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Inward Foreign Direct Investment in Korea: Location patterns and local impacts

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ABSTRACT

Multinational Enterprises (MNEs) decide the location of firms in accordance with political, economic, technological, and social conditions. Despite the radically increasing volume of inward FDI in Korea, little attention has been paid to local outcomes of this activity. Thus, the purpose of this research is to analyse spatial, economic and demographic outcomes at both national and Seoul metropolitan levels. Where FDI is destined nationwide and metropolitan-wide; how does spatial distribution of inward FDI vary in different industries; and what spatial impacts can be seen in the city by the flows of FDI into Korea? To answer these research questions, this research uses data of Foreign Invested Enterprises (FIEs) collected by the Ministry of Knowledge Economy of Korea. This dataset includes the location of the firms, industry types, and initial year of foreign investment from the 1960s to the 2000s. Data analysis involves the use of spatial analysis, ArcGIS and regression models. Research findings suggest that FDI tended to highly concentrate in Seoul and its surrounding provinces (called the Capital Region). This spatial concentration was strengthened in the 2000s and was more evident in producer services while manufacturing FIEs dispersed to periphery of Seoul. At a metropolitan level, FIEs appeared in major business centres of Seoul. The accumulation of foreign capital in the urban core has brought local impacts involved with vitality of economic activities and demographic changes due to close connections between donor and host countries.

Introduction

Foreign Direct Investment (FDI), a core element in global capital flows, is the outcome of corporate strategies to maximise profits in worldwide competition given deregulated institutional changes (Sun, Tong, & Yu, 2002), motivated by resource and market seeking strategies (Dunning, 1997). Sequentially, to acquire resources and capabilities, firms are eager to efficiently seek strategic assets such as technology, organisational capabilities as well as new markets (Dunning, 1997). FDI is investment usually involving a long-term relation and reflecting a lasting interest in the host country (Razin & Sadka, 2007). Thus, FDI delivers 'a package of assets and intermediate products' that include capital, technology, management skills, access to markets and entrepreneurship (Dunning, 1993). The capital invested in host countries is used for production and can involve the transfer of new technologies and management skills from foreign investors.[1]

The volume of FDI flows has risen remarkably worldwide, especially since the 1990s. The 1990s witnessed that world flows of FDI increased approximately seven-fold (Razin & Sadka, 2007). Recent flows of FDI are unprecedented. The aggregate volume of inward FDI in the 2000s was 48 times larger than the 1970s worldwide.

The influence of massively flowing global capital, therefore, will be reflected on space. Due to extensive flows of capital at global scales, global cities are emerging as a basing point for global capital accumulation (Friedmann, 1986; Sassen, 2001b). Flows of capital change economic activity and urban structure. Not only direct investment in infrastructure, but also investment in other industries can reshape urban structure as capital plays a crucial role in production activity. In addition, the flows of capital via Multinational Enterprises (MNEs) take place along with flows of people. For instance, MNEs dispatch expatriates to host cities to manage and coordinate their production. Therefore, FDI flows have brought spatial outcomes to host cities (He & Yeung, 2011; Wu, 2000). What impacts have inflows of FDI brought to cities and regions? Where does FDI activity take place? This study pays attention to these questions interrelated, using the example of South Korea (hereafter Korea).

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[1] This paper addresses FDI activities involving production. Speculative investment is out of the research scope in this paper although this is an important topic.

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A massive increase in FDI flows is taking place in Korea. As the Korean economy is integrating into the world market, the magnitude of inward FDI has increased drastically. This rapid increase in the FDI inflows began in the late 1990s in Korea. The annual average inward FDI in 1980–1989 was US$ 550 million, but it increased to US$ 4,200 million in 1990–1999 and to US$ 11,144 million in 2000–2009, showing an increase of more than 20-fold over the last three decades (Ministry of Knowledge Economy of Korea). In accordance with the increasing volume of FDI flows, there is a new trend in spatial structure channelled via inflows of FDI. Hence, this study is to examine spatial patterns of inward FDI and explore the impacts of the location choice of global capital accumulation that can result in the creation of new spatiality in a globalising era.

Foreign nationals, economic opportunities and FDI

The literature has asserted that the agglomeration economy is crucial to accumulation of global capital (He, 2002) explaining spatial patterns of inward FDI (Coffey & Shearmur, 2002; Lizieri & Kutsch, 2006; Morshidi, 2000; Sassen, 1995; Storper & Venables, 2004). As foreign investors attempt to avoid disadvantages associated with lack of local knowledge, their location choice tends to be highly concentrated in small geographical areas (He, 2003). This agglomeration has been analysed at different geographical scales in the literature.

FDI at global and national scales

There are two main factors to facilitate FDI flows. Firstly, considerations at large scales are upon political factors such as political stability, the degree of global integration, and advancement in a legal system. Hence, risks at this level are likely to be a long-term (Conner, Liang, & McIntosh, 1999). Liberalisation of government policies was seen as necessary to ensure that nations may keep pace with other countries. Institutional changes have enabled capital to freely move over country boundaries. Regulated systems are the initial barrier for international capital flows. Policy changes have founded a basis for the expansion of the market economy and included greater privatisation and more developed financial markets (Bevan, Estrin, & Meyer, 2004). These changes have also been stimulated by the actions of some major international institutions such as the OECD and the WTO (Tesser, 2004). There are a number of examples of deregulation and liberalisation that led to massive flows of global capital worldwide. Eastern European countries liberalised and privatised their economies after the collapse of the Berlin Wall. These countries have tried to reduce transaction costs to enhance inward FDI (Bevan et al., 2004). A liberalisation policy has prompted inward FDI in Turkey and the possible EU membership has made it a major recipient of FDI (Erdal & Tatoglu, 2002).

Secondly, assessment on risk–return relations by firms plays a pivotal role in location choice (Caves, 1971; He, 2002). Economic growth in certain countries results in the shift of FDI (Dunning, 1998). Developing countries have become the main recipient of capital inflows due to deregulation and high expected returns. For instance, newly industrialised countries (NICs), such as Korea, Taiwan and the Philippines, have attracted new capital flows (Dunning, 1998). The emerging economy of China made her the major destination of FDI in the world (Sun et al., 2002). China has been the second largest FDI recipient following the U.S.A. since 1994 by virtue of accessibility to large markets and abundant labour that can lead to higher return rates (Sun et al., 2002).

As a result, global cities and their regions are commonly recognised as basing points for inbound FDI (Friedmann, 1986; Sassen, 1995). These cities are called global 'capital capitals' (Sassen, 1999). Extended metropolitan areas revolving around the global city is referred as global city-regions (O'Connor, 2010; Sassen, 2001a). The global city-regions are the central areas for urban transformation in the era of globalisation. In this broad city-region intensive global activities are observed in small geographical areas (Grant & Nijman, 2002); specialised clusters appear resulting in spatial polarisation (Fainstein, 2014; Rhein, 1998; Walks, 2001); and urban forms are changing in more polycentric ways (Beauregard & Haila, 2000; Hall, 2001). Inward FDI adds one more complexity into the global city-regions intensively in selected hot spots and extensively in overall business activities.

FDI at metropolitan and local scales

Spatial concentration of inward FDI was seen at regional scales, such as American cities (Grosse & Trevino, 1996) and coastal regions in China (He & Yeung, 2011; Sun et al., 2002; Wu, 2000). The literature acknowledged the importance of market size and demand, infrastructure, industrialisation, labour quality, labour cost, per capita income, geographical and cultural distances in choosing FDI locations (Grosse & Trevino, 1996; He & Yeung, 2011; Sun et al., 2002). At local scales, clusters of FDI have been observed, too. Typical examples include Silicon Valley, M4 corridor, Tokyo and Osaka, and Bangalore for IT firms (Dunning, 1998). In the analysis of Chinese cities, accessibility to railway terminals and highways, labour markets, major hotels, and developmental zones played an important role in the location decision of FDI firms (Wu, 2000).

Of course, spatial patterns of FDI activity vary depending on types of industry (He, 2003; He & Wang, 2010; He & Yeung, 2011). Financial activities and business services became more important than industry from 2000 onwards (OECD, 2002). This shift was felt in FDI, too (Douglass, 2000). Service sectors rely on quality information and are vulnerable to the agglomeration economy more than routinized industries (Guimaraes, Figueiredo, & Woodward, 2000; Kim, O'Connor, & Han, in press). So, service firms concentrate spatially more than manufacturing firms as seen in the U.S.A. and the U.K. (Glickman & Woodward, 1988). In these countries, locations of FDI in manufacturing were decentralised to peripheral areas.

Not only economic considerations, but informal, cultural factors have explained the location of FDI. The literature has acknowledged that the FDI flows are closely associated with migration networks. Migration networks offer advantages to investors due to their roles that encourage understandings of heterogeneous systems offshore. The importance of ethnicity in FDI activity has been felt in various countries. In the Central and Eastern European countries, political alliances, migration, trade and cultural ties are more significant than institutional arrangements related to transaction costs (Bandelj, 2002). Hong Kong and Taiwan are main investors especially in Guangdong and Fujian provinces possibly due to linguistic advantages and geographic closeness (Sun et al., 2002). Ethnicity in host countries accelerated by global migration has played a certain role in spatial patterns of FDI.

Economic and cultural (migration) factors of FDI have brought economic and spatial impacts on host cities. For instance, Wu (2000) argued that FDI has rapidly transformed urban structures in Chinese cities since the economic reform, leading to a more polycentric urban development.

A framework for impacts on host cities

Despite substantial academic efforts into cross-border capital flows, past studies focused on partial aspects of the impacts that