

THE PENINSULA

Korea's Drive for Developed Market Reclassification

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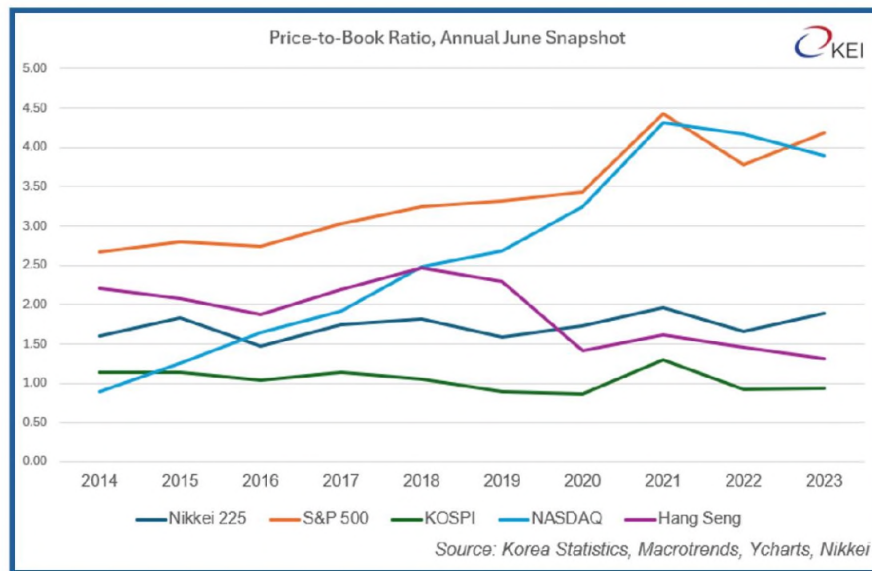
MSCI, a New York-based international ratings provider, is soon to release its annual [Market Classification Review](#). The findings will determine what next steps Korea needs to focus on to move from the index of emerging markets to that of a developed one. Once the latter occurs, it would allow Korea to be listed alongside other Asia-Pacific economies, such as Japan and Singapore, on the [MSCI World Index](#), which Goldman Sachs estimates could bring in an additional [\\$44 billion](#) in portfolio inflows from abroad.

Given the fact that Korea joined the OECD in 1997, its classification as an emerging market might seem odd. However, there are a number of crucial factors explaining its persistence and what Korea is doing to address it.

Under the MSCI's framework, the [official criteria](#) for getting classified as a developed market relies on a country's level of economic development, equity market size and liquidity, and accessibility for foreign investors. So far, Korea meets the first two criteria but remains [locked out](#) on the third due to barriers to its foreign exchange convertibility and overall ease of access for foreign investors.

For example, in MSCI's most recent [market accessibility review](#) published this month, Korea's continued ban on short-selling, quality of information disclosure, and level of foreign exchange market liberalization were among the factors cited as areas needing improvement before any adjustment in Korea's classification can be made. MSCI watches closely for changes, and if enough are made to warrant a reconsideration, economies are

The Yoon Suk Yeol administration has since prioritized market reforms addressing some of these factors, specifically targeting corporate governance inequalities, capital efficiency, and the broader “Korea Discount” where the Korean stock market’s average price-to-book ratio is considered undervalued compared to regional competitors.

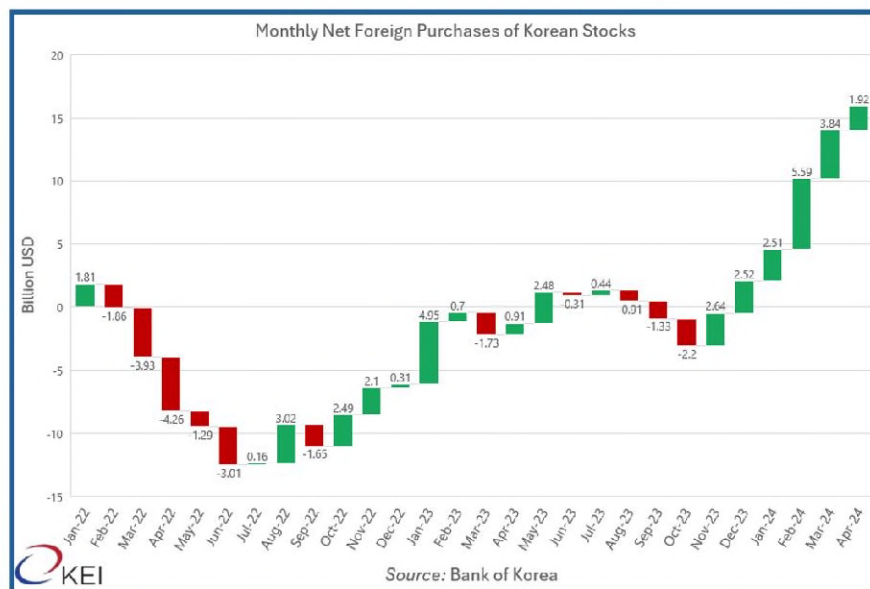
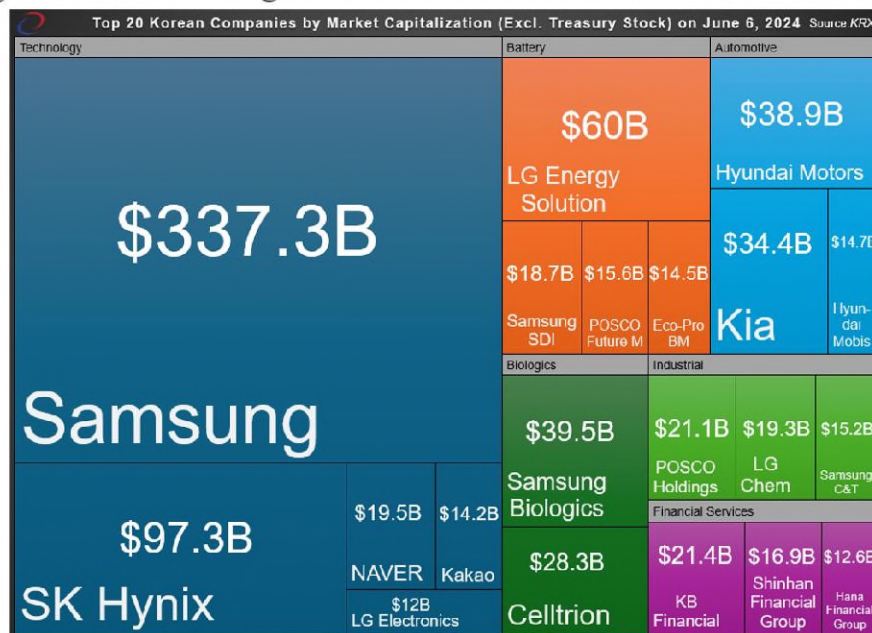


As part of this, last year, the Korean government initiated several efforts to attract more international investors. Among other things, it eliminated a cumbersome pre-registration system for foreign investors, put in plans to extend trading hours for the won to mirror exchanges abroad, aligned its ex-dividend system with global standards, and increased measures for company disclosures to be released in English.

But perhaps the most promising has been the Corporate Value-up program initiated in February. It aims to direct institutional investment funds into an index of Korean companies that successfully undertake corporate governance reforms, such as improving the treatment of minority shareholders or increasing transparency in reporting and ownership. Known as the Korea Value-up Index, the companies who make it can also take advantage of preferential tax incentives in return for increasing shareholder returns.

Mirroring the success of similar reforms taken in Japan, the Value-up Index further incentivizes change by taking a “name and shame” approach, where companies that engage in reform gain the prestige of being published on the index while the ones that don’t are spurred by the social pressure to do so. In Japan’s case, this approach initiated by the Tokyo Stock Exchange (TSE) has been successful in facilitating structural change, prompting increased attention from foreign investors. If its outcomes are any indication, the Value-up method is likely to follow suit in promoting capital efficiency and corporate governance changes, thereby addressing one of the root causes of the Korean discount.

While other factors still need to be considered, such as the continued absence of a *bona fide* offshore foreign exchange market for the Korean won or Korea’s extended ban on short selling, the panoply of reforms to Korea’s business landscape is likely to be effective



Although Korea will have to watch this year's review to see how its latest reforms are being received, with many of the biggest changes still on the horizon, Korea's financial future could be bright. The strength of the recent improvements means that a move to the developed market watchlist could be more likely once all of the reforms go into effect. With this in mind, some analysts suggest a full reclassification could come sometime in the next two years, providing a valuable opportunity for president Yoon's administration to get it done within his term. Given Korea's global role in supplying chips, batteries, and automobiles, a developed market debut may only be a matter of time.

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