markets, hoping to export cars to Eastern Europe, which Daewoo saw as an ideal market. However, GM saw Eastern Europe as Opel's territory and actively blocked Daewoo's efforts to expand. In addition, Daewoo wanted to invest in the booming Korean auto market, but GM was not interested in investing additional capital to take advantage of this market.

Relations soured to the point of dissolving the JV in 1991, with Daewoo agreeing to buy out GM's stake in the JV, paying $170 million for complete control of Daewoo Motor Company. Despite the brief breakup, GM and Daewoo would later join forces again. Although Daewoo managed to escape serious financial harm during the 1997 Asian Financial Crisis, Daewoo found itself in need of investors after its questionable acquisition of rival Korean automaker SsangYong in 1998. Daewoo strongly preferred a takeover from rival Hyundai or at least Ford, but those two would eventually chose not to invest, thereby reopening the door for GM and creating a new company, GM Daewoo Motors. The new JV between GM and Daewoo was established in 2001, with GM investing $400 million for a commanding 67 percent stake, allowing it tight control over the JV's operations. A group of Korean investors led by the state-owned Korea Development Bank (KDB) held the remaining 33 percent stake. The new JV would enjoy greater success than its previous incarnation, introducing eight new models to date, but would suffer from a variety of issues in its home market of Korea. Much of the new JV's success was tied to its production of vehicles for export to the American and European market, but Korean consumers shunned the brand in favor of Hyundai and Kia. Various public opinion polls revealed that the average Korean consumer viewed the GM Daewoo brand as a hostile foreign takeover of a Korean company. This public perception problem would continue on for many years even as GM Daewoo upgraded its design, production facilities and marketing that lead to the immensely popular Altheon sedan, and eight new models available for export to more than 150 markets.

Despite its efforts to grow the company, GM Daewoo, like its parent company in the United States, suffered heavy losses during the 2008 global financial crisis; sales dropped amid currency-related losses and a drop in global demand. The downturn left GM to seek loans from governments around the world, including KDB, in an effort to keep the company afloat both in Korea and around the world. Lending between mutual investors is traditionally kept secret from the public, but KDB routinely went public about its dealings with GM, often times leaking erroneous info about the financial health of the company in an effort to turn public opinion against the company. The bitter battle between the KDB and GM Daewoo would continue for many months until the two finally reached an agreement on December 1, 2010, after months of negotiations. According to the Associated Press and Agence France-Presse, the agreement will require GM to guarantee redemption of GM Daewoo's preferred shares held by local (Korean) creditors. GM is also required to share licenses with its South Korean unit for vehicles they jointly develop. Under the agreement, KDB will have a greater say in GM Daewoo's management with the appointment of three outside directors to GM Daewoo's board. KDB will also have veto rights over GM Daewoo's management decisions. As part of the new arrangements, the stake limit for this right was lowered to 15 percent from the previous 28 percent.

GM's dealings with Daewoo from 1984 to 1991 and again since 2001 demonstrate the best and worst of FDI in Korea. Although the new GM Daewoo proved to be far more successful than its predecessor, GM was not without its share of problems in Korea. Despite its success in designing, manufacturing, and selling automobiles, U.S.-based GM fell victim to a game of entrapment with government-owned KDB and hostile misrepresentations of its management. Furthermore, GM's relationship with KDB was always tenuous at best. KDB extended a $2 billion credit line to GM as part of the initial deal to create the new JV in 2001. The latest deal allowed government-owned KDB veto rights and three positions on the board of directors. Although GM was in need of a capital infusion that only the Korean government seemed to be able to provide, the onerous provisions of that capital seem to cripple GM's future corporate flexibility. Although the U.S. government took full corporate ownership of GM in 2009, the scope of its investment to save GM justified the provisions of the deal. With only a 17 percent stake in GM Daewoo, KDB's terms far exceed the scope of its investment, and the deal does not seem to have the corporation's best interests in mind, but those of the Korean government.

Although GM's foray into the Korean market has been fraught with difficulty, the fact that it has endured this long demonstrates what it truly takes to succeed as a foreign investor in Korea. For starters, it takes great patience; GM's negotiations with KDB dragged on for the better part of two years. It requires resolve to succeed despite past failures. And finally, it requires wedding a company to a single market, and staying in the game no matter the circumstances. The semi-success of GM Daewoo shares none of the characteristics of MetLife's successful foray into the Korean market. GM Daewoo could not tap into and improve its workers in any systematic way—the worker's union was just too entrenched, and powerful enough to resist any real professional development. The company also failed on the macro-level by failing to take full advantage of Korea's then-booming automobile industry and automobile export market because of Daewoo's own failing before the JV with GM. All told, the GM Daewoo JV could not, or chose not to, capitalize on the macro- and micro-level opportunities afforded to them

V. CASE STUDY 3 (FAILURE): LONE STAR FUNDS

The most famous failure of FDI in Korea is the case of Lone Star Funds' acquisition of Korea Exchange Bank (KEB) in 2003. Arthur Alexander has meticulously examined the chronology of Lone Star's troubles in Korea in his paper "Policy Implications of Korea's Low Level of Foreign Direct Investment," and I will merely summarize and update the Lone Star case to reflect the continued problems with private equity funds in Korea.

In 2003, Lone Star Funds, a mid-cap private equity firm based out of Dallas, purchased 70.9 percent of the distressed Korea Exchange Bank (KEB) for $1.2 billion. KEB was a product of Korea's push towards liberalization in the late 1980s and early 1990s, and like other South Korean banks that were privatized during that period, suffered when the loans it made to the *chaebol* were defaulted on during the buildup to the Asian Financial Crisis. Similar to other private equity firms doing business in Korea at the time, and along the lines of all private equity firms, Lone Star identified an undervalued company with sound economic fundamentals that had fallen on hard times. Lone Star would restructure the company, eliminate its nonperforming loans, and sell the company for a profit once the two-year moratorium expired in 2005.

Lone Star swiftly employed Western-style corporate restructuring practices, cutting four hundred jobs and overhead expenses, mostly by closing nonperforming branches, and updating technology. With the global economy booming and Korea's renewed exposure to international capital, Lone Star quickly turned KEB into a profitable company. By summer 2005, the *Wall Street Journal* reported that KEB's ratio of bad loans to total loans fell to 1.32 percent, easily making it a healthy and profitable asset for Lone Star to unload. The outlook looked bright as the two-year moratorium on divestment was set to expire in October 2005 and Lone Star was primed to gain a healthy return on its investment.

Lone Star's problems began to surface almost as soon as KEB recovered from its malaise and began earning profits. After many years of watching foreign firms earn profits from Korean companies, the Korean government slowly realized that it was not receiving taxes from foreign firms' purchase of Korean companies during the Asian Financial Crisis. The reason for the loss of tax revenue was that Korea had signed bilateral tax treaties banning dual taxation, which allowed foreign companies to be taxed only in their home country. Most foreign firms, including Lone Star, created subsidiaries in these countries to take advantage of the loophole. By April 2005, Korean tax authorities began questioning Lone Star's financials, and soon they began raiding Lone Star and other foreign private equity firms in Korea, eventually culminating in $200 million in tax penalties and indictments for personal tax evasion against Lone Star executives.

However, the nightmare for Lone Star would not end there. In February 2006, National Assembly members began pushing the "independent" Board of Audit and Inspection (BAI) for further investigations into Lone Star's original 2003 purchase of KEB. At the local level, the Seoul district prosecutor's office launched a probe into Korean government officials and KEB executives for allegedly accepting bribes and committing fraud in an effort to unload the then-failing company. Prosecutors further alleged that KEB and Lone Star executives conspired with government officials to undervalue the company so as to avoid regulations in the initial sale of the bank. Lone Star would also come under attack from its own workers when the KEB union organized several rallies to protest Lone Star's sale of the bank. Despite the investigations and negative publicity, Lone Star reached an agreement with Kookmin Bank to sell three-quarters of KEB's shares for $7.8 billion. The sale, if completed, would return a huge profit for Lone Star and would be the country's largest acquisition ever.

The good fortune would not last long, as Lone Star's legal troubles began hampering Kookmin's due diligence research of KEB and Lone Star, and the bank hinted that it might delay, or even cancel, the original agreement to take over KEB. In May 2006, the Seoul city government announced its plan to revise certain tax treaties in an attempt to tax the capital gains of all foreign companies owning local firms. In addition, the National Tax Service launched a nationwide audit of all foreign companies. Nearly 5,000 companies fell under the probe.

So by May 2006, current and former Lone Star executives were under indictment, the firm was under investigation for manipulating financial data, and the government was attempting to collect taxes that had been protected under tax treaties. Moreover, the government was attempting to rewrite bilateral tax treaties and was auditing the books of nearly 5,000 foreign companies. Lone Star's sale of KEB to Kookmin would eventually fall apart due to the legal investigations, but Lone Star's prosecution would continue for many more months to come.

Lone Star would eventually find a new suitor in the British giant HSBC and confirm a deal to sell KEB's remaining shares for $6.3 billion. However, Korea's regulatory agencies refused to approve the sale while Lone Star was under investigation. Lone Star's legal woes would continue into late 2008, by which time the financial crisis took full hold on the global economy and HSBC announced that it was abandoning its pursuit of KEB after failing to renegotiate a lower price to reflect the new economic climate.

It was not until late November 2008 that a Seoul court ruled the sale of KEB to Lone Star was legal and the firm was finally cleared of its legal and regulatory woes. Since the ruling in late 2008, Lone Star has been unable to divest its shares of KEB and has been searching for potential buyers. In March 2010, Lone Star renewed its discussions with Kookmin bank to purchase KEB for $3.9 billion, but the Korean government's attempt to sell its 57 percent share in Woori Finance Holdings (Korea's largest financial firm) overshadowed the sale and hampered Lone Star's ability to generate interest in the smaller KEB. Since then, the Australia and New Zealand Bank Group (ANZ) and Korea-based MBK Partners have expressed interest and are conducting due diligence.

The troubles of Lone Star's foray into Korea worried many foreign investors and no doubt played a role in the massive FDI exodus from 2006 to 2010, as chronicled by a December 2007 Heritage Foundation report and comments by then American Chamber of Commerce president Tami Overby. A 2008 *Los Angeles Times* survey on the Lone Star case reported that foreign investors worried about the way in which investigators from the Supreme Prosecutors' Office fed a steady stream of insinuations about corporate malfeasance to the Korean media, stoking nationalist resentment against foreign investors. Investors additionally accused the prosecutors of harboring a grudge against foreign private equity firms.

VI. CONCLUSION

President Lee's efforts to increase FDI in Korea demonstrate the serious commitment of Korean political leaders to build their country as an attractive investment destination and Northeast Asia hub. Yet despite their efforts, Korea is still not among the premier destinations for international investors. The desire of top political leaders and policymakers of all stripes to attract investment is chronicled here in this paper and in many others. As Alexander noted, the institutional framework to attract such investment has grown stronger every year since 1998; return on investment is comparable with other Asian countries, and Korean assets have become cheaper since the global crisis began. Yet, investors have consistently chosen other Asian countries over Korea.

The Economist Intelligence Unit's 2010 *Country Commerce* report on South Korea further states that "despite government attempts to create a more foreign-friendly investment environment, South Koreans regularly voice concern about foreign takeovers of domestic companies." This is in many ways similar to the claims made in the EIU's 2007 report that Korean government bureaucrats still hold an apparent de facto negative attitude toward foreign involvement in Korea's economy: "The government's attitude towards foreign trade emphasizes exports and slow liberalization of imports. This attitude remains deeply ingrained in the outlook of the government and the country despite continuing globalization and liberalization."

As seen earlier, it is not for a lack of effort that FDI in Korea remains at a historic low. Key Korean policymakers have taken major steps to address the concerns of foreign investors, including incentive structures for government bureaucrats who promote FDI. However, the government can do little to change the Korean public's suspicions of foreigners and foreign investment. It has essentially created its own worst enemy with its loan-based command economy favoring domestic industries and is now finding it difficult to reverse decades of aversion to foreign investment. FDI in Korea is still at times subject to insufficient regulatory transparency; inconsistent, ad-hoc changes in the interpretation of regulations by lower level bureaucrats; underdeveloped corporate governance; and the lingering remains of economic domination by the remaining national economic champions, the *chaebol.*

In private interviews, foreign business leaders operating in Korea acknowledged the disconnect between top-level policy and bottom-level implementation. Some business leaders explicitly referenced earnest high-level Korean officials who truly want to correct Korea's FDI imbalance. However, many were quick to point out lower-level bureaucrats' failure to understand the increased competition from other Asian economies, especially cheaper labor throughout the rest of Asia. These leaders also cited these factors as the main impediments to correcting South Korea's FDI problem: Korea's difficult labor relations; sudden regulatory changes without advance notice; constantly shifting safety standards; and the remnants of Korea's old command economy personified by a combination of national and local implementation and interpretation. Many were also quick to point out that news about Korea does not reach Western companies that often, and that when it does, it is usually a negative story about one of these issues. Western CEOs see the negative news of the few brave companies to enter Korea and choose to invest elsewhere, knowing that they will receive a higher return on investment without the headaches.

Many of these business leaders' complaints about the Korean market are personified in GM's and Lone Star's dealings in Korea. Indeed, GM and Lone Star serve as important warning signals for foreign firms planning to enter Korea. The failure of Lone Star, the partial success of GM Daewoo, and the success of MetLife demonstrate how imperative it is for foreign investors to build support through Korean society and government. It is important to cultivate relationships with the lower-level agencies, such as the FSS, KDB, and the district prosecutor's office, no matter what the national government puts forward. In the successful case of MetLife, the company was able to paint itself as a "Korean" company by launching its "professional agency force" and cultivating local talent, and creating a perception of MetLife as a responsible "Korean" stakeholder. This had the double effect of heading off any potential labor disputes and setting the market standard for labor, which other insurance companies soon adopted. MetLife also inadvertently benefited from the creation of the FSS and the overall regulation of the insurance market. The impact of the FSS's membership in IAIS cannot be overstated. The FSS could not impose inconsistent ad-hoc regulations at any level, provide insufficient transparency, or use poor corporate governance, because of the uniform international standards set by IAIS. GM and Lone Star were not as fortunate.

Despite great improvement in Korea's FDI framework, this paper has pointed out numerous areas where the Korean government should improve if it is to rehabilitate its image as an investment destination. The complaints of current business leaders and the cases listed above prove that foreign perceptions matter, and the Korean government must take radical steps to change these perceptions. Many of these problems, such as the militant labor unions, are a structural feature of the Korean economy itself, and policies to increase FDI will do little to solve them. It seems that the Korean economy as a whole must adjust to its new geopolitical reality as a "nutcracker" position between China and Japan in order to truly stimulate FDI and advance its economy to the next level. As this paper has demonstrated, the desire to attract investment is there, but the will is not.

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