Investment Down, but More Free Trade in Korea's Future

by *Troy Stangarone (ts@keia.org)*

After a record year in 2004 that saw foreign direct investment (FDI) inflows to Korea increase by 97.7 percent, 2005 saw a step back with a drop of nearly 10 percent, from $12.8 billion to $11.6 billion. According to the Ministry of Commerce, Industry, and Energy (MOCIE), a combination of high oil prices and a strong won discouraged foreign companies from investing in the Korean economy. However, a reduction in FDI was not unexpected, as the government had cut a tax reduction period for foreign investors from ten years to seven beginning in 2005. Other experts have noted that it is also a reflection of the magnet China has become for FDI in the region.

While there was a year-to-year drop in pledged FDI, MOCIE noted that, through the first 10 months of reportable data for 2005, actual implemented foreign investment was running at nearly 83 percent of previously stated investment plans. This reflected an actual investment in the Korean economy of $6.8 billion for the period of January to October.

There was also year-to-year growth of 19.3 percent in the number of FDI cases to 3,666 total cases. Medium and small scale investments—investments with a value of less than $100 million—also expanded, with small scale investments seeing a rise of 2.4 percent and medium scale investments rising by 24.6 percent.

According to MOCIE, the prospects for the current year show FDI levels remaining around their historical average of $11 billion. MOCIE also cited the strong competition for FDI in the region as an additional factor for a leveling off of FDI in Korea.

Large Fluctuations in Sectoral FDI

The services industry saw a strong boost in FDI for 2005, with an increase of 35.2 percent, as telecommunications services, real estate, and financial services pulled in foreign investment. In contrast to the services sector, the manufacturing sector saw FDI fall off 50.5 percent from the previous year. Despite the decline in manufacturing investment, auto parts, telecommunications equipment, and aerospace continued to see strong levels of investment.

EU Investment Rises while U.S. and Japanese Investment Drops

For 2005, the largest source of FDI came from the European Union, which committed $4.78 billion, up 58.9 percent from the previous year. FDI from the United States fell 43 percent from the previous year, to $2.69 billion. FDI from Japan also decreased in the last year, but by a smaller amount (16.8 percent), to $1.88 billion.

Potential United States-Korea Free Trade Negotiations Clear Important Hurdles

After much speculation, it appears that the United States and Korea are close to entering into negotiations for a free trade agreement. In late January, U.S Trade Representative Robert Portman stated that he hoped negotiations would begin soon, but emphasized that there are still issues to be discussed. Ambassador Portman's comments were preceded a week earlier by positive comments from Korea's President Roh Moo-hyun in his New Year's speech. In that speech, President Roh, while discussing the various FTA agreements that Korea is pursuing, stated that "We also have to conclude one with the United States for the future of our economy."

While both sides have expressed optimism, they have also acknowledged that there are issues to be resolved before deciding to begin negotiations. Those issues have often been believed to be the return of U.S. beef to the Korean market and a reduction in the Korean film screen quota. In January, announcements were made on both of these issues. Seoul announced that it would begin accepting new imports of boneless beef from cattle 30 months and less in age from the United States in March. Subsequently, it announced that the screen quota for the number of days that theaters are required to show domestic movies would be reduced from 146 to 73 days.

A free trade agreement between the United States and Korea would offer both the opportunity for economic gains and a deepening of the strategic alliance between the two countries that has existed for more than five decades. If signed, Korea would represent the third largest trading partner, behind Mexico and Canada, with which the United States had entered into an FTA. For Korea, the United States would represent the largest trading partner with which it would have an FTA. However, Korea is currently pursuing FTAs with a wide range of states and organizations, including Japan, Canada, India, Mexico, Russia, MERCOSUR, China, the EU, and ASEAN.