

Regional Headquarters Inducement Strategy of South Korea's Free Economic Zones: The Pursuit of a Premier Business Hub in Northeast Asia*

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South Korea's ambitious plan to be a premier business hub in Northeast Asia, one of the main goals of which is to become a regional headquarters (RHQ) center, has sparked great interest in the Incheon Free Economic Zone (IFEZ). However, since the FEZ was established, its RHQ inducement strategy has been lackluster, as it has failed to attract targeted RHQs. The results of this paper have important implications for developing countries pursuing an RHQ inducement strategy through free economic zones (FEZs). The IFEZ policy has focused on overcoming the problems hindering the achievement of its goal of becoming a business hub for Northeast Asia through an RHQ inducement strategy.

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*The author thanks Boroo Zuzaan and two anonymous reviewers for their contributions. This work was supported by the Konkuk University.

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KEYWORDS: Incheon Free Economic Zone; Northeast Asia business hub; regional headquarters; regional headquarters inducement environment; foreign direct investment policy.

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Nine years have passed since the establishment of the Incheon Free Economic Zone (IFEZ) in South Korea in 2003. The IFEZ is located thirty-five kilometers west of Seoul. It occupies an area of 209.4 square kilometers across three regions (Songdo [松都], Cheongra [青羅], and Yeongjong [永宗]), and enjoys many geographical advantages. The IFEZ is a national level development project, and its purpose is to contribute toward the achievement of a Northeast Asian business hub.

South Korea's economy experienced a period of economic growth in the 1970s and 1980s, achieving a growth rate of 9-10 percent. However, after the end of the 1990s, manufacturing industry located in the northeast of the country faced increased competition from China in terms of cheap labor and from Japan in high-technology fields. As a result, the South Korean government drew up a new development strategy for the twenty-first century that was aimed at enhancing national competitiveness by developing new technologies, improving the industrial environment, and developing advanced multinational corporations.¹ The South Korean government named this new policy the "Northeast Asian Business Hub Strategy."² Through this policy, South Korea aims to become a regional hub for logistics, multinational corporations (MNCs),³ and finance in Northeast Asia. South Korea's Ministry of Finance and Economy selected the free economic zone system as a key policy measure to achieve this new

¹You-Il Lee and Michael Hobday, "Korea's New Globalization Strategy: Can Korea Become a Business Hub in Northeast Asia?" *Management Decision* 41, no. 5 (2003): 498-510.

²The Government of the Republic of Korea, *Dynamic Korea—A Nation on the Move* (Seoul: Economic Policy Bureau, Ministry of Finance and Economy, 2004).

³A regional business hub is a place where the RHQs of MNCs are clustered. Chang-Jae Lee, *Korea's Strategy for Becoming a Northeast Asian Business Hub: Based on Case Studies of Major Business Hubs* (Seoul: Korean Institute for International Economic Policy, 2002): 123-36.

vision. In developing countries, FEZs are recognized as an efficient way to construct an advanced infra-system in a specific area within a short period of time.

In 2003, the South Korean government designated three free economic zones (FEZs): Incheon (仁川), Busan/Jinhae (釜山/鎮海), and Gwangyang (光陽). Among them, the IFEZ has the most advantages in terms of operating as an RHQ center. Incheon is located near Seoul, a financial center with a good supply of highly qualified research and development (R&D) human resources,⁴ and it has an ideal logistics base. These conditions aid the coordination, control, and business planning functions of the RHQs of MNCs.⁵ As a hub for RHQs, the IFEZ aims to attract the Northeast Asian business headquarters of more than three hundred firms by 2014.⁶

When the South Korean government announced the establishment of the IFEZ in August 2003, local governments in underdeveloped regions of South Korea expressed concerns that South Korea's FEZ policy, which favored regions adjacent to the Seoul metropolitan area, might hinder efforts to develop South Korea in a more balanced manner.⁷ Despite such concerns, the central government has invested huge amounts of capital in the IFEZ. The key driving force behind the government's interest in the

⁴Shanghai gives companies better access to local and international talent. This is Shanghai's second advantage as an RHQ location, next to the advantage of market proximity. Shanghai, with its international and metropolitan appeal, is increasingly attractive to highly skilled professionals from Hong Kong, Singapore, and even London and New York. The IFEZ is less attractive to highly qualified local and international talent. Even in Shanghai there is still a shortage of senior international managers with sufficient Asian and Chinese market knowledge and language skills. *European Union Chamber of Commerce in China, European Business in China: Asia-Pacific Headquarters Study* (Beijing: European Chamber, 2011): 23.

⁵The tasks performed by RHQs include any combination of the following: financial operations, data management, telecommunications, research and development (R&D), accounting, logistics, and marketing. Phillippe Laserre, "Regional Headquarters: The Spearhead for Asia Pacific Markets," *Long Range Planning* 29, no. 1 (February 1996): 30-37.

⁶"IFEZ Strives to Become the Hub of Northeast Asian Business." <http://www.forbescustom.com/EconomicDevelopmentPgs/IFEZ.html> (accessed April 11, 2012).

⁷Sung-Hoon Lim, "FDI Inducement Strategy of Incheon FEZ for Northeast Asian Business Hub: The Past, the Present, and the Future," *Incheon Studies* 1, no. 1 (2007): 47.

IFEZ is the intense competition with other Asia-Pacific countries for foreign direct investment (FDI) to meet South Korea's needs in a globalized world.⁸ Asia-Pacific countries, including Singapore, Hong Kong, China, and Malaysia, have long competed to achieve advanced economic systems through FDI, particularly through programs intended to attract the RHQs of the multinationals. Singapore was the first to establish itself as an RHQ location, launching its regional headquarters scheme in 1986. Malaysia announced its RHQ inducement plan in 1991, and in 1995, it promised to provide an attractive package of fiscal and non-fiscal incentives to companies locating their RHQs in Malaysia. In 2001, Shanghai enhanced its incentives to foreign firms that established an RHQ in the city by adding to its existing RHQ inducement measures. Hong Kong has for decades made efforts to establish itself as a global financial center by offering a variety of business services and professional support services.

A question then arises: how has South Korea fared in terms of attracting RHQs to the IFEZ? The results of the present study, using FDI inducement data of the IFEZ from August 2003 to May 2009, indicate insufficient progress. Since its establishment in 2003, the IFEZ has not been able to attract any RHQs.

This study examines the problems associated with the RHQ inducement program within the IFEZ, and presents policy suggestions for the South Korean government, as well as other developing nations wishing to explore similar strategies. In the following section, I review the present status of the IFEZ's RHQ inducement efforts aimed at becoming a premier Northeast Asian business hub. In the third section, I compare the RHQ inducement environment of the IFEZ to those of other major Asian nations, and address the RHQ inducement issues within the IFEZ. In the fourth section, I offer policy suggestions that may resolve the current issues surrounding the IFEZ. The conclusion summarizes the main findings of this study and suggests policies that may help attract RHQs to the IFEZ in the future.

⁸The competitive environment stimulated the South Korean government and the whole country to take action. Lee and Hobday, "Korea's New Globalization Strategy," 498-510.

Table 1
FDI Inducement by the IFEZ

Sector	Total number of FDI projects	Total construction budget (a)	Amount of FDI based on MOUs (b)	The amount of FDI arrived (c)
Infrastructure construction	8	52,988.6	6,293.1	207.07
Manufacturing operations	22	980.5	320.7	274.2
Education facilities (school/research institute)	0	0	0	0
Total	30	53,969.10	6,613.80	481.17
Percentage	–	(c)/(a)×100 = 0.9%	(c)/(b)×100 = 7.4%	–

Note: Measured in million USD (as of June 2009 in the stock level).

Source: Incheon Free Economic Zone Authority (IFEZA), *Current Situation and Future Outlook of the IFEZ's FDI Inducement* (Incheon: IFEZA, 2009).

RHQ Inducement Performance of the IFEZ

As of June 2009 (in the stock level), the IFEZ had attracted US\$481 million in FDI, representing thirty projects on a contractual basis and eighteen on a memorandum of understanding (MOU) basis. Of the US\$481 million, US\$201 million (eight projects) was invested in infrastructure development, and US\$280 million (twenty-two projects) was in manufacturing operations. There were no R&D projects (see table 1). The total amount of FDI in the IFEZ was only 7.4 percent of the total expected amount (US\$6.6 billion) indicated on MOUs and contracts, meaning that only a small fraction of the expected amount of FDI was realized (as of June 2009 in the stock level).⁹

Aside from the small amount of FDI, the most serious problem is that the IFEZ has failed to attract any RHQs. This record is extremely poor, especially when compared to Hong Kong (1,298 in 2008), Shanghai (223 in 2008), Malaysia (388 in 2008), and Singapore (4,200 in 2008) (see table 2).

⁹Report of the Incheon Free Economic Zone, October 1, 2010, http://ifez.go.kr/invest_result_pds.do.

Table 2
The Number of RHQs Attracted by Major Asia-Pacific Countries/cities

Nation/Year	2004	2005	2006	2007	2008
Hong Kong	1,098	1,167	1,228	1,246	1,298
Singapore	202	350	415	n.a.	n.a.
Shanghai	n.a.	79	154	184	223
Malaysia	169	184	342	371	388

Source: Estimated by the author by using published references. Invest Korea, *Asian Countries' FDI Policy and Their Performance in Attracting Regional Headquarters*, FDI Report 2009-4 (Seoul: Invest Korea, 2009); Malaysian Investment Development Authority (MIDA), *MIDA, Performance of the Manufacturing and Service Sectors 2006* (Kuala Lumpur: MIDA, 2006); Singapore Economic Development Board (EDB), "Singapore: The Preferred Destination for HQ Operations," *EDB News*, January 1, 2007.

The IFEZ's lackluster performance may be due to South Korea's lack of competitiveness in terms of Asia-Pacific RHQ inducement compared to these other countries. Therefore, it is necessary to identify the problems that are reducing the competitiveness of the IFEZ as an RHQ location.

Comparison between the RHQ Inducement Environment in the IFEZ and that of Other Major Asian Nations

Identifying the problems associated with the IFEZ's ability to attract RHQs will help the South Korean government choose appropriate reform measures to facilitate the IFEZ's transformation into a viable Northeast Asian business hub. Furthermore, this could help other developing countries that are exploring similar strategies to that of South Korea. According to Boyle, "No firm will find a single ideal location. Indeed, in the first instance, the absence of any serious defect is more important than the presence of a few outstanding attributes. Average to good in all categories is most likely to keep a location in contention until the choice set is narrowed to a few potential locations."¹⁰

¹⁰M. Ross Boyle, "Corporate Headquarters as Economic Development Targets," *Economic Development Review* 6, no. 1 (January 1988): 52.

Incomplete Infrastructure and Amenities

It is very difficult to induce RHQs and MNCs while the infrastructure of the IFEZ is still under construction. Firms will only set up RHQs after the appropriate commercial structures and residential facilities have been completed. In the manufacturing sector, domestic workers can be mobilized, but many RHQ functions rely on expatriates. The IFEZ is scheduled for completion by 2020. It is being constructed in three stages: a base establishment stage (2003-2009), a development stage (2010-2014), and a completion stage (2015-2020). At present, the project is in the development stage. To date, only 55.3 percent of the planned reclamation of land from the sea for an industrial area has been completed. In addition, only 56.6 percent of the roads, 54.6 percent of the water supply system, and 57.3 percent of the sewage treatment recycling facilities are in place.¹¹ It will be difficult to attract much FDI until this work is complete, as infrastructure is a very important factor in attracting RHQs.¹²

In other parts of Asia, infrastructure development has played an important role in RHQ operations. For instance, based on the excellent infrastructure within the banking sector in Hong Kong, the RHQs of service firms located there operate like mini-banks, financing and lending to their subsidiaries, and act as consultants for purchasing foreign currency, foreign currency hedging, and taxation. And, as a result of the well-established and sophisticated logistics systems, RHQs in Shanghai and Singapore handle intrasubsidiary sales of components smoothly within the region. In the case of Kuala Lumpur, the air transportation facilities are below international standards, and this is a serious impediment to the operation of RHQs.¹³

The amenities offered by Singapore are such that it can attract large numbers of managerial-level employees who are very much concerned

¹¹http://ifez.go.kr/bus_1step.do (accessed June 16, 2012).

¹²Economist Intelligence Unit (EIU), *Business Asia* (London: EIU, 2002); Akira Aoki and Dennis S. Tachiki, "Overseas Japanese Business Operations: The Emerging Role of Regional Headquarters," *Pacific Business and Industries* 1 (1992): 26-39.

¹³Avenell Simon, "Competition for Corporate Regional Headquarters" (working paper of Asia Research Center of Murdoch University, no. 67, November, 1996), 17-19.

with their working and living conditions. Singapore's well-developed education, healthcare, and childcare systems, in particular, prove attractive to managers from overseas, while MNC employees are attracted to Hong Kong and Shanghai on account of the easy access to international products, swift and convenient administrative processes, and the strong presence of Western culture, restaurants, and entertainment in these cities. Although the IFEZ has been trying to improve its environment to satisfy such needs, it still lags far behind Singapore and Hong Kong.¹⁴

Overlap in FDI Inducement Strategies of FEZs

Since 2003, South Korea has designated six FEZs. Incheon, Busan/Jinhae, and Gwangyang were established in 2003; three more zones, the Yellow Sea, Daegu-Gyeongbuk (大邱慶北), and Saemangeum/Gunsan (萬金/群山) followed in 2008. As of 2009, only 30-40 percent of the work on the first three FEZs was complete.¹⁵ This meant that the additional three zones were designated before the first three were completed, resulting in an overlap in their functions. FEZ policies, driven mainly by politics, ultimately led to an overlap in the MNCs targeted by the six FEZs. The FEZs targeted similar kinds of MNCs, such as those in the high-tech, logistics, tourism-leisure, and manufacturing sectors.

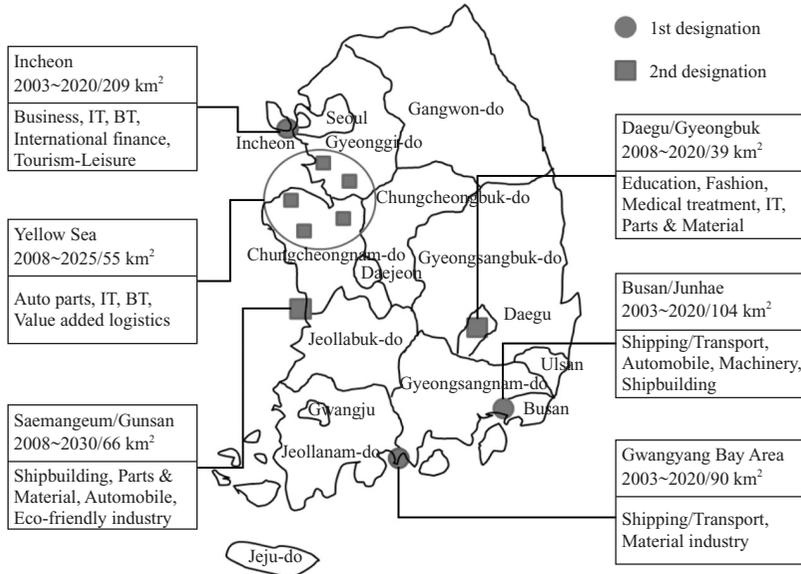
Major Asian locations pursue different FDI inducement strategies to leverage their attractiveness as RHQ locations. In the 1990s, almost 90 percent of Hong Kong's RHQs were in services. In contrast, Singapore became a hub for manufacturing operations in Southeast Asia, with 67 percent of its RHQs in that sector. The difference was largely a result of the approaches taken by the two governments with regard to manufacturing.¹⁶ In the face of increasing operating costs, the Hong Kong government kept managerial and service operations at home, while moving manufacturing

¹⁴European Union Chamber of Commerce in China, *European Business in China*, 21-23.

¹⁵Presidential Council on National Competitiveness (PCNC), "The Activation Plan of Free Economic Zones" (paper presented at the 3rd Conference of PCNC, Seoul, May 23, 2009).

¹⁶Stephen Wing-Kai Chiu, Kong-Chong Ho, and Tai-Lok Lui, *City-States in the Global Economy* (Boulder, Colo.: Westview Press, 1997): 164-68, 170-71.

Figure 1
Industries Targeted by Korean FEZs

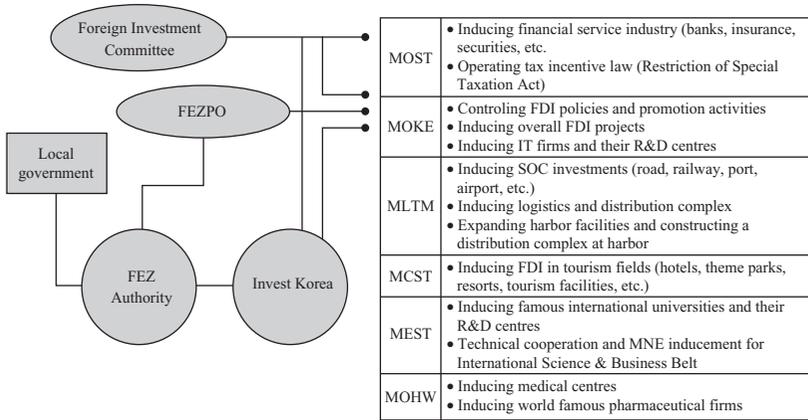


Source: Composed by the author using information from the following source: Presidential Council on National Competitiveness (PCNC), "The Activation Plan of Free Economic Zones" (paper presented at the 3rd Conference of PCNC, Seoul, May 23, 2009).

operations to China. The Singaporean government supported manufacturing by developing the requisite policies and incentive packages. Furthermore, both are currently repositioning themselves in different ways to maintain their attractiveness as Asia-Pacific RHQ locations. While Hong Kong is focusing on strengthening economic relations with China and adopting financial and cross-border trade liberalization measures, Singapore is focusing on building competitive advantages, innovation capabilities, and skilled talent in its strategic industry sectors.¹⁷

¹⁷European Union Chamber of Commerce in China, *European Business in China*, 13.

Figure 2
FEZ Authorities and the FDI Inducement System



Note: the Free Economic Zone Planning Office (FEZPO); the Ministry of Strategy and Finance (MOSF); the Ministry of Korea Economy (MKE); the Ministry of Culture, Sports and Tourism (MCST); the Ministry of Land Transport and Maritime Affairs (MLTM); the Ministry of Education, Science and Technology (MEST); the Ministry of Health Welfare (MOHW).

Duplication of FDI Inducement Activities of Authorities

An overlap in FDI inducement strategies is a serious problem, and the duplication of FDI inducement activities by several investment promotion agencies (IPAs) is another. Aside from the IFEZ authorities, other authorities participating directly or indirectly in attracting FDI to FEZs include metropolitan councils, central investment promotion agencies, the Free Economic Zone Planning Office (FEZPO), and line ministries in charge of the various industries (see figure 2).¹⁸

This duplication may make it less likely that firms will be induced to set up RHQs in the IFEZ. In the other major Asian nations, it is clear which government agencies are tasked with attracting RHQs. The key agencies in these countries are Invest HK in Hong Kong, the Economic Develop-

¹⁸Sung-Hoon Lim, "FDI Inducement Strategy of Incheon FEZ for Northeast Asian Business Hub: The Past, the Present, and the Future," *Incheon Studies* 1, no. 1 (2007): 45-63.

ment Board (EDB) in Singapore, and the Malaysian Industrial Development Authority (MIDA) in Malaysia.

Paying for Short-Term Performance

The types of industries attracted to the IFEZ are quite different from those originally targeted. The culture/entertainment industry has the highest investment ratio (22.44 percent), followed by the chemical industry (16.46 percent). Manufacturing and machinery/equipment account for 14.96 percent and 14.38 percent, respectively, and food products 14.82 percent. These results indicate that FDI performance is inconsistent with the designated purpose of the IFEZ. That is, manufacturing firms account for the largest share of the FDI, whereas firms supporting RHQ functions, such as financial services and logistics, account for a smaller share (e.g., transportation/warehousing accounts for only 1.8 percent) (see table 3).

What can be the reason for this reversal? The opponents of the Incheon Administration claim that it has focused too heavily on short-term quantitative performance (i.e., FDI inducement focusing on manufacturing sectors) and not enough on attracting firms that can help the IFEZ's transformation into a premier Northeast Asian business hub. The South Korean government and public judge the IFEZ's achievement mostly in terms of the quantity of FDI it has attracted. Thus, the Incheon Administration, under heavy pressure to perform, may have focused on short-term projects rather than those that support the IFEZ's goals. The large quantities of FDI in the machinery and transport equipment sectors have been attracted with minimum effort on the part of the Incheon Administration. Seoul and other metropolitan areas strictly regulate the expansion of existing manufacturing facilities and the establishment of new plants,¹⁹ while FEZs do not operate under these kinds of limits. With the exception of some special

¹⁹This is regulated by the Seoul Metropolitan Area Readjustment Planning Act to control overpopulation. <http://www.law.go.kr/engLsSc.do?menuId=0&subMenu=5&query=%EC%88%98%EB%8F%84%EA%B6%8C%EC%A0%95%EB%B9%84%EA%B3%84%ED%9A%8D%EB%B2%95> (accessed June 17, 2012).

Table 3
FDI Inducement by the IFEZ by Industry

Industry Type	Incheon (1998. 1~2003. 7)			Incheon (2003. 8~2009. 5)			Incheon (1998. 1~2003. 7)			Incheon (2003. 8~2009. 5)		
	Total	Ratio	Type of industry	Total	Ratio	Type of industry	Total	Ratio	Total	Ratio	Total	Ratio
Public Service	177,000	0.01	Food-Products	104,000	0.03	Food-Products	96,956,000	5.16	9,452,000	14.82	—	—
Mining	42,000	0.12	Fishery	0	0.00	Fishery	—	—	—	—	—	—
Metal	33,792,000	1.87	Transport Machinery	6,550,773	0.76	Transport Machinery	450,663,000	17.74	221,868,757	7.18	48,278,554	1.76
Finance/Insurance	—	—	Transportation/Warehousing (logistics)	302,847	0.00	Transportation/Warehousing (logistics)	202,533,000	18.87	48,278,554	1.76	—	—
Machinery/Equipment	45,316,000	1.40	Restaurant/Accommodation	217,279,589	14.38	Restaurant/Accommodation	578,951,000	21.99	19,595,685	1.01	—	—
Other Manufacturing	8,288,000	2.15	pharmaceuticals	54,926,900	14.96	pharmaceuticals	30,000,000	10.91	1,187,441	0.36	—	—
Agriculture/Livestock/Forestry	—	—	Electric power/Gas	—	—	Electric power/Gas	106,046,000	4.48	42,000,000	4.66	—	—
Distribution (retail & wholesale)	59,632,000	0.76	Electricity/Electronics	82,863,725	1.22	Electricity/Electronics	340,212,000	3.57	183,085,229	2.10	—	—
Entertainment	106,565,000	2.27	Home Construction	366,972,493	22.44	Home Construction	81,000	0.21	607,713	0.86	—	—
Real estate/Rental	815,780,000	31.59	Paper/Wood	272,251,396	7.58	Paper/Wood	32,950,000	1.75	985,000	0.68	—	—
Non-Metal	16,779,000	1.12	General Construction	897,778	0.09	General Construction	—	—	25,080,266	3.83	—	—
Business Services	3,013,000	0.15	Communication	9,957,693	0.21	Communication	—	—	108,978	0.01	—	—
Textile/Fabric/Garment	40,000	0.01	Chemicals	—	—	Chemicals	18,972,000	0.46	609,030,034	16.46	—	—
Water Supply	—	—	Total	—	—	Total	2,946,788,000	4.67	2,263,336,851	3.49	—	—

Notes: Measured in US\$,%; the ratio indicates the amount of FDI attracted to the IFEZ to the total amount of FDI in Korea as a whole. Bold letters indicate the top five ranked industries in terms of FDI.

Source: Estimated by the author by using the FDI database of the Ministry of Korea Economy (MKE).

cases, it is virtually impossible for manufacturing firms to find sites for new factories in Seoul, Incheon, or other metropolitan areas.

The relative backwardness of the service and finance sectors in South Korea could be a reason for the IFEZ's poor performance in attracting FDI. South Korea has a strong manufacturing base in electronics, automobiles, and heavy industries, and a manufacturing-focused mind-set is still dominant. The country's traditional export-oriented development strategy was based on mobilizing its abundant workforce to produce manufactured goods for export to the world market. Most recently, a report by the Economist Intelligence Unit, referring to a research study on RHQs in the Asia Pacific region by Michael Enright and Edith Scott, pointed to industry-type density (i.e., a strong base of the specific industry) as a significant factor when choosing a location.²⁰ This partly explains the dominant position of Hong Kong, with its dense networks of service and financial personnel, as the major RHQ center for service sector firms. It also explains why Singapore, a leading location for manufacturing industries in the region, is a dominant RHQ center for manufacturing.²¹

Disadvantageous Position with regard to Incentives

South Korea is at a disadvantage with respect to investment incentives for RHQs, because, as a member of the Organisation for Economic Co-operation and Development (OECD), it is prohibited from using investment incentives to attract MNC capital for international banking, distribution, logistics, and RHQs.²² This has obviously restrained South Korea from implementing the kind of investment incentive system that would induce MNCs to invest in those sectors, the very kinds of investment that violate OECD norms concerning harmful tax competition.²³ This may not

²⁰Michael Enright and Edith Scott, "The RHQ Question," *Business Asia* 32, no. 25 (2000): 1-4.

²¹Economist Intelligence Unit (EIU), *Business Asia*, 43.

²²Organization for Economic Co-operation and Development (OECD), *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (Paris: OECD Center for Tax Policy and Administration, 2004).

²³See *ibid.* OECD member countries, having approved the 1998 Report, agreed that they

fully explain the IFEZ's poor performance in attracting RHQs. However, it is interesting to note that Singapore, Hong Kong, China, and Malaysia are not OECD members.

In Singapore, the EDB requires reports on yearly returns from firms to assess corporate targets in spending and employment, because it partly customizes its generous incentives on a case-by-case basis.²⁴ Kuala Lumpur also courts RHQs with well-designed incentive packages (see table 4).

Late Launch of a Business Hub Policy

South Korea's business hub policy was launched long after those of Hong Kong and Singapore, and some time after those of China and Malaysia. After the economic crisis of 1997, South Korea needed an innovation-driven growth strategy that was different from the old input-driven one.²⁵ Most studies point out that the contribution of economic inputs (e.g., labor and capital) decreased during the 1990s, and higher productivity became essential for further growth.²⁶ At the same time, South Korea attempted to meet the challenge of world economic trends, such as globalization, the rise of the Chinese economy, regional integration, and the emergence of IT and a knowledge-based economy. To address these chal-

would act collectively and individually to eliminate harmful tax practices with respect to preferential tax regimes within OECD member countries. In 2000, the OECD committee identified forty-seven preferential tax regimes in nine categories as potentially harmful. These categories were insurance, financing and leasing, fund management, banking, headquarters regimes, distribution center regimes, service center regimes, shipping regimes, and miscellaneous activities.

²⁴Kong-Chong Ho, "Competing to Be Regional Centers: A Multi-agency, Multi-locational Perspective," *Urban Studies* 37, no. 12 (1990): 2337-56.

²⁵National economies go through a number of stages of competitive development that reflect the characteristic sources of advantage of that nation's firms in international competition and the nature and extent of internationally successful industries. However, the stages do not explain everything about a country or its development process. Instead, these stages highlight those attributes of a nation's industry that are most important to rising economic prosperity. Porter divides national competitive development into four stages: factor-driven, investment-driven, innovation-driven, and wealth-driven. If a country aspires to become a developed nation, it must ultimately reach the innovation-driven stage. Michael E. Porter, *The Competitive Advantage of Nations* (New York: Free Press, 1990), 565-67.

²⁶Korean Development Institute (KDI), *The Analysis on Factor of Growth in Korea* (Seoul: KDI, 2002).

Table 4
The RHQ Inducement Environment of the IFEZ and its Major Rivals

Section	Incheon Free Economic Zone	Hong Kong	Singapore	Shanghai (Pudong)	Malaysia
Area	<ul style="list-style-type: none"> ♦ 209 km² 	<ul style="list-style-type: none"> ♦ 1,076 km² 	<ul style="list-style-type: none"> ♦ 699 km² 	<ul style="list-style-type: none"> ♦ 6,341 km² (Pudong, 522 km²) 	<ul style="list-style-type: none"> ♦ 329,750 km²
Main FDI promotion authority	<ul style="list-style-type: none"> ♦ Incheon Free Economic Zone (IFEZ) planning office ♦ IFEZ Authority 	<ul style="list-style-type: none"> ♦ Invest HK 	<ul style="list-style-type: none"> ♦ Economic Development Board (EDB) 	<ul style="list-style-type: none"> ♦ Administration Committee of Special Economic Zone/ Administration Committee of Economic Technology Development Zone 	<ul style="list-style-type: none"> ♦ Malaysian Industrial Development Authority (MIDA)
Income tax rate	<ul style="list-style-type: none"> ♦ The highest tax rate: 35% (foreigners can choose between a one-time tariff of 17% or 30% of total income) 	<ul style="list-style-type: none"> ♦ The highest tax rate: 20% (a one-time tariff of 15% for foreign firms) 	<ul style="list-style-type: none"> ♦ The highest tax rate: 20% (0~20%) 	<ul style="list-style-type: none"> ♦ The highest tax rate: 45% 	<ul style="list-style-type: none"> ♦ The highest tax rate: 27% (1~27%)
Corporate tax rate	<ul style="list-style-type: none"> ♦ 13%/25% 	<ul style="list-style-type: none"> ♦ 16.5% 	<ul style="list-style-type: none"> ♦ 17% 	<ul style="list-style-type: none"> ♦ 25% 	<ul style="list-style-type: none"> ♦ 25%
Firms paying reduced taxes	<ul style="list-style-type: none"> ♦ Foreign firms located in FEZ 	<ul style="list-style-type: none"> ♦ No tax reduction for firms 	<ul style="list-style-type: none"> ♦ Foreign firms awarded by the EDB (high technology, initial investment, etc.) 	<ul style="list-style-type: none"> ♦ All domestic and foreign firms (no reverse discrimination against domestic firms) 	<ul style="list-style-type: none"> ♦ All domestic and foreign firms (no reverse discrimination against domestic firms)

Table 4 (Continued)

Section	Incheon Free Economic Zone	Hong Kong	Singapore	Shanghai (Pudong)	Malaysia
Tax incentives	<ul style="list-style-type: none"> ◆ Exemption from corporate taxes, etc. (100%) for 3 years and a reduction of 50% for 2 years for firms in manufacturing and tourism) 	<ul style="list-style-type: none"> ◆ None 	<ul style="list-style-type: none"> ◆ Pioneer Status: exemption from corporate taxes for 5-15 years ◆ Development and expansion incentive: 13% of corporate taxes for 10 years ◆ 3.3% accelerated depreciation on initial investment for 3 years or a 50% tax deduction, etc. 	<ul style="list-style-type: none"> ◆ Exemption from corporate taxes (100%) for 2 years, 50% for 3 years (for firms in financial services, 100% for 1 year and 50% for 2 years) 	<ul style="list-style-type: none"> ◆ Pioneer Status: income tax exemption equivalent to ~70% of statutory income for 5 years ◆ Investment tax allowance: allowance equivalent to 60% of the qualifying capital expenditure incurred within 5 years
Incentives for RHQ	<ul style="list-style-type: none"> ◆ None 	<ul style="list-style-type: none"> ◆ None 	<ul style="list-style-type: none"> ◆ Tax incentives/cash grants ◆ Tailored incentive package (a corporate tax rate of 15% for up to 5 years on incremental qualifying income) 	<ul style="list-style-type: none"> ◆ Tax incentives (e.g., 15% of corporate taxes for hi-tech MNCs) ◆ Cash grants (start-up grants, rental subsidies, and sales subsidy, etc.) 	<ul style="list-style-type: none"> ◆ Tax incentives (corporate tax exemptions for 10 years) ◆ Exemption from Foreign Investment Committee Rules

Table 4 (Continued)

Section	Incheon Free Economic Zone	Hong Kong	Singapore	Shanghai (Pudong)	Malaysia
Education facilities for foreigners	<ul style="list-style-type: none"> ◆ International school ◆ Establishment available ◆ Locals allowed to enter international schools 	<ul style="list-style-type: none"> ◆ 90 international schools (government subsidized) ◆ Independent private school system (all classes in English) 	<ul style="list-style-type: none"> ◆ 22 international schools ◆ Adding private international schools 	<ul style="list-style-type: none"> ◆ 9 international schools (including Dulwich College of U.K.) ◆ Only for foreigners 	<ul style="list-style-type: none"> ◆ 48 international schools ◆ Locals allowed to enter international schools
Medical services	<ul style="list-style-type: none"> ◆ A planned foreign medical center (only for foreigners) 	<ul style="list-style-type: none"> ◆ The use of English in major hospitals. ◆ Existence of foreign-affiliated medical insurance companies 	<ul style="list-style-type: none"> ◆ The use of English in major hospitals. ◆ Free to establish or invest in hospitals (Johns Hopkins University Hospital) ◆ Expansion of government support for public medical services 	<ul style="list-style-type: none"> ◆ 16 hospitals established through joint ventures with foreign hospitals 	<ul style="list-style-type: none"> ◆ Government-sponsored medical tourism industry

Source: Composed by the author by using the following sources: *Asian Countries' FDI Policy and Their Performance in Attracting Regional Headquarters*, FDI Report 2009-4 (Seoul: Invest Korea, 2009); Presidential Council on National Competitiveness (PCNC), "The Activation Plan of Free Economic Zones" (paper presented at the 3rd Conference of PCNC, Seoul, May 23, 2009); Sung-Hoon Lim, "FDI Inducement Strategy of Incheon FEZ for Northeast Asian Business Hub: The Past, the Present, and the Future," *Incheon Studies* 1, no. 1 (2007): 45-63.

lenges, the South Korean government argues that it should become a "hub" country in the Northeast Asian economy: a logistics hub, an MNC hub, and a financial hub. In his New Year address in January 2002, President Kim Dae-Jung (金大中) announced the basic policy direction that would make South Korea a Northeast Asian business hub. The South Korean government's Action Plan to establish this hub was agreed upon in July that year. In October, the "Draft Law on Designation and Administration of the Special Economic Zones," a key piece of legislation in the business hub plan, was submitted to the National Assembly.

However, other Asian nations had already begun to develop advanced economic systems to help overcome the shortcomings in their existing industrial and economic structures so as to survive and thrive in today's globalized environment. These nations focused on achieving their goals through FDI, particularly through programs intended to attract the RHQs of MNCs and high-tech firms. Singapore's EDB was the first to promote RHQs when it launched its operational headquarters (OHQ) scheme in 1986. In 1999, Singapore introduced its national vision for enhancing its global capacity, "The Industry 21 Plan," and implemented a multinational RHQ inducement program.²⁷ Malaysia announced the "WAWASAN 2020" policy in 1991, through which it aspires to become a fully developed country by 2020.²⁸ Likewise, Hong Kong has announced a strategic FDI policy focusing on improving its industrial production capacity and promoting the rapid development of its industrial structure. China accelerated the implementation of its strategy to advance its economic system by focusing on Shanghai.²⁹

²⁷Augustine H. H. Tan, "Official Efforts to Attract FDI: Case of Singapore's EDB" (paper presented at 1999 EWC/KDI Conference on Industrial Globalization in the 21st Century: Impact and Consequences for East Asia and Korea, August 2-3, 1999) (revised August 27, 1999).

²⁸Malaysian Vision 2020 was unveiled by the prime minister, Tun Dr. Mahathir bin Mohammad, at the inaugural meeting of the Malaysian Business Council on February 28, 1991. This vision focused on Malaysia becoming a fully developed country. See Omar Abdul Rahman, "Industrial Targets of Vision 2020: The Science and Technology Perspective," in *Malaysia's Vision 2020: Understanding the Concept, Implications and Challenges*, ed. Hamid ASA (Kuala Lumpur: Pelanduk Publications, 1993), 271-99.

²⁹Kwok-Chiu Fung, Hitomi Iizaka, and Sarah Tong, "Foreign Direct Investment in China:

Lack of Deliberation on RHQ Inducement

The fact that it made a late start is not South Korea's only problem. The IFEZ was identified as a location for RHQs nine years ago, but South Korea still does not have either a system for awarding RHQ status or any related laws; in fact, there is not even an official definition of an RHQ.³⁰

Each country and city that seeks to attract RHQs defines an RHQ differently, and there are usually laws specifying administrative guidelines for attracting RHQs. Hong Kong classifies an MNC office as an RHQ if it manages its activities without any regular interference from the main HQ, and as a regional office (RO) otherwise. This straightforward definition of an RHQ can be found in Invest HK's annual statistics of FDI inducement performance.³¹ Singapore defines an office as an RHQ according to the amount of capital invested, management conditions, the level of employment and wages, and the scale of total business expenditure, among other criteria. In Shanghai, for its local operation to qualify as an RHQ, a firm must have at least US\$400 million in total assets, manage at least three subsidiaries in China, and invest at least US\$10 million in China.³² Malaysia's classification methods are similar to those of Singapore. There are three types of RHQ, classified according to their function: operational headquarters (OHQ), international procurement centers (IPCs), and regional distribution centers (RDCs).

Policy, Trend and Impact" (paper presented at International Conference on China's Economy in the 21st Century, Hong Kong University, June, 2002), 23-24.

³⁰Sung-Hoon Lim, "An Study on the Determinants of Regional Headquarters in Comparison with Cases of Hong Kong, Singapore and Shanghai," *Review of International and Area Studies* 15, no. 2 (2006): 1-25.

³¹Invest HK, *Annual Survey of Regional Offices Representing Overseas Companies in Hong Kong* (Hong Kong: Invest HK, 2009).

³²Benjamin Kroymann, "Regional Headquarters Schemes by China's Ministry of Commerce and the Shanghai Municipal Government: Differences, Limitations, and Possible Combinations," *Pierce Law Review* 4, no. 1 (2005): 67.

Policy Suggestions for the Current Problems of the IFEZ

The above comparison between the RHQ inducement environment of the IFEZ and that of other major Asian locations throws up several issues concerning the success or otherwise of the IFEZ as a destination for RHQs. Resolving these issues is likely to be necessary if the IFEZ is to succeed in the future.

Good infrastructure and amenities are important for attracting RHQs. RHQ operations are usually more heavily staffed with expatriates, and these issues are important to people who are relocating their families. Expatriates are needed because of the distinct roles of an RHQ.³³ Malecki and Bradbury claim that quality-of-life factors are the most important elements in attracting the right sort of personnel for R&D, and the right sort of personnel are the most important ingredients for the success of a firm's R&D program.³⁴ Thus, in order to attract RHQs, international schools for children, entertainment centers, and health care facilities have to be provided. The necessary infrastructure must be in place to facilitate RHQ operations. At the very least, the land on which the RHQs are to be constructed must be prepared.

Targeting and inducement strategies for RHQs cannot succeed in places that lack the basic conditions for RHQ operations. Overlapping RHQ targeting strategies lead to over-competition between local governments and inefficiency in resource allocation. Targeting foreign investors in sectors in which they have a comparative advantage would be more crucial. Busan is already the world's third-largest container port. With further expansion, Busan, along with the port of Gwangyang, could become a major transshipment hub and distribution center for Northeast Asia. Saemangeum/Gunsan FEZ should target MNCs in the new and renewable energy and future-oriented new industries because of its existing

³³Laserre, "Regional Headquarters," 30-37.

³⁴Edward J. Malecki and Susan L. Bradbury, "R&D Facilities and Professional Labour: Labour Force Dynamics in High Technology," *Regional Studies* 26, no. 2 (1992): 123-36.

manufacturing base and eco-friendly environment.³⁵

Furthermore, organizations should be assigned specific roles, and an effort should be made to make it clear which agencies are responsible for attracting RHQs. Although the South Korean government has acknowledged the performance problems associated with the duplication of efforts, there have been no central government intervention or coordination measures to address this issue.³⁶ The burden of bureaucracy is a serious impediment to MNCs seeking a location for their RHQ because it increases their transaction costs. MNCs appreciate coordination between different regulatory bodies in order to preclude unclear or contradictory guidance and regulation.³⁷

It is difficult for any country to achieve its economic goals in the short term. Rather than rushing to make short-term achievements, the IFEZ authorities should monitor and evaluate their RHQ inducement activities, and reflect on their findings. An important rule here is that "if you cannot measure it, you cannot manage it; and what gets measured, gets improved."

The disadvantageous position that South Korea faces in offering incentives could be another issue. However, this may not fully explain the IFEZ's poor performance in attracting RHQs. Evans points out that tax concessions, such as those offered under the OHQ scheme in Singapore, can create taxation complications for the firms concerned.³⁸ Furthermore, Perry claims that the OHQ scheme does not seem to have had a major impact on firms' choice of Singapore for the location of their RHQs.³⁹ The failure of government incentives to significantly influence location selec-

³⁵Dong-Ryal Kim, "A Poor Record of FDI Attraction and Revitalization Issue," *Hyundai Research Institute Economic Weekly* 10, no. 38 (2010): 15.

³⁶Presidential Council on National Competitiveness (PCNC), "The Activation Plan of Free Economic Zones" (paper presented at the 3rd Conference of PCNC, Seoul, May 23, 2009).

³⁷European Union Chamber of Commerce in China, *European Business in China*, 25.

³⁸Keith Evans, "Operational Headquarters in Singapore," *APTIRC—Bulletin* 8, no. 5 (1990): 158-64.

³⁹Martin Perry, "New Corporate Structures, Regional Offices and Singapore's New Economic Directions," *Singapore Journal of Tropical Geography* 16, no. 2 (December 1995): 181-96.

tion can be explained by the fact that many MNCs choose the locations of their RHQs for strategic reasons, such as ease of coordination, control, and business planning functions.⁴⁰ Host government incentives tend to be considered once the strategic importance of the region is established. In this sense, government incentives become secondary to other considerations.⁴¹ Thus, it may be more important for the South Korean government to pay attention to the main factors influencing RHQ location choice (e.g., living conditions and hard infrastructure).

Problems associated with being a latecomer could be solved if the IFEZ authorities improved their RHQ inducement activities (e.g., targeting and leads generation) and remedied weaknesses in the infrastructure and administration. However, it might still be difficult to attract MNCs from other countries, as relocation costs are likely to be heavy. In addition, they may not want to lose the advantages they enjoy in the countries in which they currently operate. Besides this, criteria for RHQs should be decided. It is difficult to develop RHQ inducement strategies and programs if it is not clear if an RHQ is operational or distributional. Fixing criteria will enhance spending efficiency and targeting performance.

Concluding Remarks

In this paper, I have examined the economic situation in South Korea where the IFEZ was designated as a center for RHQs, and reviewed the effectiveness of the RHQ inducement program of the IFEZ. In comparison to competing Asian countries, such as Hong Kong, Singapore, Malaysia, and China, the IFEZ has lagged far behind in attracting RHQs, and the South Korean government's efforts in this direction in general have failed to meet expectations.

⁴⁰Henri Wai-chung Yeung, Poon Jessie and Martin Perry, "Towards a Regional Strategy: The Role of Regional Headquarters of Foreign Firms in Singapore," *Urban Studies* 38, no. 1 (January 2001): 157-83.

⁴¹*Ibid.*, 170.

As a result of this study, several issues related to the IFEZ's poor performance as an RHQ location have been raised. Accordingly, we have suggested certain policy changes to resolve these issues.

At present, the IFEZ is at the development stage. If RHQs are to fulfill their distinct functions (e.g., coordination, support, and administration), they require well-developed infrastructure and amenities. RHQ targeting would be effective if it was focused on the IFEZ, as it has the ability to satisfy the basic requirements of RHQs. The unfavorable regulatory environment and bureaucratic burden are seen by MNCs as serious impediments when they are choosing locations for their RHQs. A proper assignment of roles among organizations and clarification of which agencies are responsible for the task of attracting RHQs are required. To date, no RHQ has been established in the IFEZ. One reason for this could be South Korea's position as a base for manufacturing industry. However, another reason may be the emphasis that the IFEZ authorities put on short-term quantitative results. Changes in such performance measurements can bring better results. A disadvantageous position with respect to incentives may not fully explain the poor performance of the IFEZ's RHQ inducement measures. It may benefit the South Korean government to pay more attention to the basic factors that affect RHQ location choice. The fact that South Korea lagged behind many other countries in launching a business hub policy may have put the IFEZ at a disadvantage as an RHQ center, but this should not be a hindrance in the long term. In addition, to facilitate the establishment of a successful RHQ inducement strategy, South Korea has to consider legislation that clarifies the identity of an RHQ; this could then be reflected in its targeting activities.

These issues are not unique to South Korea. Developing countries interested in attracting RHQs may face similar problems. Here, first and foremost, the RHQ inducement strategy has to focus on creating and maintaining promising RHQ location selection factors, and guaranteeing the normal operation of the RHQ.

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