Analysis of Effects of Increased Overseas Direct Investment on the Current Account Position

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As Korea's overseas direct investment have become active since 2000, the outstanding stock rose sharply to 160.6 billion dollars in 2011 from 20 billion dollars in 2001, and the consequent increase in transactions with overseas subsidiaries is expected to have affected the current account.

According to the result of a panel analysis using performance of overseas subsidiaries, increased overseas direct investment had a conspicuous export-inducement effect, which arose from overseas subsidiaries' import of the intermediate goods, etc. needed for overseas production from Korean companies. However, since the increased overseas direct investment also generated a statistically significant export-substitution effect — exports of domestic goods decline in line with increases in production and sales by overseas subsidiaries — increased overseas direct investment did not have a statistically significant overall effect on the goods account, with the mutual offset of these export-inducement and substitution effects. Nor did the increased overseas direct investment have a significant effect on the current account, which covers royalties and dividends from overseas subsidiaries as well as the goods account. According to the analysis using macroeconomic data on the balance of payments and international investment position, the effect of overseas direct investment in improving the current account position has weakened since 2003 and has recently shown less statistical significance. These results from empirical analysis seem attributable to the weakened effect in enhancing the goods account due to the progress of localization, including increased investment for the purpose of entering local markets overseas and the increased weight of purchases in overseas local markets by overseas subsidiaries. It is also because the improvement in the services and primary income balances does not yet have a significant influence on the current account as a whole.

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These results suggest that efforts are needed so that domestic businesses' expansion of their overseas direct investment and the progress of localization do not have possible negative effects on the current account, given that current account stability is vital for the Korean economy. It is necessary to increase exports of technology-intensive intermediate goods and the inflow of royalties by improving the domestic investment environment in areas of higher value-added business such as core technology development and design. It is also important to increase dividend income by strengthening support for the local management of overseas subsidiaries to help them enhance their growth and profitability.