Providing Foreign Investors With Effective Incentives

With the liberalization of cross-border trade and investment, countries worldwide strive to attract foreign direct investment (FDI) to achieve sustainable economic development. As the development stage and economic situation of each country vary, governments carry out systems and incentives for FDI tailored to their circumstances. Developing countries opt mainly to provide tax support to advance the industrial structure, and some countries aiming to establish large-scale infrastructure focus on providing site location support, such as for the construction of an industrial complex. Developed countries boast a well-developed cash grant system to pursue balanced regional development.

In the wake of the Asian Financial Crisis in 1997 and 1998, Korea shifted its FDI policy approach from passive to active. To this end, the Foreign Investment Promotion Act was enacted, under which incentives including tax support and local site support were introduced. In 2004, Korea introduced a cash grant system as an incentive for strategic investment promotion. By introducing the cash grant, often called a developed country-type incentive and one used as a means of strategic FDI inducement, the Korean government adopted and implemented most of the standard investment incentives. Ten years later, though, there arose a need to improve the system so that it reflects and is in keeping with the many changes in Korea’s investment environment.

For a decade, Korean law had prohibited a foreign-invested company that had been given a cash grant from receiving additional financial support, seeing this as a double benefit. In the calculation of cash grant limits, if a foreign company provided with rented land, including a complex-type foreign investment zone, applied for a cash grant, site creation costs covered by the government were included in the cash grant limit. In the early stage of cash grant implementation, companies that had been operating in Korea and owned a land site did not encounter difficulties calculating the cash grant amount. But for companies that rented land, the site creation cost exceeded the cash grant limit, given the high land prices of Korea. As a result, they were unable to receive a cash grant. In other words, foreign companies wishing to come to Korea needed to first secure a site for business and faced limitations applying for a cash grant.

At the request of local governments and foreign investors, the Office of the Foreign Investment Ombudsman (OFIO) asked that the Korean government reform the cash grant system to take into consideration present-day issues and offer effective cash grants. The OFIO said it would be more reasonable to include the amount of the reduced rent (investors receive such related benefits when moving into a rented site) in the cash grant limit in order to prevent double incentives. In response, the government revised the Operation Guide for the Cash Grant System as of December 3, 2014 to mandate that in cases where rented land has been provided, the amount of reduced rent during the investment project period to be covered by the cash grant shall be included in the cash grant limit.

With the Korea-China free trade agreement set to go into effect this year, the Korean government has set key policies to attract FDI in promising areas based on the platform of the pact. Also, the government will provide differentiated incentives to foreign-invested companies based on their contributions to job creation, technology transfer and industrial sophistication. As a part of these government efforts, the newly streamlined cash grant system will help Korea better promote FDI.

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