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The Characteristics and Implications of Japanese Foreign Direct Investment into Korea: An Analysis Based on Statistical Data from Both Countries

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Abstract | The purpose of this study is to analyze Japanese FDI into Korea after the year 2000 and its recent reduction. This study is based on statistical data from Japan and Korea, and outlines policy strategies toward expanding this investment. The analysis makes several points: That Korea has to compete with other Asian countries to receive investment from Japan, but lacks an advantage; that the FDI into Korea is around two percent of the Japanese outward FDI, which recently decreased to around one percent; that Japanese FDI into Korea is occurring under such circumstances where Japanese outward FDI in general has shown expansion in non-manufacturing industries in recent years; that the amount of Japanese investment after 2000 has increased, but overall the proportion of Japanese direct investment in Korea has decreased, dropping under ten percent after 2015; and that Japanese investments are still concentrated in the manufacturing industry. There are several findings related to the recent decrease in Japanese investments: That the Japanese proportion has decreased, yet the investment amount itself remains at the previous level; that political conflict is one reason for the decrease in Japanese investments; that the specific details of investment activities are positive, even though investment is not expanding. This study suggests policy interests could encourage Japanese FDI through the following measures: Korea should enhance its advantage as a production base to invite high-quality Japanese investments; investment in the research and development areas of the service sector needs support; and political conflicts between Korea and Japan need to be minimized while civil exchanges need to be increased. As this analysis was conducted at a macro level, its efficacy is somewhat limited. To overcome this, several future research subjects are suggested in conclusion.

Keywords | Japanese outward FDI, Japanese FDI into Korea, Korean inward FDI, industry type, political conflict

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Introduction

There are various ways to examine the role of Japan in the Korean economy, including through highlighting the role of foreign direct investment (FDI hereafter). Japan was traditionally a major country supplying FDI in Korea. The statistical data on Korean inward FDI was started by the government in 1962, but Japanese FDI only started to statistically appear from 1965 when the normalization of Korea-Japan diplomatic relations occurred. From this point records show that Japan played a major role in supplying FDI. For instance, while the amount of Korean inward FDI itself was not large, declared Japanese investment was over ninety percent of this national total in 1973. Then, over time as other countries invested more the proportion of Japanese FDI tended to decline.

Looking at the situation of the Japanese FDI into Korea after 2000, the number of declared investment cases was roughly 500, and the declared investment amount was in the range of 1.5 billion dollars. In 2012, Japanese FDI into Korea increased dramatically due to the Great East Japan Earthquake. The number of declared cases was 564, the declared amount was 4.54 billion dollars, and the overall proportion of Japanese FDI within the national total was 27.9 percent. However, such investments started to decline after 2013. The number of declared cases, the declared amount, and the overall proportion of Japan were 299, 1.25 billion dollars, and 5.9 percent, respectively, in 2016, and 328, 1.84 billion dollars, and 8.0 percent in 2017 (analysis of inward FDI statistics of the Ministry of Trade, Industry and Energy, Sanŏp T'ongsang Chawŏnbu n.d.). It can therefore be stated that over recent years the overall proportion of investment originating from Japan has remained consistently under ten percent, indicating Japan's diminished role in providing inward FDI to Korea.

Since the past role of Japan was enormous and at one time covered over ninety percent of Korean inward FDI, the current situation brings up the following questions. What are the current characteristics of Japanese FDI into Korea? Why did Japanese FDI decrease dramatically from 2013? What are the factors that affect the recent levels of Japanese FDI into Korea? And, what kind of policy does the Korean government need to help increase Japanese investments?

The purpose of this study therefore is to analyze the characteristics of Japanese FDI into Korea after 2000 and the recent circumstance based on statistical data from the two countries, and to suggest policy foci to increase future Japanese FDI into Korea. The reason this study focuses on the period after 2000 is that Korea actively promoted open economic policies after the Asian Financial

Crisis, which resulted in an increase of inward FDI.

The layout of this study is as follows. The second section reviews the existing literature related to the Japanese outward FDI and discusses the characteristics of this body of work. The third section examines the characteristics of Japanese outward FDI and that into Korea based on Japanese statistical data to investigate the Japanese perspective on this investment. The fourth section then studies the characteristics of inward FDI in Korea and that from Japan based on Korean statistical data to explore the Korean perspective. Finally, the fifth section utilizes the results of the previous sections to analyze the characteristics of Japanese FDI into Korea and the recent circumstance of low investment, and suggests policy changes to increase this investment in the future. The final, conclusive section summarizes the study and proposes related future research interests.

Literature Review and Characteristics of the Study

1. Previous Research on the Japanese Outward FDI

The overseas expansion of companies usually begins with exports or licensing, but many companies end up conducting direct investments as their capabilities enhance over time. Similarly, many Japanese companies initially only exported to expand overseas but eventually changed toward active direct investment, a trend which has resulted in a substantive body of research on their FDI. Research on Japanese companies was obviously active in Japan, and advanced to the point where precise local theories of FDI came to describe the characteristics of such investment (Kojima 1978; Ozawa 1979). Although there are some studies in Japan that have dealt specifically with Japanese FDI into Korea (Momomoto 2013, 2018), they are limited in number. Therefore, this study aims to investigate the prior literature in Korea regarding the outward FDI of Japanese companies after 2000. These fall into the following categories: studies on the outward FDI of Japanese companies in general; studies on outward FDI from the perspective of a comparison between Korea and Japan; and studies on the FDI into Korea undertaken by Japanese companies.

First, studies conducted on the outward FDI of Japanese companies were generally undertaken to privilege various particular perspectives including investment decision factors, characteristics of overall investment, and differences in regions of investment. With regards to investment decision factors, Kim Eŭn-hŭi (2001) has analyzed that Japanese manufacturing companies decided share ownership in FDI affected by factors such as transaction cost, negotiation power, and other local issues. While Kim Chŏng-ŭn (2002) found that the effective tax rate and foreign currency exchange rate within the major countries of investment played a significant role in the decisions on investment amount within those nations when Japanese companies decided to execute FDI.

In characterizing the overall investment tendencies demonstrated by Japanese companies, No T'aek-hwan (2000) has highlighted that a "hollowing-out of industry" type of FDI was common in Japan while the inflow of FDI was low during the 1990s. Park Young-Ryeol, Kwak Jooyoung, and No Jung-Hyun (2011) have emphasized that direct investment in Asia made by Japanese companies then changed from joint venture to wholly owned subsidiary in the mid-2000s, and Yi Hong-pae (2015) has stated that the FDI of Japanese companies after 2010 had the purpose of opening and securing sales channels instead of avoiding trade barriers or reducing costs. In relation to the FDI expended by Japanese Small and Medium sized Enterprises (SME), Pak Tong-ryŏl (2000) emphasized that Japanese government provided Japanese SMEs with various forms of official support for their FDI, and Pak Kyŏng-ryŏl (2014) has stressed that human exchange and business networks were important in the process of creating FDI for Japanese SMEs. There are also several studies on the regional characteristics of FDI made by Japanese companies. For example, Paek Sŭng-uk (2005), Sŏng Yong-mo (2006), Kim Il-sik and Kim Chŏng-han (2011), and Kim Il-sik (2013a) analyzed the strategies and performances of the companies that invested in China. Kim Il-sik (2013b) focused on the differences of investment made in ASEAN and China. In counterpoint, Ch'oe Ch'ang-gyu and Yi Myŏng-hun (2004) compared Korea and East Asian countries as regions of FDI from Japanese firms, suggesting measures to attract investment toward Korea.

Second, various studies on outward FDI from the perspective of comparison between Korea and Japan have also been conducted. Kang Han-gyun and Kim Sŏng-gi (2010) have compared the overall characteristics of Korean and Japanese outward FDI, and found that the central area of investment was Asia for Korea while it was North America and Europe for Japan. They showed that Korea had a greater tendency to invest in wholly owned subsidiaries than Japan due to the differences in the history of investment. Also, in terms of Korea and Japan's respective investment regions, No Tŏk-hwan and Tu Chŏng-wan (2004), Chŏng Su-wŏn (2007), Kang Han-gyun (2009), and Han Ki (2013) have compared the two nation's investment into China, while Kim Sŏng-gi, Ch'ae Tu-byŏng, and Kang Han-gyun (2010) have examined their respective investments within Asia. In addition, Chŏng Su-wŏn (2011) compared Korean and Japanese investment within five Southeast Asian countries, and Ko Ta-hye (2017) focused on their respective investment towards the ASEAN market.

Third, there have been studies on the FDI into Korea from Japanese companies that offer a direct precedent to this paper. Among such studies before 2010, Yi Suk-chong (2000) and Yim Ch'ŏn-sŏk (2001) investigated the phenomenon of increased Japanese FDI into Korea after the Asian Financial Crisis, and stressed the need to emphasize the advantage of Korea as a production base for semi-finished products in the manufacturing industry or capital goods. Agari (2001) focused on the periodic characteristics of Japanese FDI into Korea from the 1960s to the 1990s, concluding that wage increases after 1988 had served to discourage Japanese investment. Okuda (2002) emphasized that the Japanese FDI into Korea demonstrates all the characteristics of other investment into developed countries after the early 2000s. Ch'oe Tong-ik (2004) demonstrated the necessity for local management within Japanese companies in Korea, and Ryu Sang-yŏng and Chŏn Yong-il (2005) illuminated how political and regulatory factors had played a significant role in Japanese FDI into Korea from 1962 to 2004.

Lee Hyungoh and Han Mi-kyŏng (2005) studied changing patterns in the market entry methods of Japanese companies into Korea from the perspective of demand characteristics. Kang Han-gyun and Yi Kyŏng-gu (2006) have argued that the overall characteristics of Japanese FDI into Korea include: small-scale investment per case; low share ownership; high sensitivity towards political and economic situation; the high influence of investments before the Asian Financial Crisis; increase of investments related to IT after the Crisis; a decrease of investments in the manufacturing industry after the Plaza Accord of 1985 and an increase of investments in the service industry; and a relatively high proportion of manufacturing industry investment compared to the US or EU. Lee Hyungoh and Pak Chong-sŏng (2007) also observed the following characteristics of Japanese companies in Korea, including a higher Japanese share ownership, a higher proportion of investment in the service industry, and a greater focus on securing the market with the purpose of expansion over time. Kim Hyŏn-kyŏng (2008) researched the effect of governance type on the management methods of Japanese companies that invested in Korea.

There have been numerous other studies conducted after 2011. For example, Kang Ch'ŏl-gu (2011) focused on the effect of Japanese investment companies on the local economy of Taegu/Kyŏngsangbuk-do. Kang Han-gyun (2011) looked at the content of cross FDI between Korea and Japan. Kang Chae-jŏng and Ko Kwang-myŏng (2012) analyzed the characteristics of expansion into Korea depending on the share ownership type of the Japanese companies that invested in Korea. Ch'oe Chong-il and Yi Ki-dong (2013) observed the effect of social capital on decisions relative to location for FDI into Korea made by Japanese manufacturing companies. Kim Pong-hŭi, Kim Sŏng-gi, and Kang Han-gyun (2013) and Kim Pong-hŭi (2014) studied Japanese FDI into Korea by comparing it with the US, which showed that its proportion within the total investment was decreasing. However, Japan had a high proportion of investment in the manufacturing industry, while food and accommodation were also major investment sites within the service industry, and Japan had a greater employment effect than the US in both the Korean manufacturing and service industry.

2. Characteristics of the Study

As set out above, there is substantial Korean literature on Japanese FDI and investment in Korea after 2000. These studies are mostly from the perspective of a single nation. In other words, the studies on Japanese outward FDI or comparison studies between the FDI of Korean and Japanese firms are written from the viewpoint of Korea or Japan, while studies on Japanese FDI into Korea have been mainly from a Korean perspective. Yet, since companies consider the characteristics of both the investing and invested nations when they decide on FDI, there is a need to analyze the investment from the perspective of both nations.

When compared to the existing literature, this study's major innovation is that it analyzes the Japanese FDI into Korea through the lens of both Japan as the investing nation and Korea as the investee. Japanese companies engage in investment activities considering the situations of various countries including their own, which means that they will decide on FDI into Korea when Korea has an advantage over other nations. Therefore, it is necessary to examine Japanese FDI into Korea relative to the overall trend of total Japanese outward FDI and the overall proportion of FDI into Korea. On the other hand, the domestic situation in Korea vis-à-vis the Korean market and policies of the Korean government affect Korean advantages. Hence, it is essential for Korean government and business interests to study such issues in order to understand Japanese FDI into Korea.

In addition, this study focuses on the types of industry likely to garner investment, among other diverse issues related to Japanese FDI into Korea. Traditionally, most FDI was in production activities, and the extant research on FDI has focused particularly on the manufacturing industry. However, there are active investments in not only the manufacturing industry but also non-manufacturing industries, such as the service industry, and even direct investment in the manufacturing industry tends to be in specific areas. Therefore, to observe the overall activity of FDI into Korea made by Japanese companies, this study focuses on delineating the characteristics of industry likely to attract such investment.

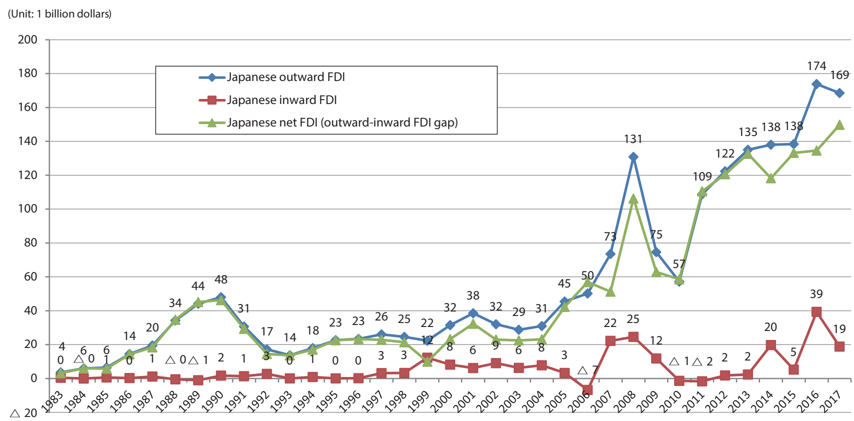
Furthermore, this study is unique in its methodology, using official statistical data from Japan and Korea. In the case of Japan, released data on outward FDI and inward FDI from the Ministry of Finance and Japan External Trade Organization (JETRO) provided the main source. For Korea, outward FDI was calculated using Export-Import Bank of Korea data while inward FDI was extracted from Ministry of Trade, Industry and Energy data. This study appropriately processed this data from each agency for the express purpose of examining the Japanese FDI into Korea at a macro level.

Japanese FDI into Korea Based on Japanese Statistical Data

1. Japanese Outward FDI

Japan has a unique pattern of investment unlike other developed nations, as its outward FDI is much larger than the inward FDI. Dunning and Narula (1996) proposed the theory of Investment Development Path to describe the hypothetical FDI pattern of a nation. According to the theory, the outward-inward FDI gap or net investment amount becomes negative with the increase of investment inflow during the first and second stage, which then moves closer to zero as the investment outflow increases in the third stage. The net investment amount becomes positive in the fourth stage and continues to increase, but the investment inflow also increases in the fifth stage to complete the pattern of positive and negative net investment amount alternating afterwards.

As figure 1 depicts, Japan shows a pattern of FDI that does not follow the theory of Investment Development Path. In other words, Japan maintained a greater outward FDI than inward FDI after the 1980s, keeping a positive amount of net investment. Inward FDI increased temporarily in 2007, 2008, 2014, and 2016, but remained at low levels overall. On the other hand, outward FDI increased after the Plaza Accord of 1985, became dormant in the 1990s after the collapse of the bubble economy, and increased again after 2000. There was a dramatic decrease in investment after the 2008 Financial Crisis, but it regained increasing momentum after 2011. In 2017, outward FDI was 168.6 billion dollars while inward FDI was 18.8 billion dollars, resulting in a large outward-inward investment gap of 149.7 billion dollars (JETRO). Accordingly, the Japanese balance of trade was negative in certain years, but the current account balance remains positive due to the increase of income balance from outward FDI.

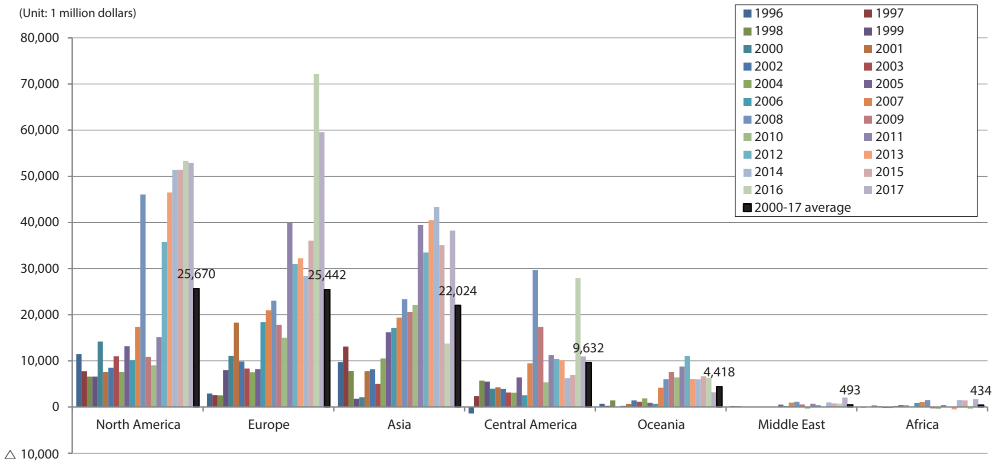


Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan).

Figure 1. Trend of Japanese FDI

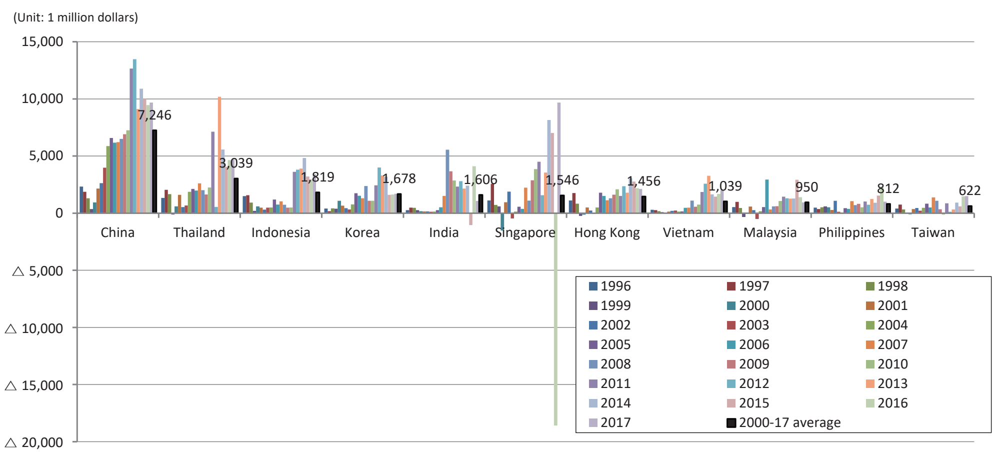
As illustrated above, Japan's economy is a powerhouse in not only trade but also investment, and this paper now moves on to investigate where outward FDI occurred. Figure 2 categorizes Japanese outward FDI based on regions. Looking at the yearly average investment amount from 2000 to 2017, the most investment occurred in North America, then Europe and Asia. According to White Paper on International Trade, large amounts of investment were concentrated in non-manufacturing industries like real estate in the US when Japanese yen appreciated in the late 1980s after the Plaza Accord. After the collapse of the bubble in the early 1990s, investment in Asia relative to the manufacturing industry increased significantly (Keizai Sangyōshō 2014, 228-42).

Asia is one of the critical regions of investment for Japan, and figure 3 depicts the investment status of each regional nation. Investment in Asia was already at a high level in the mid-1990s, but it increased significantly during the 2000s after the Asian Financial Crisis. For yearly average values from 2000 to 2017, it is notable that China had the largest amount of investment, followed by Thailand, Indonesia, Korea, India, and Singapore. At this time, investment in Korea was on average 1.68 billion dollars per year, which was a quarter of 7.25 billion dollar-investment in China, and ranked fourth in Asia in terms of investment amount.



Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan).

Figure 2. Regional trend of Japanese outward FDI



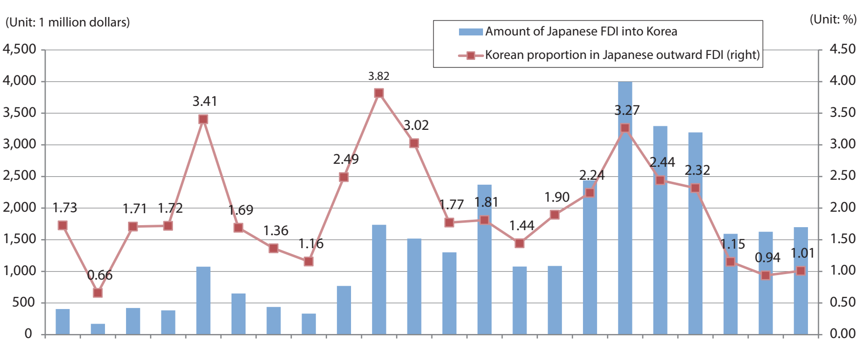
Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan); negative value means that withdrawal amount was more than execution amount.

Figure 3. Trend of Japanese outward FDI to Asian nations

2. Japanese FDI into Korea and Proportion of Korea

Before investigating Japanese FDI into Korea in detail using Korean data, this section first creates a general overview based on Japanese data. Figure 4 shows the trend of Japanese FDI into Korea using data from Ministry of Finance, Japan. The Korean and Japanese data on Japanese FDI into Korea do not exactly match due to the difference in statistics collection, although there is no significant difference in the overall pattern. First, looking at the investment amount after 1996, it shows a general increasing trend, the scale of which has grown smaller recently. In other words, except for the 1.07 billion dollars in 2000, the investment amount never exceeded one billion dollars annually from 1996 to 2004. After 2005, the amount tended to surpass one billion dollars per year, reached its maximum at 4.0 billion dollars in 2012 right after the Great East Japan Earthquake, and stabilized at around 1.6 billion dollars after 2015.

On the other hand, Korea took around two percent of Japanese outward FDI from 1996 to 2017 with a yearly average of 2.07 percent from 2000 to 2017. During this period, there were three booms in 2000, 2005, and 2012, with 3.4 percent, 3.8 percent, and 3.3 percent, respectively. The first boom was right after the Asian Financial Crisis and the third one was just after the Great East Japan Earthquake, both of which were special situations that affected direct investment. Especially, in 2012, not only the proportion of investment in Korea was high but the investment amount was also the largest ever, and this could have been recognized at the time as possibly a temporary situation. Meanwhile, the proportion invested in Korea over the three years from 2015 to 2017 has remained



Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan).

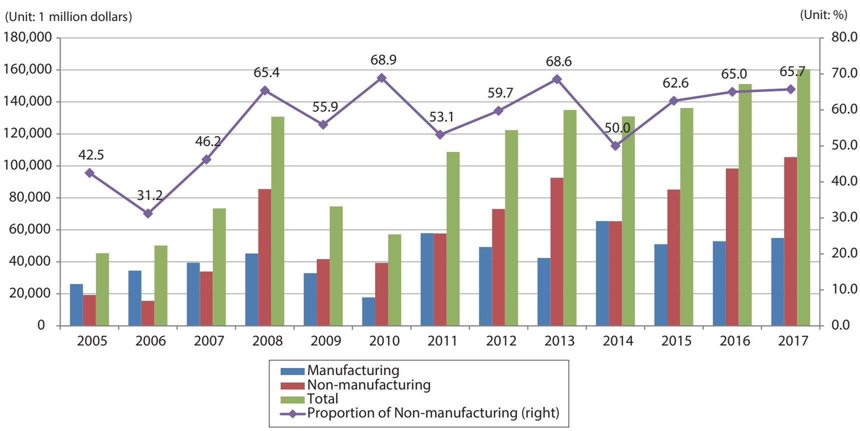
Figure 4. Amount of Japanese FDI into Korea and Korean proportion

at an extremely low level of around one percent. This information implies that Korea is not an attractive country for Japanese investment.

3. Industrial Trend of Japanese Outward FDI

As evidenced above, Japanese companies have more actively conducted outward FDI after the year 2000. This section aims to investigate the industries in which those investments occurred. Figure 5 depicts the trend of investment in manufacturing and non-manufacturing industries after 2005. Despite the fluctuations in manufacturing industry investment, the amount has remained around forty billion dollars per year. On the other hand, while non-manufacturing industries showed a brief decreasing tendency after the 2008 Financial Crisis, the pattern has demonstrated a large overall increase. As a result, in 2017 investment in the manufacturing industry was 55 billion dollars, but that of non-manufacturing industries was around twice as much with 105.5 billion dollars. This increasing interest in non-manufacturing industries was evident in the proportion of non-manufacturing industries in the total direct investment amount, which exceeded fifty percent after 2008, foreshadowing an even greater increase over the next decade. Underlining this transition is the fact that the proportion of non-manufacturing industry in 2006 was 31.2 percent, but it reached double this proportion, at 65.7 percent in 2017.

Next, figure 6 shows the trend of Japanese outward FDI for specific industries

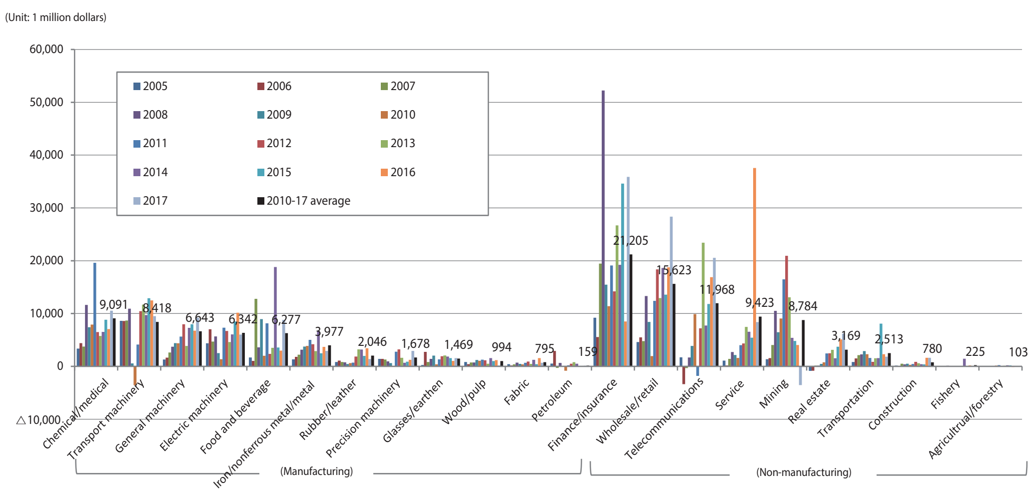


Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan).

Figure 5. Trend of Japanese outward FDI in manufacturing and non-manufacturing

within the manufacturing and non-manufacturing sector. In general, non-manufacturing industries have engaged in active investment, and this is confirmed by the data for yearly average investment amounts from 2010 to 2017. In other words, the industries that ranked first to fourth in their yearly average amounts were finance/insurance, wholesale/retail, telecommunications, and services, all of which are non-manufacturing industries. The industry that ranked fifth is the chemical/medical industry, which is a manufacturing industry, but then the sixth industry is again non-manufacturing, albeit mining. From seventh place onward manufacturing industries are dominant including transport machinery, general machinery, electric machinery, food and beverage, iron/non-ferrous metal/metal. However, their investment amounts are not even half the amount ventured within the finance/insurance or wholesale/retail industries.

It is therefore clear that this pattern of investments occurred in a way whereby non-manufacturing industries overwhelmed manufacturing industries after 2008 based on the overall industrial characteristics of Japanese FDI after 2000. In addition, finance/insurance, wholesale/retail, telecommunications, and services received the majority of investments among non-manufacturing industries. These investments in non-manufacturing industries were usually in developed countries, and the country comparison chart shows that most investments after 2010 were in North America and Europe.



Source: Processed by the author using Nihon Bōeki Shinkō Kikō (n.d.) (originally from Ministry of Finance, Japan).

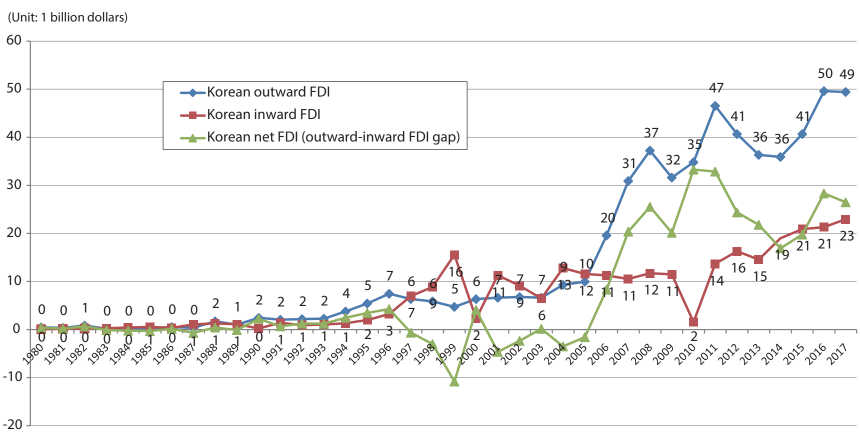
Figure 6. Trend of Japanese outward FDI in specific industries

Japanese FDI into Korea Based on Korean Statistical Data

1. Korean Inward FDI

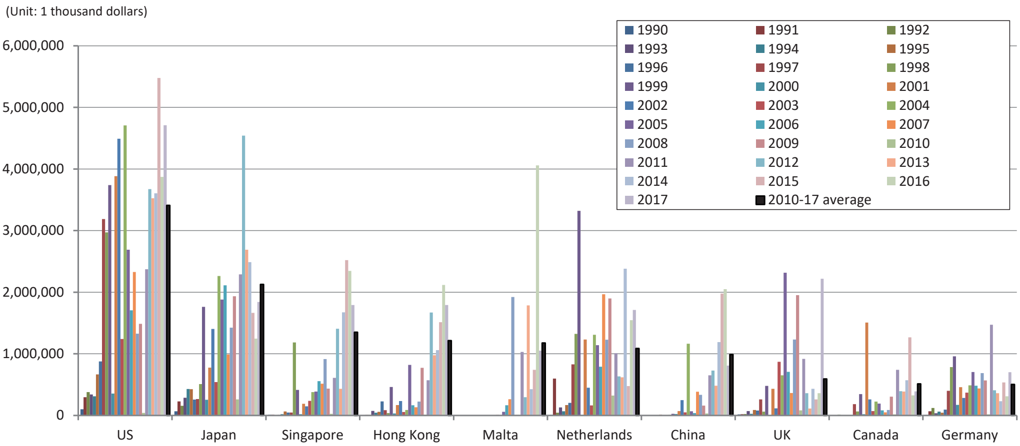
The previous section investigated FDI into Korea from a Japanese perspective. This section now investigates Japanese FDI into Korea from a Korean viewpoint. Figure 7 illustrates the trend of outward FDI and inward FDI to demonstrate the overall pattern of FDI in Korea. Korean FDI existed in the 1980s, but it was only after the Asian Financial Crisis in 1998 that foreign investment flourished as an open economic policy was followed. The investment pattern of this period shows negative net investment values until 2005, which turns around to positive after 2006. After 2012, net investment has tended to decrease; however, today outward FDI still exceeds inward FDI by a large amount. According to the Investment Development Path theory of Dunning and Narula (1996), Korea is in the fourth or fifth stage, but there is a high possibility that, like Japan, the status of positive net investment may continue in the future.

Since Japanese FDI into Korea, the subject of this research, is a portion of total Korean inward FDI, it would be appropriate to observe the overall situation of Korean inward FDI first. For Korea, the regions of major investment have been Asia, Europe, and America, while the regions of minor investment were



Source: Processed by the author using Han'guk Such'ulip Eŭnhaeng Haeoe Kyŏngje Yŏn'guso (n.d.) (performance of 1980 is the accumulation of those in 1968-80) for outward FDI, and Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts) for inward FDI.

Figure 7. Trend of Korean FDI



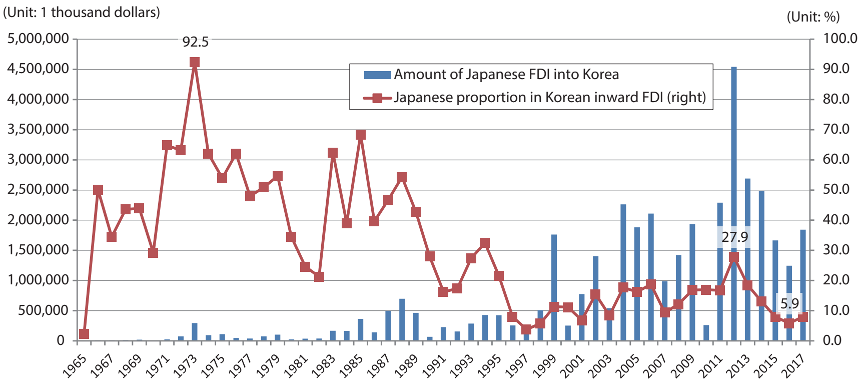
Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 8. Trend of Korean inward FDI by country

the Middle East and Africa, in terms of yearly average amounts from 2000 to 2017. Figure 8 shows the annual investment amounts on average by country between 2010 and 2017, with the top nations in order being the US, Japan, Singapore, Hong Kong, Malta, the Netherlands, China, the UK, Canada, and Germany.

Japan has therefore invested the most in Korea after the US based on dollar amounts after 2010. This fact notwithstanding, there has been a dramatic change in the position of Japan as an investing nation in Korea over the long run. Figure 9 depicts the trend of Japanese FDI into Korea after the normalization of Korea-Japan diplomatic relations in 1965. While in dollar amounts Japanese investment was low until the 1980s after diplomatic normalization, the proportion of Japan among the Korean inward FDI was historically highly significant. In this regard, the Japanese proportion was the highest at 92.5 percent in 1973, and the yearly average from 1970 to 1989 remained at 49.5 percent. Therefore, during this period Japan was responsible for half of the Korean inward FDI, which means the Korean economy was historically highly dependent on Japan.

However, in the 1990s, Japan gradually held a lesser portion of investment, and after 2000, while the absolute investment amount continued to rise, its relative proportion to other nations got even lower. After 1996, the Japanese proportion accounted for under twenty percent except for 2012. As a result, the yearly average Japanese FDI into Korea from 2000 to 2017 was 1.7 billion



Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 9. Amount of Japanese FDI into Korea and Japanese proportion

dollars, or 13.8 percent in terms of proportion. Due to the Great East Japan Earthquake of the previous year, the investment amount reached 4.54 billion dollars, or 27.9 percent of the total in 2012. Yet, this phenomenon was only temporary as the amount and proportion immediately decreased afterwards. In more recent years, the Japanese proportion even crashed to 5.9 percent in 2016. Based on table 1 that shows the order of FDI into Korea by country, Japan ranked first in 2012, second in 2013 and 2014, fourth in 2015, and seventh in 2016, showing a definite decreasing tendency. And it is significant that investments from both Singapore and China exceeded those from Japan in 2015 and 2016.

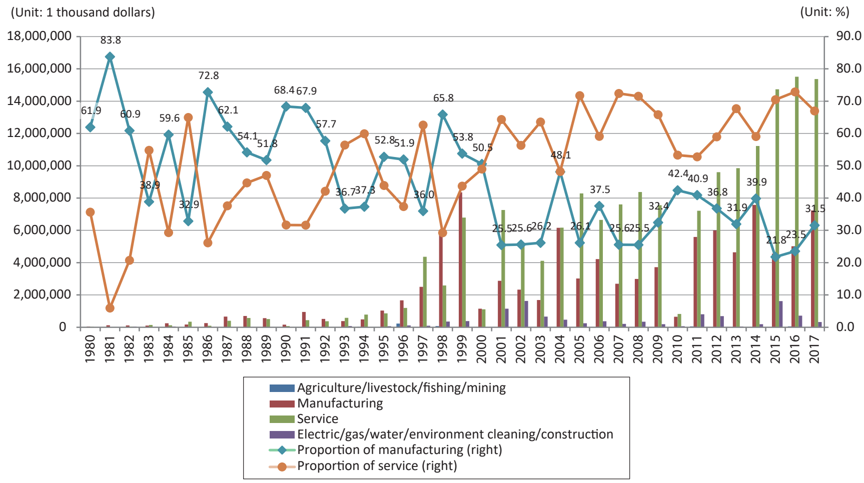
2. Industrial Trend of Korean Inward FDI

One of the aims of this study is to understand FDI relative to the different types of industry engaged in such. To this end, it is appropriate to examine the changes that Korean inward FDI went through in terms of industry types. Figure 10 divides industries into four categories of agricultural/livestock/fishing/mining, manufacturing, service, and electric/gas/water/environment cleaning/construction industries. Among these, manufacturing and service industries comprise the most investments while the other two aforementioned categories of industries are relatively minor in scale. The two major industries show different tendencies, though, as the manufacturing industry has tended to decrease and the service industry increase. Paying attention to the period around 2001 when

Table 1. Ranking of investing countries in Korean inward FDI

Rank/Year (1 thousand USD)	2012		2013		2014		2015		2016		2017	
1st	Japan	4,541,610	US	3,525,455	US	3,606,231	US	5,478,886	Malta	4,058,671	US	4,710,299
2nd	US	3,674,116	Japan	2,689,750	Japan	2,487,648	Singapore	2,521,119	US	3,872,916	UK	2,218,062
3rd	Hong Kong	1,669,800	Malta	1,785,059	Netherlands	2,380,448	China	1,978,346	Singapore	2,347,378	Japan	1,842,430
4th	Singapore	1,405,407	Hong Kong	976,484	Luxemburg	1,920,125	Japan	1,664,982	Hong Kong	2,118,098	Singapore	1,793,130
5th	China	726,952	Luxemburg	711,570	Singapore	1,672,654	Hong Kong	1,514,920	China	2,049,170	Hong Kong	1,791,604
6th	Netherlands	632,621	Netherlands	618,008	China	1,189,362	Virgin Islands	1,277,297	Netherlands	1,547,398	Netherlands	1,710,645
7th	Germany	407,864	France	529,928	Hong Kong	1,061,042	Canada	1,268,362	Japan	1,245,967	Malta	1,051,076

Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

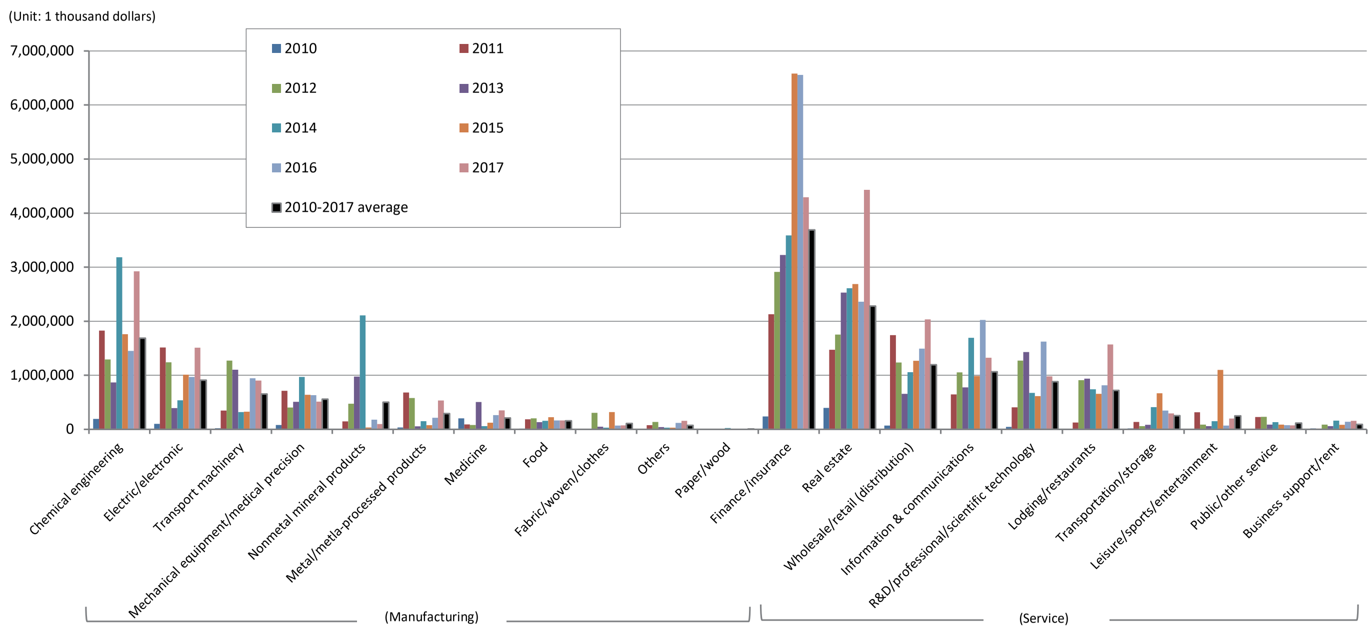


Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 10. Trend of Korean inward FDI by industrial categories

the proportion of service industry started to surpass that of manufacturing, it is noticeable that the annual average proportion of manufacturing industry was 55.1 percent from 1980 to 2000, which then decreased to 31.8 percent in between 2001 and 2017. On the other hand, the annual average proportion of the service industry improved greatly from 40.7 percent to 63.2 percent during the same period. This pattern exemplifies the phenomenon in which the service industry became responsible for the majority of inward FDI after 2001 in Korea.

Next, figure 11 shows the recent investment trends of sub-industry categories in manufacturing and service industries in order to examine which sub-category is responsible for the majority of inward FDI. For manufacturing, the industries investing the most money based on annual averages from 2010 to 2017 were chemical engineering, electric/electronic, transport machinery, and mechanical equipment/medical precision. Whereas for the services sector, the biggest industry investments were within finance/insurance, real estate, wholesale/retail (distribution), and information and communications. Across all industries, the top five categories are finance/insurance, real estate, chemical engineering, wholesale/retail (distribution), and information and communications, which include four service industries out of the five, demonstrating highly active investment within the service industry. In connection with the Japanese FDI and the overall trend of investment in Japan and Korea, it is also possible to see



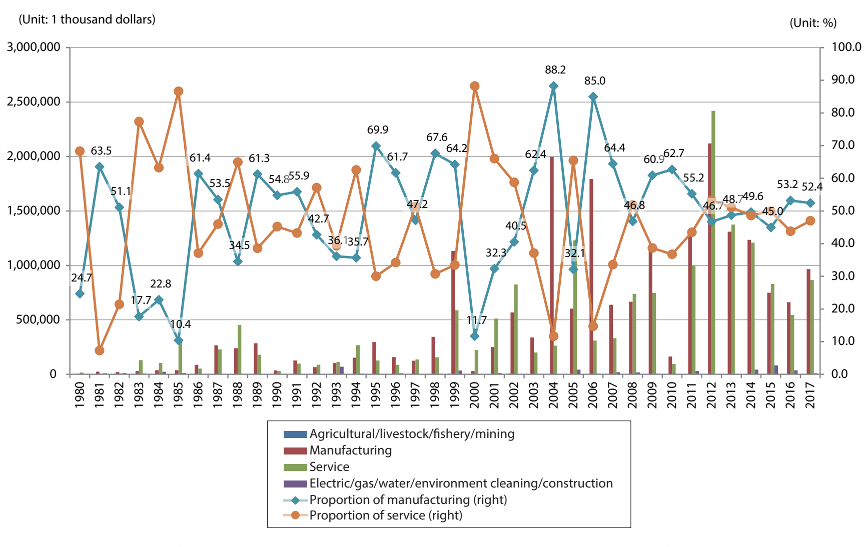
Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 11. Trend of manufacturing and service industries in Korean inward FDI

that both the fields that Japan invests in overseas, and that Korea receives inward FDI within, are expanding around the service industry

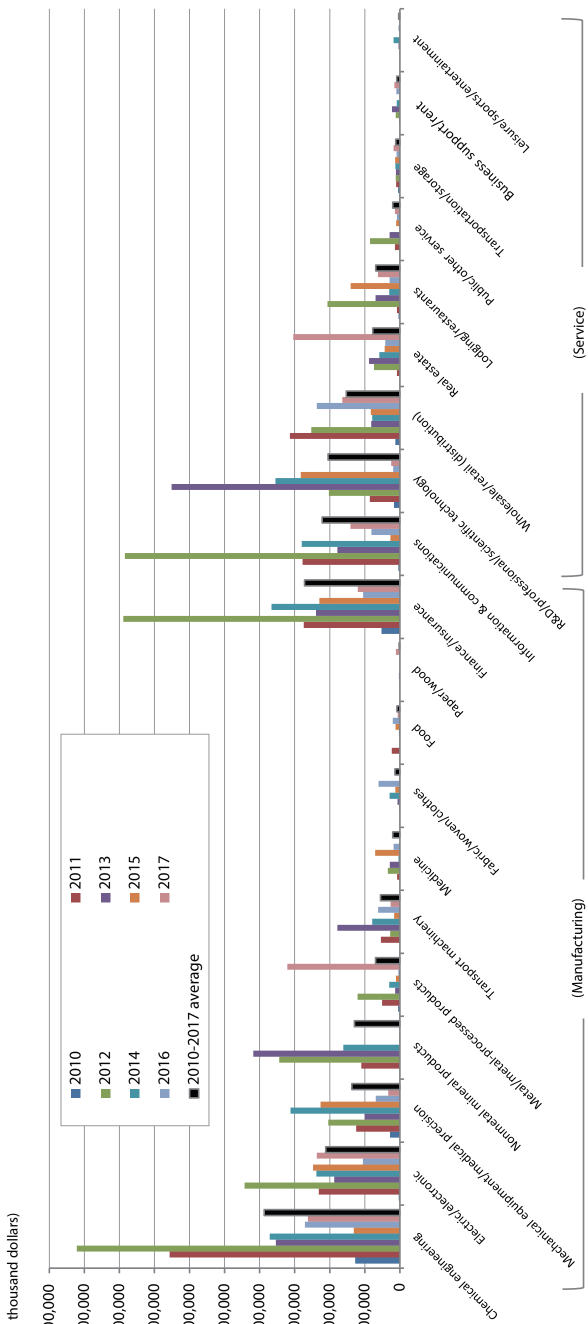
3. Industrial Trend of Japanese FDI into Korea

So far, the results have showed how inward FDI in Korea has shifted to focus on service industry. This section aims to discuss the changes of investment from Japan in terms of this industry. Figure 12 depicts the trend of Japanese FDI into Korea by industrial classifications. In comparison to figure 10, which described the industrial trend of overall Korean inward FDI, there is an interesting point to make here. In terms of overall inward FDI, the focus of investment was manufacturing before 2000 while it was service after 2001; however, it is difficult to find such change in investment from Japan. The proportion of investment fluctuates around fifty percent between manufacturing and service industry without any emphasis on a specific industry. Rather, the proportion of manufacturing industry is greater after 2001 than before. The actual yearly average proportion of manufacturing industry investment was 45.2 percent in between 1980 and 2000, which increased to 54.5 percent in between 2001 and 2017. On the other hand, the yearly average proportion of service industry investment



Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 12. Trend of Japanese FDI into Korea by industrial categories



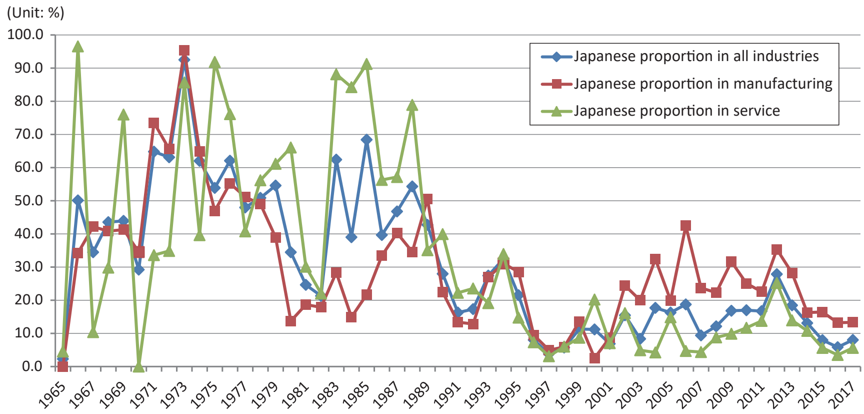
Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 13. Trend of Japanese FDI into Korea in manufacturing and service industries

dropped from 48.9 percent to 44.2 percent during the same period. Therefore, the proportion of manufacturing industry engagement is still high after the year 2000 in terms of Japanese FDI into Korea.

Figure 13 also shows the same trend of a high proportion of manufacturing industry activity when it comes to Japanese FDI into Korea in relation to specific industrial fields. First, the main industries were related to material/parts such as chemical engineering, electric/electronic, mechanical equipment/medical precision, and nonmetal mineral products from 2010 to 2017 in the manufacturing industry. This phenomenon reflects Japanese companies attempting to exploit a competitive advantage in the material/parts industry by investing in Korea. Meanwhile, the major industries engaged in investment in the service industry were finance/insurance, information and communications, R&D/professional/scientific technology, and wholesale/retail (distribution). In comparison to the overall inward FDI, the finance/insurance industry still maintains the highest investment rank, but it is notable that the second and third are knowledge-intensive industries like information and communications and R&D/professional/scientific technology. Furthermore, two industries among the top five lie within the manufacturing industry.

Figure 14 displays the proportion that Japan receives in Korean inward FDI within all industries, the manufacturing industry, and the service industry, respectively. It shows that the proportion of Japanese activity in the manufacturing and service industries has decreased gradually, as it has within all industries. However, it is interesting to note that the proportion of Japanese activity in the manufacturing industry was higher than either all industries or the service industry since 2001. In other words, the proportion of Japanese activity in inward FDI after 2001 was lower than before, but investment in the manufacturing industry was at a relatively greater amount. The actual yearly average of Japanese proportion of investment across all industries was 13.9 percent from 2001 to 2017. Relative to this, the service industry was 9.7 percent, while the manufacturing industry was at a higher level of 23.3 percent. The fact that manufacturing companies from both nations with mutually beneficial interests and characteristics have strategically allied to dominate in the global market is notable (Momomoto 2018).



Source: Processed by the author using Sanŏp T'ongsang Chawŏnbu (n.d.) (based on declared amounts).

Figure 14. Trend of Japanese proportion in manufacturing and service industries

Characteristics and Implications of Japanese FDI into Korea

1. Characteristics of Japanese FDI into Korea

One of the purposes of this study is to analyze the characteristics of Japanese FDI into Korea after the year 2000. To this end, this research investigates this FDI from both Japanese and Korean perspectives. Based on the observations above, the following section will first discuss these characteristics from a Japanese point of view, before moving on to the Korean.

First, Japan transitioned from an export-oriented nation to an investment-oriented nation after 2000, and Korea may not be an attractive country to invest in from the Japanese point of view. This means that Korea is in a competitive situation with other Asian nations, and Korea was the fourth-highest investment recipient among Asian countries in terms of the yearly average amount between 2000 and 2017, with an investment amount that was only a quarter of that in China.

Second, the proportion that Korea took within the overall Japanese outward FDI was around two percent after 2000, but it has diminished significantly in recent years. The yearly average of Korean proportion from 2000 to 2017 was 2.07 percent, with a decreased proportion after 2015 of around one percent. In other words, Korea is no longer an important country of investment for Japan.

Third, the proportion of non-manufacturing industries engaged in Japanese outward FDI has increased after 2000, and Japanese investment into Korea is occurring against this backdrop. In statistical terms, the proportion of non-manufacturing industries maintained a high level of fifty to seventy percent after 2008, with especially active outward FDI in finance/insurance, wholesale/retail, communication, and service areas.

With regards to the characteristics of Japanese FDI into Korea, the Korean perspective can be summarized in the following three points. First, Japanese FDI into Korea is only a part of Korean inward FDI. While Japan was the major investing nation in the past, after 2000, its relative investment underwent a sharp decrease even though the absolute amount had increased from the past. In this respect, the proportion of investment coming from Japan was extremely high in the 1970s and the 80s with yearly average of about fifty percent. This yearly average decreased to lower than twenty percent after the mid-1990s, with the exception of 2012.

Second, the Japanese proportion dropped to under ten percent after 2015, showing the recent advancing decline of the Japanese position as an investing nation for Korea. The actual proportion of Japanese investment in 2015 was 5.9 percent. This decline is striking considering the level was as high as 92.5 percent in 1973. In other words, it is not only that Korea is no longer a major country for investors from Japan but also that Japan is no longer a key investing nation for Korea.

Third, the industrial characteristics show that the overall inward FDI in Korea after 2001 was particularly active within the service industry, but the manufacturing industry continued to draw high portion of investment from Japan. Additionally, the Japanese proportion across the entire level of industrial investment was low after 2000, but in manufacturing industries, the proportion of Japanese FDI into Korea maintained a higher level than that of all-industry level after 2001. This indicates that investment from Japan is still important in the manufacturing industry.

Another purpose of this study is to address the circumstances behind the decline in Japanese FDI into Korea after 2013. An in-depth analysis of such topic is beyond the scope of this paper, but a brief discussion can be outlined as follows. First, in terms of the investment amount, recent Japanese FDI into Korea for the three years—2015, 2016, and 2017—followed in a similar trend from the past, rather than being particularly low. The proportion of investment in Korea over this period for Japanese outward FDI was around one percent, and the Japanese proportion in Korean inward FDI was under ten percent. However, this could be attributed to the relative lack of increase in Japanese FDI into Korea in comparison to the dramatic increase in Japanese outward FDI and

Korean inward FDI. The Japanese proportion of Korean inward FDI dropped from 15.1 percent per year (between 2000 and 2014) to 7.3 percent per year (between 2015 and 2017). However, in terms of the investment amount, the yearly average of 1.58 billion dollars in between 2015 and 2017 was similar to the yearly average of 1.72 billion dollars in between 2000 and 2014. With the exclusion of 2012, the yearly average amount between 2015 and 2017 was actually larger than the yearly average amount of 1.52 billion dollars in between 2000 and 2014.

Second, it is difficult to deny that Japanese FDI into Korea has stalled recently, something for which the political conflict between Korea and Japan can be held accountable. Diplomatic tensions between Korea and Japan after 2012 have continued due to territorial and historical problems, and it is natural to expect that these political factors played a role in affecting FDI into Korea from Japanese companies (Han'guk kyŏngje 2016). The impact of political tensions between countries relative to FDI can also be observed in Korea-China relations. As table 1 shows, China ranked third in 2015 for Korean inward FDI, but it dropped to fifth in 2016 and tenth in 2017 due to the bilateral conflict surrounding THAAD deployment.

Third, even though Japanese FDI into Korea has stalled recently, that which continues retains many positive aspects. As discussed earlier, Japanese investment has persisted in the manufacturing industry and it has been conjectured that a lot of investment has been made in hi-tech fields such as chemical engineering, electric/electronic, mechanical equipment/medical precision, and nonmetal mineral products. Also, investment in knowledge-intensive fields such as finance/insurance, information and communications, and R&D/professional/scientific technology were the dominant interests in the service industry. In particular, it should be stated that investment from Japanese companies in the material/parts industry will continue if Korean large companies in the advanced manufacturing industry maintain their production bases in Korea.

2. Policy Implications for Securing Japanese FDI into Korea

Japan was historically a major investing country within Korean industry after the normalization of Korea-Japan diplomatic relations, and the contribution that Japanese companies made in developing the Korean economy cannot be easily denied. The investment amount from Japan increased after 2000, and reached its historical peak in 2012 with 4.54 billion dollars. However, the Japanese proportion of Korean inward FDI has dropped significantly and the investment amount has effectively stalled during the current period. Under these circumstances, this research aims to suggest the following policy implications related to securing further Japanese FDI into Korea based on the analysis above.

First, to secure high quality investment from Japanese companies in the manufacturing industry, it is essential to improve the advantage of Korea as a production base. There are many cases where Japanese companies have invested in Korea to supply material and parts to Korean industry from locations close to the major companies that manufacture automobiles, semiconductors, and LCD panels, such as Samsung and Hyundai (Lee Hyungoh and Han Mi-kyŏng 2005). Korea no longer has an advantage in the production of simple processed and assembled products, but the continued domestic production of advanced products such as semiconductors is, therefore, critical to secure investment from Japanese companies. As production bases are apparently moving overseas rapidly, deregulation and support are necessary more than ever to promote greater domestic investment by Korean large corporations.

Second, Japanese companies will expand their investment in the service industry as the proportion of the service sector is increasing in Korean inward FDI. In particular, it is necessary to actively support and secure investment in research and development areas. As noted, Japanese investment is active in R&D/professional/scientific technology fields. In this regard, it is necessary to promote further investment in these areas with greater policy support. Considering the high level of Korean technology in fields such as IT and biotechnology, securing investment from Japanese companies in these areas would be immensely productive. In addition, it is crucial to clarify a policy vision supporting the further growth of Korea as a global research and development center for knowledge-driven industries.

Third, considering the negative effect that political conflict between Korea and Japan has had on direct investment between the two nations, it is necessary for the governments of both nations to do more to support each other to minimize any further political issues. It is important to form a more future-oriented relationship between the two countries by actively promoting economic cooperation through direct investment, and demonstrating how such has resulted in the economic development of both nations. In the long run, improved mutual understanding through transnational programs to promote social and cultural exchange between young adults will also doubtless have positive effects in helping to resolve historical political conflicts and promote economic cooperation.

Conclusion

The purpose of this study is to analyze the characteristics of Japanese FDI into Korea after 2000, assess the recent situation of low investment using statistical data from Korea and Japan, and suggest policy foci to expand future investment. In its analysis, this paper utilized public statistics from Korea and Japan and focused on primarily industrial characteristics to investigate Japanese FDI into Korea.

In summary it can be stated that Japanese FDI into Korea after 2000 had the following characteristics. From the Japanese perspective, Korea is not necessarily an attractive investment destination when compared to other competitive states in Asia. The proportion of Korean investment in Japanese outward FDI was low at around two percent and it has recently decreased to around one percent. Also, Japanese FDI into Korea is occurring as Japanese outward FDI in non-manufacturing industries is expanding in general terms. From the Korean perspective, the amount of Japanese investment after 2000 has increased but the Japanese proportion of Korean inward FDI has diminished. In fact, the proportion after 2015 has dropped significantly to under ten percent. However, the manufacturing industry still maintains a high proportion of Japanese investment into Korea.

The following points must be emphasized regarding the low investment from Japan in recent years. While the proportion coming from Japan has decreased, the investment amount itself has kept the previous level. Also, and as stressed here, Korea-Japan political conflicts have played a significant role in stalling investment from Japan, though nonetheless the ongoing investment content is positive.

Furthermore, based on the overall analysis this study suggests the following policy changes to help secure future Japanese FDI into Korea. These include: the need to improve the advantage of Korea as a production base to secure high-quality Japanese investment; the necessity to actively support and secure investment in research and development within the service industry; and greater effort to minimize political conflicts between Korea and Japan and expand intercultural social exchanges within the civilian community.

This study primarily used publicly available statistical data to analyze Japanese FDI into Korea after the year 2000 from a macro level. Such an analysis helps us to understand the overall flow of investment, but it is of limited value in setting out the more specific contexts of individual industrial areas and companies within the trend. Therefore, in terms of future research, a series of in-depth analyses of the changes within individual industries and companies related to the Japanese FDI into Korea would be productive. Specifically, it would be meaningful to analyze the effects of the structural shifts within specific industries directly relative to Japanese FDI into Korea. By studying individual companies at a micro level one could investigate what range of factors affect FDI into Korea. Then, ultimately, highly specific policy changes could be informatively suggested and logically considered.

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