

# Reshoring Pattern-Analysis of China Based Korean Firms and Its Policy Implications

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## 1. Change in Climate for Investment in China and Background to Korean Reshoring Support Laws

Korea's export environment has changed significantly in the last few years. This is shown by the dramatic fall of export tariff to the EU, the world's largest economic block, and the U.S., the second largest export partner, to as much as 100%, owing to the Korea-EU and Korea-U.S. FTAs, which were signed in 2011 and 2012, respectively. The improved export environment in Korea caused by the FTAs

prompted Korean manufacturers that operate abroad to return to Korea. With this, Korean manufacturers that set up their operations in China to take advantage of the country's abundant labor force and cheap wages are now looking for new opportunities because of the deterioration of China's investment climate. The changes in China's investment climate can be viewed from three perspectives with the first being the change in policy toward foreign investments. China's policy for foreign inve-

stment inducement took a turn from “quantitative growth-oriented investments” to “qualitative growth-oriented investments” and curtailed the various incentives it granted to labor-intensive foreign-invested companies in China. The second perspective is the trend of enhanced rights of Chinese workers and social security systems. The Chinese government has established legal groundworks to protect the rights of Chinese workers by reinforcing labor-related laws, including the Labor Contract Law (June 2007), Employment Promotion Law (August 2007), Social Insurance Law (July 2011), among others. Changes in the system for the improvement of worker rights incurred additional economic costs for Korean companies that operate in China. These costs were particularly severe for small and medium-sized companies who went to China in order to take advantage of the country’s low wages. The third and last perspective is the steep rise in the minimum wages in China. The Chinese State Council announced that it will raise minimum wages by 13% every year and the regional minimum wages as of January 2013 was as much as RMB 1,400 (Beijing) and RMB 1,500 (Shenzhen). This dramatic rise in wages is the factor that exerts the most direct burden on Korean manufacturers for which labor costs are proportionally large.

The reshoring, i.e., return to Korea of Korean companies that went abroad, emerged as a response to the deterioration of China’s investment climate.

There are alternatives to the reshoring, such as relocating to Midwestern China or to a third country, such as those in Southeast Asia, where wages are cheaper, but these pose as challenging options as they are all places with high risks. Midwestern China may have low wages and may provide various advantages but there is a good chance that such incentives for inducing investment could be curtailed in a few years. In

the long run, relocation to Midwestern China was not a priority for companies. Third countries, including those in Southeast Asia, may have low wages but have poor industrial fundamentals for manufacturing, such as infrastructure and logistics, and a lack of a skilled labor force. Consequently, returning to Korea may be a viable option for Korean companies in China when they consider the changes in export conditions owing to the FTAs, high labor productivity, and the effects of — Made in Korea. In particular, in cases in which major export markets of Korean manufacturers in China are concentrated in the EU or the U.S., they can take advantage of the tariff reduction if they return to and do export from Korea, coupled with a wider market access.

In this regard, in July 2012, the Korean government announced the enactment of the “Support for Foreign-invested Companies’ Return to Korea Law” (“Reshoring Company Law”) and was officially enacted on August 6, 2013. The purpose of the reshoring Company Law is to provide support to reshoring companies in terms of tax, location, human resources, and finance to promote job creation in Korea and invigorate domestic investment. The detailed enforcement order to this law is still undergoing discussion. Therefore, in order to implement the reshoring Company Law effectively, it sought to stereotype the Korean manufacturers in China and select the business types that are appropriate for the reshoring. It is expected that such selection process will help in the forecast of candidates for support under the reshoring Company Law and in the application of policies by incorporating the special characteristics of Korean companies.

## 2. Stereotyping of Reshoring Companies and Selection of Businesses Appropriate for Reshoring

### A. Stereotyping of Reshoring Companies

The types of Korean manufacturers in China were reviewed by dividing them into countries that procure raw materials (“Purchase Place”) and major export markets that mainly export products manufactured in China by the relevant company (“Export Place”). This study selected the Korea-EU and Korea-U.S. FTAs as factors that promote reshoring. Therefore, the third country that is included in Purchase Place and Export Place represents the EU and U.S. markets. Whether tariff is imposed is expressed as  $O^{**}$  for each finished product and as  $O^*$  for raw materials.<sup>1</sup> These were expressed in terms of before and after the reshoring. To be specific, if the customs tax level falls after the reshoring as compared to the tax level before the reshoring, such company will benefit in terms of saved customs taxes after the Reshoring.

This study inferred that factors other than the customs tax are identical.

In the above matrix, customs tax savings is realized in theory in A-1, B-1, and C-1 in which the final export place is China. However, in reality, these are companies that seek to make their sales in the Chinese domestic market. Because they are those for which access to the domestic market is more important than anything else, relocating their manufacturing site to Korea may be inappropriate and thus, they should be excluded from the type of companies that are amenable to a Reshoring. In the end, companies that have a relatively high chance of making a Reshoring in the above matrix are B-2 and C-3, which are typical labor-intensive processing businesses, and B-3 and C-2, which are those that use the Korea-EU and Korea-U.S. FTAs. Among those that use the FTAs, those items that become subject to trade conflicts, such as Chinese products in the EU or the U.S., will be more likely to make a Reshoring to Korea. The detailed results as to the matrix analysis are shown in Table 2 below.

**Table 1. Stereotyping Matrix for Korean Companies in China in accordance with Purchase/Sale Structures**

Purchase Place \ Export Place		Export Place		
		China (1)	Korea (2)	Third Country (EU/U.S.; 3)
China (A)	Before	No customs tax	$O^{**}$	$O^{**}$
	After	No customs tax	$O^*$	$O^*$
Korea (B)	Before	$O^*$	$O^{**}$	$O^*, O^{**}$
	After	$O^{**}$	No customs tax	No customs tax
Third Country (EU/U.S.; C)	Before	$O^*$	$O^*, O^{**}$	$O^{**}$
	After	$O^{**}$	No customs tax	No customs tax

Note:  $0 < O^* < O^{**}$ .

<sup>1</sup> For reference, if only processing is done in China, customs tax as to the raw materials ( $O^*$ ) receive refunds. Only customs tax regarding finished goods following processing is assessed on the customs office of the final importing country.

**Table 2. Company Types Appropriate for Reshoring Based on the Results of the Matrix Analysis**

Classification	Type	Content	Reference
Types inappropriate for reshoring	A-1, B-1, C-1	Types that enter the Chinese domestic market	-
Types amenable for selective reshoring	A-2, A-3	Types that procure Chinese raw materials	Reshoring is possible when the difference between export customs tax for finished goods and import customs tax for raw materials exceeds the rise in wages and logistics costs incurred in relocating the manufacturing site to Korea There is a chance that when they make a reshoring, they could change their procurement of raw materials from China to Korea.
	B-2, C-3	Typical labor-intensive processing business	It is more likely that relocation to a place with lower wage, such as Southeast Asia, will be more appropriate. However, there is a chance for partial return to Korea for small-quantity production of expensive products.
Types appropriate for reshoring	B-3, C-2	Types that use the Korea-U.S./Korea-EU FTA	Those items that are the subject of trade conflicts, such as Chinese manufactured goods in third country markets have a greater advantage. It is possible to enhance regulation against improvement trade, reduce favors, such as customs tax refund, difficulty in management of improvement trade, among others.

### B. Business Type Selection Based on the Allowance of the Korea-EU and Korea-U.S. Customs Taxes

Customs tax savings that result from the FTAs will be greater when customs rates that were originally applied to goods are higher. In addition, it will be advantageous if customs tax is immediately abolished. Therefore, this study conducted an analysis on the items with a cu-

stoms tax abrogation schedule that ranges from immediate abrogation to within five years. As a result of the analysis, it was possible to select the business type for the company types for which reshoring is possible by looking at the purchase and sale types of the Korean companies in China. The business types that are appropriate for reshoring following the abolishment of FTA customs tax and the purchase and sale structure are laid out in Table 3.

**Table 3. Advantageous Business Types for Reshoring Following the Abolishment of FTA Customs Tax and the Purchase and Sale Structure**

Sale/Purchase Type (Purchase/Sale)	Possibility of Customs Tax Savings from Customs Tax Abrogation upon reshoring	Proposed FTA Concession	Business types Favorable Under the Korea-U.S. FTA	Business Types Favorable Under the Korea-EU FTA
B-3 (Korea/EU or U.S.)	Export customs tax on finished goods to EU/U.S.	Proposed EU/U.S. concession	Leather/wood, textiles/shoes, glass/jewelry/accessories, etc.	Chemical/plastic, textiles/shoes machinery/electric goods, transportation mode
C-2 (EU or U.S./Korea)				
C-3 (All EU or U.S.)	Import customs tax on finished goods from EU/U.S. to Korea	Korea concession	Leather/wood, textiles/shoes	Leather/wood, textiles/shoes and transportation mode
	Export customs tax on finished goods to EU/U.S.	Proposed EU/U.S. concession	Leather/wood, textiles/shoes, glass/jewelry/accessories, etc.	Chemical/plastic, textiles/shoes machinery/electric goods, transportation mode

The business types expressed in Table 3 are results that take customs tax savings into consideration. Aside from customs tax, wage is one of the important factors considered by companies when they decide to make a reshoring. Because Korea has higher wages than China, those business types with a high proportion of wages will have a hard time considering making a reshoring despite the customs tax savings. With this, by taking as reference the manufacturing cost statement based on the across-the-board investigation of companies in 60 manufacturing business types collected by the Bank of Korea, business types with a low proportion of wage vis-à-vis total manufacturing cost for a given period was extrapolated and then finally, the business types with major benefits and overlapping business types were extrapolated through the abrogation of customs tax analyzed above. The result was synthetic rubber, plastic substance, uniforms, textiles, synthetic fiber, leather/bag/shoes, among others. In addition, business types that have a slightly higher wage proportion than average but take advantage of

the above customs tax savings and overlapping business types are mills, provisional construction work, computer and peripheral devices, textiles, electronics/audio/telecommunication devices, semiconductor parts, auto parts, among others.

### 3. Comparative Analysis of Major Countries' Reshoring Policies

Reshoring policies are one of the policies that were actively pursued or are being pursued not only in Korea but also in the U.S., Japan, and Taiwan. Japan's early adopted reshoring policies had significant effect on Korea's policy formulation. The U.S., which became interested in reshoring since 2012 and thus, started adopting relevant policies, may be behind Korea in terms of specificity in policies, but it can still learn from the U.S.' job creation, revival of the manufacturing industry, among others.

There are repeating and similar themes in the background to major countries' reshoring policies, such as job creation, balanced development of regions, and reinforcement of domestic manufacturing foundations. The first theme is that a macroeconomic industrial development objective, called the revival of the manufacturing industry, is behind the U.S.' reshoring policy. Most of the U.S.' reshoring companies have the U.S. domestic market as their targets. Accordingly, factors, such as productivity, proximity to the domestic market, among others, rather than the export environment, played the determinative role in companies' decision to make a reshoring. This is starkly different from Korean companies' reshorings, which were largely prompted by the improved export environments. In sum, benchmarking is vital when considering the U.S.' reshoring policies while the Korean government provides location and financial support to reshoring companies. Japan emphasizes energizing regional economics through inducing reshoring companies and thus created a system in which the regional government's powers are strengthened and in which business types that comport with the special traits of the regions are liberally induced. The high-level autonomy granted to the local governments allowed them to adopt support policies that are flexible and subjective according to reshoring companies' demands. However, it may be inappropriate for Korea to determine locations by merely linking them with business types, considering that the proportion of foreign export companies is high among its reshoring companies. Therefore, there needs to be more cooperation between the central and local governments in Korea than in Japan. In the case of Taiwan, the country's aim of disengaging itself from dependency on the Chinese economy played a role in pursuing the reshoring of Taiwanese companies in China. However, considering that Taiwan's reshoring companies are concentrated in overseas exports rather than Taiwan's domestic market, it shares a similarity

with Korea. This is a point that Korean policy-makers should be mindful of.

## 4. Major Policy Implications

### A. The Need for Tailored Support that Takes into Consideration the Types of Korean Reshoring Companies and Business Types

Some companies do not have much knowledge in reshoring policies and some do not even understand whether their company is fit for the reshoring and whether they can obtain benefits under the FTA. Therefore, there is a need to select appropriate company types and business types and encourage them to take a reshoring.

This study shows that Korean reshoring companies may be divided largely into "export-oriented reshoring companies" for utilizing the Korea-EU and the Korea-U.S. FTAs and "domestic market-oriented reshoring companies" for the Korean domestic market. This sets Korea apart from Japan and the U.S. where domestic market-oriented reshoring companies take up a large percentage of reshorings. This is also why tailored support policies that take the circumstances of Korea into consideration are necessary. For instance, the location policy may be provided in both export-oriented and a domestic market-oriented companies. Given that export-oriented companies must consider environmental factors favorable to export when they move in, locations must be provided with emphasis on the relevant industry foundation for domestic market-oriented companies.

### B. Encouraging Partial Return and Expansion of Support

For companies that consider making a reshoring, returning to Korea after complete dissolution of the overseas workplace may pose a great risk. Most companies realistically desire

partial return and with this, reshoring support policies should try to encourage partial return as well. The expansion of partial return may raise the level of corporate participation and work as a driving force behind the reshoring policy. However, since the major point of interest of small-scale investors is to lower investment costs to the maximum, it is important to lower the barrier by way of leasing plants or buildings within industrial complexes to reshoring companies.

### **C. Adoption of a Cooperative Body between the Central and Local Governments and the Reshoring Promotion Body**

Creating a cooperative body between the central and local governments is linked to supporting a tailored policy that is appropriate for the reshoring company types mentioned above. Korean reshoring companies are distinctly divided into export-oriented and domestic market-oriented companies so policies appropriate for each type must be adopted. If autonomy is granted only to the local government, there is a risk that it may become a race to induce companies. Therefore, there needs to be a cooperative body that can enable sufficient dialogue between the central and local governments. Through this, positions of the central government, which draws the blueprint for policies, and the local governments, which actually induce the companies, need to be adjusted.

Because there is lack of cases regarding the success of reshoring as of now, it is very important to publicize this policy accurately in China where companies that could take the reshoring are concentrated. Local interviews showed that there were many cases where even the provisions of the enacted reshoring company laws were not adequately conveyed and cases where there was a lack of manpower to publicize the reshoring policies.

### **D. Raising the Efficiency of Job Supply and Demand Policy**

The concerns of Korean companies that consider making a reshoring in relation to employment after returning to Korea are not about wages but about supply and demand. The job supply plan of the government for reshoring companies makes use of women whose experience has been cut short in provinces—a human resources act that has gotten praises from companies. With this, Korea needs a department that specializes in managing and matching employable women in provinces. Currently, the employment network run by the central government will not be realistic considering the lack of information for women in provinces where curtailment of experiences is severe.

In addition, policy-makers need to think deeply about the effective creation of jobs. The plan to use women with employment curtailment is significant as a way of addressing the niche market, but it will be difficult to avoid the criticism that its goal is simply to raise the numbers. The core of unemployment issues in Korea is youth unemployment and not surplus human resources. In order to address this, plans must be pursued under which expert human resources could be supplied through invigorating industry-academic programs linked to the colleges within regions where reshoring companies move in, as well as effective job creation.

### **E. Resolving the Dissolution Issue: Possibility of Incorporation into the Korea-China FTA**

Returning to Korea entails complex procedures. Local dissolution is one of the most substantial obstacles. In China, the complexity of dissolution, unpredictable administration, and tax audits make operations difficult. However, for successful implementation of reshoring policies, easy dissolution of the overseas workplace is a must. This is because companies cannot take

advantage of the reshoring support policy unless their overseas workplace is dissolved. Therefore, if a provision that can resolve the local dissolution issue could be included in the Korea-China FTA, it will be possible to include investor protection provisions that are more advanced to the point that a bilateral investment

treaty (BIT) could be included. As to such inclusion, the executed BITs and FTAs should be reviewed for any precedents and incorporate them to the extent possible. With this, creating a new provision can be an alternative if there are no precedents. **KIEP**