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# Outward FDI and Hollowing-out: Towards the Strategic Re-location of Korean Industries

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## I. Korea-U.S. Trade Deals and the Investment Surge[1]

Following a prolonged period of negotiations under the "reciprocal tariff" regime, Korea, similar to other major exporters like the European Union and Japan, secured reduced tariff rates conditional upon committing to large-scale local investments in the United States. The U.S. administration has consistently placed the reconstruction of American manufacturing and domestic job creation at the top of its policy agenda. This commitment is so steadfast that Washington recently hinted at the possibility of re-imposing higher tariffs, citing Korea's lukewarm implementation of the agreed-upon investment pledges.

Crucially, this surge in investment is not merely a political concession but reflects a fundamental restructuring of global value chains. As geopolitical uncertainties intensify, Korean firms are pivoting from a traditional strategy of cost minimization to one of risk minimization. By establishing production bases directly within the United States, these companies aim to insulate themselves from future trade barriers and secure stable access to their most critical market, effectively decoupling their supply chains from geopolitical flashpoints.

The scale of capital Korea has pledged to invest locally in the U.S. is staggering, potentially large enough to induce fundamental shifts in the valuation of the Korean won. The bilateral agreement encompasses a monumental package: USD 200 billion in direct cash investments and USD 150 billion in shipbuild-

[1] This World Economy Brief is based on the main findings of Koo et al. (forthcoming).

ing cooperation. These plans are rapidly materializing, evidenced by the U.S. government's recent release of "America's Maritime Action Plan," which explicitly designates Korea as a key partner in rebuilding U.S. naval and commercial maritime capabilities.

Beyond the maritime sector, this investment wave spans across Korea's core strategic industries, including semiconductors, electric vehicle batteries, and advanced electronics. Major Korean conglomerates are rapidly breaking ground on large-scale manufacturing facilities across key U.S. states. This broad-based migration of manufacturing capacity signifies a deep integration of Korea's industrial ecosystem with the U.S. supply chain, moving far beyond simple assembly operations to include high-value-added production processes.

It is unprecedented for Korea to execute outward FDI (OFDI) of this magnitude based on a bilateral government agreement. Consequently, this unparalleled volume of capital outflow has sparked intense debate and varied projections among economists regarding its potential impact on the domestic economy.

## II. The Hollowing-out Hypothesis

Among the various economic forecasts regarding the massive investment pledges to the United States, there is a prevalent negative prediction that this capital outflow will trigger the "hollowing-out" of the Korean economy. The primary concern is that as the manufacturing bases of Korea's major conglomerates relocate to the U.S., domestic job creation will severely contract, potentially leading to the collapse of the domestic manufacturing ecosystem.

Does an established empirical stylized fact exist regarding the impact of outward FDI on the home economy? Given the vast diversity in units of analysis, time periods, and industry classifications across existing literature, a dominant causal relationship that could be termed a "stylized fact" has yet to be confirmed.

Research rigorously tracking the impact of FDI history on firm performance at the firm level began to accumulate in earnest only after the 2000s. This is because robust empirical estimation requires firm-level panel data of a significant scale, and representative estimates can only be derived from data with an even distribution across industries and firm characteristics. Since such comprehensive datasets were first established in North America and Europe, early studies predominantly focused on firms in these regions.

In a seminal study, Desai et al. (2009) analyzed data on U.S. multinational manufacturers from 1982 to 2004, utilizing the GDP growth rates of foreign destination countries as an instrumental variable (IV) to isolate the causal effect of foreign expansion on domestic

economic activity. The authors found that foreign investment expansion actually drove increases in domestic investment and wages. This finding garnered significant attention as it suggested that, contrary to the conventional wisdom that OFDI shrinks domestic industry, foreign and domestic operations are complementary, and overseas expansion can enhance domestic R&D investment and firm performance.

Due to the difficulty in accessing longitudinal data that tracks the scale of firm-level OFDI, a number of studies in the 2010s sought to provide indirect evidence by examining the impact of offshoring on firm performance. Hummels et al. (2014) demonstrated that offshoring by Danish firms increased wages for high-skilled workers while decreasing them for low-skilled workers. Sethupathy (2013), utilizing U.S. firm-level data, analyzed the wage and employment effects of offshoring to Mexico. According to the analysis, while increased offshoring to Mexico was statistically significantly associated with domestic wage increases in the U.S., no empirical evidence was found regarding its impact on employment levels.

Literature utilizing Korean data has also accumulated in recent years, with notable contributions from Lee et al. (2014), Lee and Park (2020), and Jung and Hur (2024). Lee et al. (2014) analyzed the link between Korean firms' OFDI and domestic wage inequality. By classifying workers into skilled regular, unskilled regular, skilled non-regular, and unskilled non-regular categories, the authors found that the impact of OFDI on wages in Korea depends more on employment type (regular vs. non-regular) than on skill level. Lee and Park (2020) focused specifically on greenfield FDI to analyze its employment effects, while Jung and Hur (2024) identified the relationship between Korean firms' OFDI and the "servicification" of domestic employment.

## III. Study Design: Firm-level Evidence from Korea

To empirically verify the impact of OFDI on the domestic economy in Korea, Koo et al. (forthcoming) utilize firm-level panel data from the Survey of Business Activities, provided by the Micro Data Integrated Service (MDIS) of Statistics Korea. The dataset covers the period from 2006 to 2023, offering a comprehensive longitudinal view of Korean enterprise activities. We merged the primary survey data with a companion dataset that details the specific OFDI cases of surveyed firms, including the destination country and the nominal magnitude of investment in Korean won. By matching panel IDs across these datasets, we constructed a robust panel structure that allows for the tracking of firm-specific investment behaviors and performance outcomes over nearly two decades.

The authors focus on the relationship between a firm's cumulative outward FDI and three key indicators of domestic performance: domestic regular employment, sales revenue,

and export performance. By examining these variables, the study aims to determine whether expanding production networks abroad substitutes for domestic labor, validating the "hollowing-out" hypothesis, or conversely, complements it by driving overall firm growth.

To ensure the reliability of estimates, the authors employ econometric specification based on the instrumental variable (IV) approach established by Desai et al. (2009). A critical challenge in this type of analysis is endogeneity arising from various channels of reverse causality. The authors utilize the weighted average economic growth of each firm's FDI destination countries as an instrument. Furthermore, the model systematically controls for various firm characteristics that influence performance, including firm age, total asset size, and R&D expenditure, as well as firm and year fixed effects to account for unobserved heterogeneity.

## IV. Main Findings and Implications

Our analysis yields results that challenge the prevailing "hollowing-out" narrative. Contrary to concerns that overseas expansion comes at the expense of local jobs, we find that firms with larger accumulated OFDI tend to increase their domestic regular employment. This positive correlation supports the "complementarity view," suggesting that expanding global networks necessitates a concurrent expansion of domestic managerial, technical, and service capabilities to support international operations. Far from hollowing out the economy, OFDI appears to function as a driver of domestic job retention and creation, invalidating the argument that foreign investment reduces domestic employment.

In addition to employment benefits, firms that actively engage in OFDI experience significant growth in total sales revenue. By securing strategic footholds abroad, Korean firms are effectively capturing global demand and scaling their operations, which contributes to the overall vitality of the firm. Interestingly, however, the study finds that the increased OFDI does not statistically explain change in export performance. While OFDI boosts firm size and revenue, it operates as a distinct channel for growth separate from merchandise exports.

These empirical findings suggest that the Korean economy is not suffering from hollowing-out but is instead undergoing a necessary strategic reallocation of its industries. Consequently, policies based on the fear of industrial decline are unsupported by evidence. Rather than restricting capital outflows, the government should encourage firms to secure global production and service bases. A proactive reallocation strategy will allow Korean firms to strengthen supply chain resilience against geopolitical uncertainties while maintaining their competitive advantage. Furthermore, given the data indicating a rise in OFDI from service sectors such as wholesale and software, policy support must extend beyond manufacturing to help these industries scale globally.

The ultimate goal should be to maintain high-value-added activities, such as R&D and headquarters functions, within Korea, while utilizing global networks to minimize risks and access new markets. KIEP

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