South Korea – Russia economic relations: focused on FDI

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Abstract. The emphasis on economic cooperation between South Korea and Russia is growing according to the new foreign policies of the two countries. This study aims to draw policy implications for increasing inter South Korea-Russia investments as reflecting growing political significances of economic cooperation of the two countries. For that, we analyzed FDI data from Central Bank of Russia, Export-Import Bank of Korea, and KOTRA given that in globalized economies, above all the other entry modes in foreign markets, FDI plays a significant role in national economic growth as allowing firms to utilize cross-border production factors with high efficiencies. Based on the data analysis, we made the following meaningful conclusions. First, despite growing political importance, FDI flows between the two countries are insignificant, partially due to the profound sense of closeness. Second, the motivations of Korean FDI showed differences dependent on Russian cities. Third, Korean FDI in Russia is highly concentrated in the manufacturing industry. To increase FDI flows between the two countries, we recommend to launch cultural exchange programs in private sectors with long-term visions and diversify investment in a way to increase cooperation among SMEs, and start-ups in high value-added and innovative industries.

Keywords: foreign direct investment, Korea, Russia, economic cooperation, east policy, new northern policy

Introduction

In globalized economies, it becomes crucial to utilize cross-border production factors in a way to increase efficiencies and effectiveness (Moon et al., 1998; Dunning, 2003). This spurs multinational firms to select FDI as a way of market expansion rather than export or licensing. These foreign investments accelerate production fragmentations and international market integrations as creating massive global value chains. The multiple positive influences of foreign investments on national economies, for instance, job creations, knowledge spillovers, increase production efficiencies, export expansion, and economic growth of host countries or regions, are elucidated significantly in previous empirical studies (Brada et al., 2004; Antonescu, 2015; Davletshin et al., 2015; Iwasaki et al., 2015; Duarte et al., 2017). In that respect, countries are highly motivated to induce foreign investments as fomenting FDI conducive climates through policy revisions.
In 1990, South Korea and Russia established formal diplomatic ties. The two governments incrementally expand economic relations to overcome economic disconnections for the past 100 years. However, since 2012, the importance of economic cooperation in the two countries has enhanced as the new foreign policies from the two governments were announced. In 2012, the Russian government formalized the “pivot to east” policy to alleviate the polarization of wealth between west and east by strengthening partnerships with Asia-Pacific countries, including South Korea, China, and Japan. On the other hand, since 2013, the South Korean government has continued the “new northern policy” to reduce heavy dependence on China and the USA as expanding partnerships to post-soviet countries. Amid these political changes, it seems that South Korea and Russia are one of the best potential partners for more tight cooperation based on significant economic sizes of the two countries.

In that respect, the study to improve FDI flows between the two countries seems highly required. However, the previous studies are dealt with old data or confined to Korean FDI outflows towards Russia (Korenevskiy, 2005; Kang, 2007; Lee, 2012; Lee et al., 2015). In this paper, we investigate FDI flows between the two countries based on updated data from the Central Bank of Russia, Export-Impart Bank of Korea, and KOTRA. Our paper consists as follows. The second section presents traditional FDI theories. The third section explains Korean FDI outflows to Russia, while the fourth section describes Russian FDI outflows to Korea. In conclusion, we draw meaningful policy implications based on data analysis.

**Literature review: traditional FDI theories**

Historically, a plethora of theories elucidates why firms especially select direct investments as an entry mode in foreign markets instead of the export or licensing. Direct investment is well known for the highest control on foreign subsidiaries’ management, but, simultaneously, firms should take the highest risks. In this section, based on traditional FDI theories, we will investigate the motivations of foreign investments despite the high risks.

**The Internalization Theory.** Multiple theories articulate that the market imperfection is the main factor to spur firms to choose FDI as an entry mode in foreign markets. Internalization theory demonstrates that market imperfections cause unnecessary exogenous transaction costs to multinational firms (Buckley, 1976; Hymer, 1990; Rugman, 1986). Foreign direct investments allow the firm to internalize those costs from, for instance, tariff, quota, and intermediaries. As internalizing exogenous costs, firms can achieve a higher return of capital.

**Monopolistic Power Theory.** Besides, if companies hold monopolistic power or oligopolistic power, in, for instance, resource, technology, brand image, and managerial skills, there has a high possibility to fully utilize their market powers through foreign direct investment (Kindleberger, 1969; Hymer, 1976). Especially under an oligopolistic market, it inclines that locations of FDI are dependent on rival's movements. The firms in those markets move altogether to sustain their oligopolistic status (Knickerbocker, 1973; Pennings et al., 2003).

**The Exchange Rate Theory.** Multiple empirical studies articulated the impact of exchange rate and exchange rate volatility on FDI flows. Some demonstrated
that depreciation of domestic currency increases foreign capital inflows (Froot, 1991; Udomkerdmongkol et al., 2009). While the other empirical studies asserted that there is no significant relationship between exchange rate and FDI (Dewenter, 1995).

In terms of impacts of currency volatility, the negative relationship of that with FDI is demonstrated (Udomkerdmongkol et al., 2009). On the other hand, it is asserted by another study that the impact of exchange volatility differs, whether it is driven by native or host countries (Russ, 2007).

The Production Life Cycle Theory of Vernon. Following the product life cycle theory introduced by R. Vernon (Vernon, 1966), there are four stages of production cycles as follows: emerging, growth, maturity, and decline. In the first stage, companies introduce innovative products for domestic markets. In the second stage, companies export surplus as demands from foreign markets is created. In the third stage, as the rivals copy the technology, and thereby it becomes familiar, the firm is forced to corporate in foreign markets to sustain their market shares. In the last stage, supply exceeds demands in existing markets. Which forces firms to perform in developing markets where still they can sell their product.

The Eclectic Paradigm of Dunning. The eclectic paradigm (Dunning, 1980), also known as OLI theory, is comprised of three advantages to engaging in foreign direct investment: Ownership, Localization, and Internalization. Ownership advantage is firm-specific superiority driven by monopolistic power, innovative activities, and economies of scale, for instance, technology, managerial skills, patent, and know-how. Location means advantages firms can receive from FDI instead of export. The firms can benefit from production factors in host markets, FDI conducive policies of host governments, and social amity of consumers in host countries. Firms also can benefit from cross-border internalization as reducing unnecessary costs. The internalization of those costs spur companies to engage in foreign productions rather than licensing, and franchising.

South Korean FDI outflows to Russia

South Korea began investing in Russia in 1990. For the period 1990–2005, handful amounts of FDI flew in Russia from South Korea: on average 20 million US dollars. From 2006, Korean FDI outflows to Russia began to increase by 2.8 times compared with that in the previous year. During the period 2006–2010, Korea invested, on average, 342 million US dollars in Russia. In terms of the total sum of FDI inflows, for those five years, Korea investment was 1,475 million US dollars, 4.6 times of that for the period 1990–2005. Also, the Russian economic crisis in 2008 did not immediately influence on Korean investments as looking at high FDI outflows in 2009 and 2010. However, in 2011, Korean FDI decreased by one-third and maintained, on average, 114 US dollars for the period 2011–2018. It seems that Korean FDI did not recover that in 2006–2010 after the sharp decrease in 2011 (Figure 1).

In terms of absolute amounts of FDI inflows for the period 2011–2018, despite the increasing political importance, South Korean FDI in Russia remains at an insignificant level compared with other major recipient countries. Compared with the USA and China, the largest recipients of Korean FDI, Russia received only 1.3% and 3% of FDI inflows in the USA and China during that period. Be-
sides, even compared with India and Vietnam, the central partner countries for the “new southern policy” of South Korea, Korean FDI inflows in Russia is insignificant: 24.4% of that in India, and 6.5% of that in Vietnam. Korean FDI in Russia is comparable that in Kazakhstan despite the 8.6 times bigger GDP of Russia than that of Kazakhstan. Besides, as diving investments by the number of a new corporation, Korean investments in Russia are likely relatively small-sized: 5.1 million US dollars on average per corporation, second-lowest average amounts following Vietnam (Table 1).

![Figure 1. Korean FDI outflows in Russia. Data for the Export-Import Bank of Korea](source: retrieved from https://stats.koreaexim.go.kr/sub/countryStatistics.do (accessed: 29.10.2019).

**Table 1**

<table>
<thead>
<tr>
<th>Country</th>
<th>Investment (millions $)</th>
<th>Number of a new corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>912</td>
<td>180</td>
</tr>
<tr>
<td>USA</td>
<td>71,837</td>
<td>4,153</td>
</tr>
<tr>
<td>China</td>
<td>30,550</td>
<td>5,616</td>
</tr>
<tr>
<td>India</td>
<td>3,733</td>
<td>539</td>
</tr>
<tr>
<td>Vietnam</td>
<td>13,973</td>
<td>3,973</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>789</td>
<td>118</td>
</tr>
</tbody>
</table>


In terms of Korean FDI outflows to Russia by industry, the most massive amounts of that flew in the manufacturing industry, followed by agriculture, forestry, fishing, and mining. For the period 2011–2018, 44% of Korean FDI flew in the manufacturing industry. In contrast, agriculture, forestry, and fishing industries, and the mining industry, as a whole, received only 20% of Korean FDI inflows during
those periods. It seems that Korean FDI inflows in Russia are highly skewed in the manufacturing industry, which needs to be improved by diversifying investments in non-manufacturing industries (Table 3).

**Table 2**

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</tr>
</thead>
<tbody>
<tr>
<td>World (a)</td>
<td>55,084</td>
<td>50,588</td>
<td>69,219</td>
<td>22,031</td>
<td>6,853</td>
<td>32,539</td>
<td>28,557</td>
<td>8,785</td>
</tr>
<tr>
<td>South Korea (b)</td>
<td>–270</td>
<td>119</td>
<td>71</td>
<td>130</td>
<td>116</td>
<td>83</td>
<td>59</td>
<td>110</td>
</tr>
<tr>
<td>(b)/(a)</td>
<td>–0.5%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.6%</td>
<td>1.7%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>


**Table 3**

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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, and fishing</td>
<td>25</td>
<td>25</td>
<td>17</td>
<td>9</td>
<td>8</td>
<td>10</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>Mining</td>
<td>15</td>
<td>16</td>
<td>6</td>
<td>3</td>
<td>0</td>
<td>18</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>39</td>
<td>60</td>
<td>43</td>
<td>51</td>
<td>59</td>
<td>51</td>
<td>50</td>
<td>52</td>
</tr>
<tr>
<td>The others</td>
<td>21</td>
<td>9</td>
<td>57</td>
<td>53</td>
<td>110</td>
<td>31</td>
<td>25</td>
<td>20</td>
</tr>
</tbody>
</table>


**Table 4**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Moscow</th>
<th>Saint Petersburg</th>
<th>Novosibirsk</th>
<th>Vladivostok, Ussuriysk, Khabarovsk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>107</td>
<td>33</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>25</td>
<td>18</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Wholesales and retailing</td>
<td>34</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Service</td>
<td>25</td>
<td>7</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>The others</td>
<td>23</td>
<td>5</td>
<td>0</td>
<td>12</td>
</tr>
</tbody>
</table>

*Note: this data is confined to Korean companies that agree to share their information with KOTRA. Number of corporations in each industry divided by the total number of Korean corporations is given at brackets. Source: KOTRA. Retrieved from [http://news.kotra.or.kr/user/overseasCompany/kotranews/677/usrOverseasCompanyView.do?setIdx=1080&dataIdx=1](http://news.kotra.or.kr/user/overseasCompany/kotranews/677/usrOverseasCompanyView.do?setIdx=1080&dataIdx=1) (accessed 29.10.2019).*

As looking at the number of Korean corporations by Russian cities, 107 out of 161 Korean firms are based in Moscow. Saint Petersburg was the second famous city for Korean firms. Interestingly, despite the poor factor and demand conditions, some Korean firms opened their business in the cities in the Far Eastern Federal District, for instance, Vladivostok, Ussuriysk, and Khabarovsk, which seems
likely that distance and sense of closeness partially influence on Korean FDI in Russia besides market-seeking purposes. However, considering that 55.2% of Korean firms in Moscow are in wholesales and retailing and service industries, Korean FDI in Moscow shows active market-seeking purposes compared with that in the other cities (Table 4).

**Russian FDI outflows to South Korea**

On the other hand, as looking at Russian FDI outflows to South Korea, for the period 2007–2018, on average, 7 million US dollars flew in South Korea based on asset/liability calculations. For the period 2012–2015, Russian FDI inflows in South Korea remain in the positive, on average 15 million US dollars. Unlike Korean FDI in Russia, stable since 2011, the propensity of Russian FDI outflows to South Korea is rather more fluctuating from negative to positive values (Figure 2).

![Figure 2. Russian FDI outflows to South Korea in terms of balance of payment. Data for Central Bank of Russia Source: Retrieved from https://www.cbr.ru/vfs/eng/statistics/credit_statistics/direct_investment/18e-dir_inv.xls (accessed: 29.10.2019).](image)

For the period 2011–2018, Russian FDI inflows in South Korea accounted for 0.04% of the total. This is even way smaller than that of Korea's FDI outflows to Russia, 0.6% during the same period. The most Russian FDI flew in Cyprus, 26.39% of the total. However, those FDI inflows in Cyprus is challenging to be considered for production factor expansions, but round-tripping [25]. Thereby, the high Russian FDI inflows in Cyprus should be treated as an exceptional case. For purposes of production factor expansions, Russia invested the largest amounts in European countries, for example, Spain, Switzerland, Austria, UK, and Germany. Among of Asian countries, Singapore is the largest recipient of Russian FDI outflows, as received 3.24% of the total. Compared with China, and Japan, South Korea is the second largest recipient of Russian FDI outflows following China.
Despite the enormous economic sizes of the three East Asian countries (China – 2\textsuperscript{nd} largest, Japan – 3\textsuperscript{rd} most considerable, and South Korea – 11\textsuperscript{th} most extensive in October, 2018 in terms of nominal GDP), insignificant amounts of Russian FDI flew in those three countries (Table 6).

Table 6

<table>
<thead>
<tr>
<th>Investment (Total)</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>371,795</td>
</tr>
<tr>
<td>South Korea</td>
<td>149</td>
</tr>
<tr>
<td>CIS countries</td>
<td>12,247</td>
</tr>
<tr>
<td>Cyprus</td>
<td>98,135</td>
</tr>
<tr>
<td>Spain</td>
<td>67,181</td>
</tr>
<tr>
<td>Israel</td>
<td>23,371</td>
</tr>
<tr>
<td>Switzerland</td>
<td>15,891</td>
</tr>
<tr>
<td>Austria</td>
<td>15,408</td>
</tr>
<tr>
<td>Singapore</td>
<td>12,031</td>
</tr>
<tr>
<td>Turkey</td>
<td>10,505</td>
</tr>
<tr>
<td>UK</td>
<td>6,990</td>
</tr>
<tr>
<td>Germany</td>
<td>6,401</td>
</tr>
<tr>
<td>USA</td>
<td>6,254</td>
</tr>
<tr>
<td>China</td>
<td>217</td>
</tr>
<tr>
<td>Japan</td>
<td>47</td>
</tr>
</tbody>
</table>


Conclusion

In this paper, we examined FDI flows of South Korea and Russia based on updated data from the central bank of Russia, Export-Import Bank of Korea, and KOTRA. The new foreign policies of the two countries, “pivot to the east,” and “new northern policy,” increase the importance of economic cooperation between South Korea and Russia. Thereby, our study aims to draw policy implications to increase FDI flows between the two countries as analyzing the FDI trends. From the data analysis, we draw the following meaningful findings.

First, despite growing political importance since 2012, and attractive market sizes of the two countries, FDI flows between the two countries remained insignificant. The Korean FDI outflows to Russia have been stable for the period 2011–2018 since it decreased by one-third. Compared with India and Vietnam, the central countries for Korea’s “new southern policy,” Korean FDI outflows to Russia, is insignificantly small, comparable to that to Kazakhstan. While Russian FDI outflows to South Korea in terms of balance of payment is capricious as changing from the negative to the positive. The principal recipients of Russian FDI were European countries, whereas South Korea, China, and Japan received insignificant Russian investment despite one of the largest economies in the world. From those results, it is likely that a low sense of closeness and cultural proximity highly hinder the tight economic relations of the two countries (Udomkerdmongkol, Morrissey, Görg,
2009; Vernon, 1996). In that respect, it seems necessary for the governments to launch programs enhancing cultural exchanges in private sectors, besides economic programs with long-term visions. Those cultural exchanges in the bottom line will act as a catalyst to create more business opportunities between the two countries in the long-term.

Second, the motivations of Korean FDI differ in Russian cities. Korean FDI inflows in Moscow were majorly driven by market-seeking purposes, while that in Saint Petersburg was motivated by manufacturing-seeking purposes. On the other hand, despite poor factor and demand conditions, some Korean firms enter the cities of the Far East. It again emphasizes that the sense of closeness driven by relatively closer distances influences on Korean FDI in Russia.

Third, Korean FDI in Russia is highly concentrated on manufacturing industries. To increase the FDI flows, it is necessary to diversify investment in different industries. Given that historically Russia is competent in basic science. At the same time, South Korea is competent in applied science, and the two countries can expand their cooperation with high value-added service and technology industries. Besides, considering that Korean investments to Russia is on a relatively small scale, it can be promoted to cooperate among SMEs or start-ups of the two countries. The governments can launch cooperative programs providing common grounds for young and small companies, such as smart-city projects and start-up contests.

References


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ГЛОБАЛИЗАЦИЯ И ЭКОНОМИЧЕСКАЯ ИНТЕГРАЦИЯ 53
Экономические отношения между Южной Кореей и Россией: ориентация на прямые иностранные инвестиции

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Благодаря новой внешней политике Южной Кореи и России, экономическое сотрудничество между двумя странами продолжает расти. Целью данного исследования является выявление политических последствий увеличения корейско-российских инвестиций, учитывая растущее политическое значение экономического сотрудничества двух стран. Для этого были проанализированы данные о ПИИ Центрального банка России, Экспортно-импортного банка Кореи и КОТРА, так как в условиях глобализации экономики ПИИ играют главенствующую роль (в сравнении с другими видами входа на внешние рынки) в росте национальной экономики, позволяя фирмам использовать трансграничные факторы производства с высокой эффективностью. На основании анализа данных сделаны следующие выводы. Во-первых, несмотря на растущую политическую значимость сотрудничества, потоки ПИИ между двумя странами незначительны, отчасти из-за недостаточного чувства близости. Во-вторых, мотивы корейских ПИИ различаются в зависимости от города. В-третьих, корейские ПИИ в России сильно сконцентрированы на обрабатывающей промышленности. Для увеличения потока ПИИ между двумя странами авторы рекомендуют запустить программы культурного обмена в частном секторе с долгосрочными перспективами и диверсифицировать инвестиции так, чтобы расширить сотрудничество между малыми и средними предприятиями и стартап-проектами в инновационных отраслях и отраслях с высокой добавленной стоимостью.

Ключевые слова: прямые иностранные инвестиции, Корея, Россия, экономическое сотрудничество, восточная политика, новая северная политика

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