

Foreign Investors Are a Progressive Force

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Foreign investment in South Korea has never been high. For decades, the government pursued policies that successfully impeded foreign investment. Even when foreign firms managed to invest in South Korea, they were typically relegated to minority stake joint ventures with Korean partners. These policies were in part an understandable response to the country's colonial history and fears that if the economy were opened widely to foreign investors, the country's assets would be bought up wholesale by Japanese investors.

But this is not the whole story. The state-led development strategy required that firms be responsive to government dictates. The bureaucrats rightly feared that foreigners would be less pliable than their domestic counterparts and thus required exclusionary laws and regulations to marginalize foreigners. The model was successful during the catch-up phase when the path ahead was clear but began to falter and ultimately failed as the economy approached the world technological frontier, which required more far-sighted and agile decision-making from financiers, corporate managers, and government officials. Yet this approach appears to have inculcated in Koreans attitudes toward inward foreign investment that could pose a real risk to the country's economic future.

Nearly a decade after the financial crisis, the Korean economy seemingly has not escaped the clutches of a model formulated two generations ago under very different circumstances. Instead of coming to resemble ever more closely the other rich industrial economies of the Organization for Economic Cooperation and Development (OECD), Korea faces dwindling inward foreign investment. Why?

There are obvious reasons that have to do with Korean labor markets and other institutional characteristics. Problems in the labor market both discourage foreigners from investing in Korea and encourage Korean firms to establish operations elsewhere. The Korean legal system makes foreign executives criminally liable for a much broader range of behavior than elsewhere. Tax provisions further discourage expatriate managers to locate in Korea.

But what is more worrisome is that these specific manifestations may reflect xenophobia that is encouraged by dominant institutions of Korean society.

Consider some survey evidence on chauvinism. In 2002, pollsters from the Pew Survey on Global Attitudes interviewed more than 40,000 people in 46 countries around the world on a variety of issues. One of the questions they asked was whether respondents agreed with the statement that "our people are not perfect, but our culture is superior to others."

The results make for interesting reading. Consider the case of France, a country with a reputation for cultural chauvinism: When asked this question, 40 percent of French people mostly or strongly agreed with the sentiments of the statement. In Russia and the United

States, two countries known for strong nationalism, 60 percent responded affirmatively. In Japan, the share was even higher, 75 percent. In Korea it was a whopping 90 percent, the highest score of any country in the sample, half again as high as in the United States.

Paradoxically, while an astonishing share of Koreans apparently feel culturally superior to the rest of the world, they also apparently lack confidence in that culture's resilience—five out of six Koreans think that it should be protected from foreign influence.

The problem for Korea is that these attitudes are not associated with economic success. Instead they are red flags to foreign investors who wonder if such views are indicators of the type of reception that they are likely to receive from government officials, their employees, their suppliers, and their customers. For Korea, transformation of these attitudes could result in economically meaningful increases in foreign investment.

Unfortunately it is not self-evident how public policy can encourage the public to be more tolerant or less xenophobic or to take a more positive view of change, especially change emanating from foreign sources. Perhaps Korean politicians and journalists could start by adopting the policy equivalent of the Hippocratic oath: "first, do no harm."

While it is understandable that Koreans of all stripes are concerned about reports that foreign investors such as Newbridge Capital have exploited aspects of Korean tax treaties to avoid taxation, the appropriate response is to close the loopholes. Describing foreign risk-takers as "vultures" is reminiscent of German politicians' descriptions of foreign investors as "locusts." German economic performance is nothing to be envied.

Recent research suggests that there is a two-way relationship between individual attitudes or preferences and local policies and institutions. Local practices influence individual's perceptions of the world, and individual's beliefs condition the politically acceptable bounds of policy. Because of the self-reinforcing nature of this feedback loop, change comes only slowly. Once established, it can take generations for local beliefs to converge towards broader international norms. This observation raises the possibility that Korea could be facing a situation in which the reputation-derived "Korean discount" acts as a semi-permanent self-reinforcing drag on Korean economic performance.

So while bemoaning the mega-profits registered by Newbridge Capital, Koreans should keep in mind that Newbridge took an enormous risk when it invested in Korea—something that Korean investors were unwilling to do—and turned around a failed Korean institution. The Korean taxpayer, through the government's ownership stake in Korea First Bank, has been a prime beneficiary.

A similar story could be told of Daewoo Motors, once part of the fraud-ridden failed Daewoo conglomerate, which has been revitalized by General Motors. To the benefit of Korean consumers, the resurrection of Daewoo Motors also has returned a modicum of competition to the Korean car market, which had become a virtual monopoly of Hyundai.

Given the structure of the Korean economy, foreign investors, however self-interested, are a progressive force: They bring new technology, more professional styles of management; they act as a natural check on the still opaque family-dominated *chaebol*; and they are less amenable to manipulation by a state apparatus that still seeks to dominate. Instead of being demonized, they should be praised. The Korean government will not achieve its cherished goal of transforming Korea into a regional business hub without them.

Figure 1 Direct investment in Korea

