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ASSESSING SOUTH KOREA'S ROLE IN PROMOTING ESG INVESTING IN THE ASIA-PACIFIC

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ABSTRACT

This paper assesses the potential for South Korea (hereinafter, Korea) to be a regional leader in advancing environmental, social, and governance (ESG) investing, and supporting sustainable development in the Asia-Pacific region. Many economies in the Asia-Pacific region are facing threats from climate change or other environmental limits to growth. Thus, the expansion of ESG investment and green infrastructure is a major regional challenge that must be addressed for sustainable growth. We argue that Korea can play a central role in overcoming this challenge based on the following conjectures. First, Korea's developmental legacy has allowed it to reshape its financial market and investment habits to quickly expand its ESG market. This model is more relatable to developing economy governments than those offered by Western economies. Sharing Korea's experience and know-how with the region's developing economies can augment their ESG compliance capacities and make them a more attractive destination for sustainable infrastructure investments. Second, Korea's significant presence in the region as a major creditor and exporter can induce ESG adherence from the private sector as Korean investors enhance their commitment to ESG principles. While questions remain about the sustainability of Korea's ESG adherence due to the market's heavy reliance on government agency finance and ad hoc pandemic response investments, the increasing global interest in the ESG market makes it likely that the Korean government will continue to incentivize adherence to ESG principles.

Key Words: *ESG, institutional investors, ASEAN, developmental state, sustainable development*

INTRODUCTION

One of the most striking developments in finance and infrastructure development in recent years has been the growth of interest in investments that seek to promote environmental, social, and governance (ESG) aims. ESG funds have become more popular around the world, and ESG investing has been promoted by governments and international organizations through various mechanisms, including the issuance of financial products such as ESG bonds, the creation of taxonomies to identify investments as conforming to ESG principles, and policies to incentivize private-sector holdings of ESG-conforming securities. While these efforts have advanced the furthest in Europe, they are also increasingly important in Asia, where the combination of massive new infrastructure investment, growing concerns about environmental sustainability, and public support for the UN's Sustainable Development Goals (SDGs) offer new

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opportunities for both investors and borrowers. In this paper, we evaluate the potential for Korea to be a regional leader in advancing ESG investing, and, therefore, in supporting sustainable development in the region.

Korea's ESG market has seen remarkable growth since the National Pension Service (NPS) incorporated the Stewardship Code 2018. The code mandates socially responsible investing by NPS investment managers. ESG investing gained even higher traction in the pandemic as the Korean ESG market, which was mainly focused on promoting sustainable corporate governance structures, pivoted to addressing environmental issues as well.[1] In 2020, Korea overtook Japan as the largest social and sustainability bond issuer in the Asia-Pacific region. These recent developments are noteworthy, especially considering that prior to the NPS's adoption of the Stewardship Code, the Korean ESG market was lagging behind most major regional economies.[2] What has allowed for such staggering growth? What are the policy implications of this growth to the future of ESG investing in the region?

We point to Korea's developmental legacy in answering the first question. Rather than simply relying on market preferences, the state's sustained influence over the investing practices of the NPS and the NPS's strong presence in the financial market allowed state-led initiatives to be incorporated at a faster pace than other markets. Given Korea's significant presence in the Asia-Pacific region as a major creditor, this growth carries the potential to contribute to filling the sustainable infrastructure investment gap in the region. This paper also finds, however, that questions remain about the sustainability of Korea's ESG market growth. It identifies the following key policy implications from such findings.

First, Korea's unique developmental experience can allow its ESG taxonomies and rating methods to be better tailored to the interests of developing economies compared to Western counterparts, serving as a more effective model for the developing economies in the region. Second, its increased commitment to ESG principles may naturally induce participation from local private companies in the region given Korea's substantial regional presence as a creditor and exporter. Third, however, it is not yet clear whether the growth of Korea's ESG market reflects a long-term state commitment or is rather just a result of the country's ad hoc pandemic response, potentially calling into question the sustainability of the market's growth rate. Lastly, government agencies occupy the majority of ESG investing in Korea. While private sector participation is increasing, heavy reliance on government finance exposes the market's prospects to political sways.

In this paper, we first point to Korea's developmental legacy and the strong role of government financial agencies that drove the rapid development of the ESG policies and market in Korea according to the state's new policy objectives. We then identify the current demand for increased ESG investing in the region and show how the current landscape of ESG agenda-setting largely leaves out developing economies, providing Korea with substantial potential room to contribute to developing taxonomies and evaluation methods that better fit the needs of developing economies. Next, we discuss how Korea's financial presence in the region can potentially drive regional adherence to ESG principles. Lastly, we identify the challenges and opportunities in reaching this potential in the future.

KOREA'S DEVELOPMENTAL LEGACY AND ESG TRANSITION

Role of Banks in Developmental and Post-Asian Financial Crisis (AFC) Era

The rapid economic development of Asia's Newly Industrializing Economies (NIEs) and their forerunner, Japan, gave rise to a number of studies that attributed their growth to the strong role of the state in guiding economic development.[3] They argued that the state's ability to suppress consumption and exert control over allocation of capital, albeit at different levels among the NIEs and Japan, had allowed these states to maximize their comparative advantages in selected industries.[4] Given the scarcity of capital prior to their rapid development in particular, the developmental states employed heavy capital control measures to allow for selective investments. In Korea, inward remittances and foreign direct investment (FDI) were strictly monitored and restricted to avoid potential loss of control over the domestic capital market. Foreign currency earnings by exporters were swapped into trade credits managed by the Bank of Korea (BOK). Through these mechanisms, the BOK managed foreign capital inflow, selectively providing foreign currency loans to major exporters. While enabling an ambitious approach to industrial policy, however, over time such centralized management of foreign currency also induced businesspeople and politicians to develop a cozy relationship in which businesspeople would lobby for better access to foreign currency to expand their companies.

Table 1. Korean ESG Market Size (in 1 billion KRW)

	2016	2017	2018	2019
KOSPI	1,308,440.40	1,605,820.90	1,343,971.90	1,475,909.40
KOSDAQ	201,523.40	282,740.10	228,238.30	241,351.00
KONEX	4,307.80	4,908.10	6,250.40	5,325.40
Korean capital market size (F)	1,514,271.50	1,893,469.00	1,578,460.50	1,722,585.80
Korean ESG market size (G)	7,089.50	7,720.60	27,749.20	33,235.20
Ratio (=G/F)	0.50%	0.40%	1.80%	1.90%

Source: "Korea SRI Market Landscape," Korea Sustainability Investing Forum, 2021; "Market Data," Korea Exchange, 2021.

This practice began to break down as Korea democratized in the early 1990s. External pressure to liberalize the financial market led to fragmented reforms in the capital market that allowed for outbound capital flows. A corruption purge campaign followed democratization, and so the centralization of foreign capital control, despite its role as the basis for efficient resource allocation, was perceived as the source of corruption as it encouraged crony capitalism. Despite these underlying motivations, capital inflows remained under strict control as officials feared that an excessive inflow of foreign capital would fully expose the domestic market to foreign competition. This, however, caused Korea to suffer negative net capital flows. Banks were allowed to borrow short in dollars and lend long in local currencies to domestic firms, resulting in high levels of unhedged foreign currency-denominated debt. When the Korean won sharply depreciated at the advent of the Asian Financial Crisis, banks faced balance mismatches that triggered an extensive liberalization of the Korean financial market under the supervision of the IMF and the World Bank.

Despite the considerable liberalization since 1998, however, some studies assert that Korea's developmental legacy has left a clear trace in the state's willingness and capacity to control capital.[5] This is particularly manifested in the strong presence of state-affiliated institutional investors in Korea's financial market, mainly led by the NPS. Their potential to influence the market investing trends according to the state's policy is well demonstrated in Table 1. Since the NPS announced its adoption of the Stewardship Code and increased its investments in ESG-related assets in 2018, the ESG market quadrupled in only a year. The adoption of the code brought about participation from 48 institutional investors from both the public and private sectors in the same year as well.[6]

Public Institutional Investors and the Korean ESG Market

Evidence of the state's strong influence over the NPS' management can be found in its historical background. The NPS was initially designed as a developmental policy instrument to offset the quickly accumulating external debt during the Park Chung-hee administration. The pension reserves were designed to serve as an additional source of capital for the state's infrastructural projects and debt financing. Although the plan was not realized at the time, the NPS' initial design was largely intact when the pension system was finally introduced a decade later, in 1988.[7] While its management structure has gone through rounds of reforms since the Asian Financial Crisis that prohibited the use of the reserves for public projects, the state still maintains strong control over the NPS' management directions. As the governance structure of the NPS shows, the NPS is affiliated with the Ministry of Health and Welfare (MoHW) but the MoHW is required to report to the Ministry of Strategy and Finance, which will, in turn, provide guidelines on fund management and planning.[8] Therefore, considering its massive size and influence in Korea's financial market, the pension fund serves as an important financial policy instrument in proactively leading market trends to meet the state's ESG agenda, represented by the Moon administration's Green New Deal.[9]

As Table 2 demonstrates, government-affiliated institutional investors, mainly led by the NPS, have conspicuously increased their commitment to ESG-related financial products since 2018.

Table 2. Government Agency Involvement in ESG Investing (in 100 million KRW, %)

		2015	2016	2017	2018	2019
National Pension Service	Total assets	5,123,240	5,582,991	6,216,422	6,387,811	6,983,000
	ESG investments	68,516	63,700	68,778	267,400	269,800
	Ratio (%)	1.34	1.14	1.11	4.19	3.90
Teacher's Pension	Total assets	127,559	139,229	158,404	160,312	207,460
	ESG investments	1,189	2,124	1,020	1,329	1,263
	Ratio (%)	0.93	1.53	0.64	0.83	0.60
Government Employees Pension Corporation	Total assets	52,647	65,189	80,447	88,267	88,900
	ESG investments	1,091	398	739	1,022	1,633
	Ratio (%)	2.07	0.61	0.92	1.16	1.84
Korea Post	Total assets	1,091,662	1,119,820	1,168,148	1,256,597	1,300,650
	ESG investments	1,240	1,318	1,507	1,230	9,622
	Ratio (%)	0.11	0.12	0.13	0.10	0.73

Source: "Recent Global ESG Investments and Policy Trends," Korea Financial Investment Association, 2020.

Such direct participation from the public sector in enlarging the ESG market contributed to the rapid growth of the market. The market's growth, however, was not only derived from the state's control over capital management but also from the state's capacity to provide adequate data support for ESG evaluation and the development of its own rating methods and agencies. To be sure, Korea's transition towards ESG adherence is in part motivated by global market trends. Still, Korea's ability to make a radical yet effective change in a relatively brief period to become one of the leading regional issuers of ESG bonds using the state's sustained influence over public investors, demonstrates how Korea's developmental legacy allows for effective policy execution beyond regulatory governance. As the next section demonstrates, Korea can contribute to reproducing a similar experience in developing Asia by proactively sharing its knowledge and experience, and it can provide alternative perspectives to the ESG landscape dominated by Western institutions.

DEMAND FOR GREEN INFRASTRUCTURE IN THE ASIA-PACIFIC

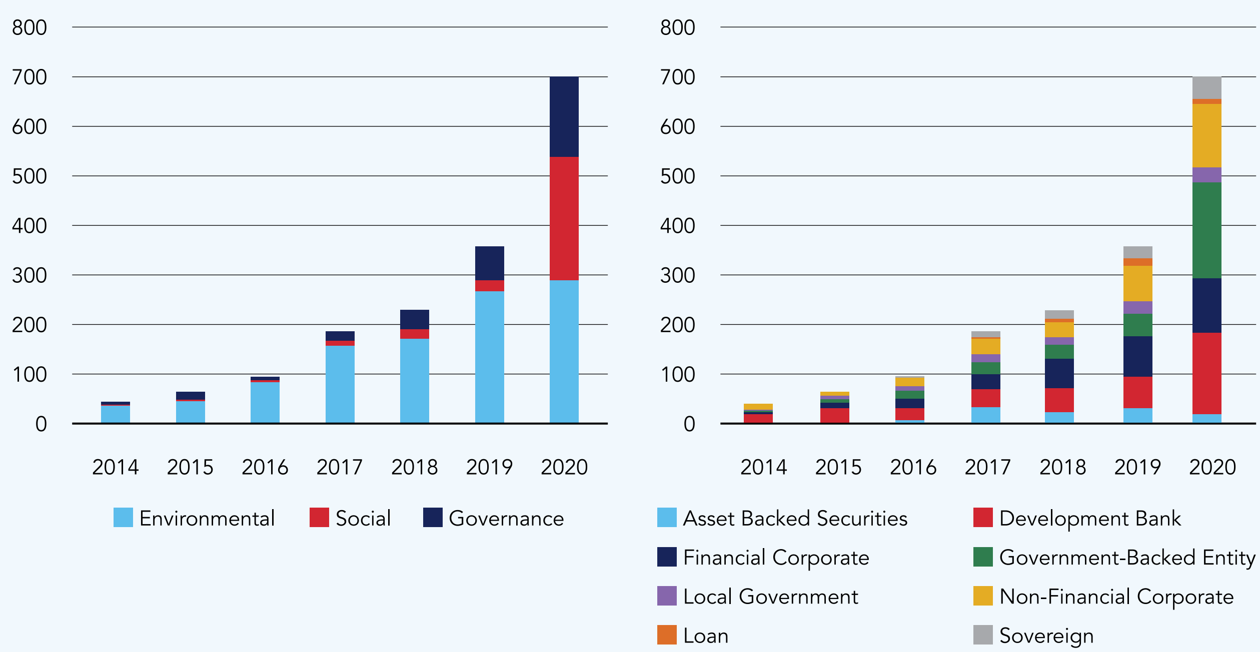
There is a strong growing demand for sustainable infrastructure in the Asia-Pacific region. In 2017, the Asian Development Bank (ADB) estimated that developing Asia will "need to invest $26 trillion from 2016 to 2030, or $1.7 trillion per year, if the region is to maintain its growth momentum, eradicate poverty, and respond to climate change."[10] There is, however, a huge gap in the current level of investment, with only $881 billion being invested in infrastructure annually as of 2017.[11] Private sector investments have been relatively limited compared to public sector and Multilateral Development Banks (MDB). This has been partially due to the high risk and uncertainty involved in project financing, which have made infrastructure projects less financially attractive investments for private sector investors. Governments and international financial institutions have had to offer credit guarantees and other incentives to attract private investors. With the rapidly developing ESG market and increasing private sector participation in ESG-related financial products, as shown in Figure 1, this new market can serve as an additional source of funding for developing Asia.

In particular, as climate change response requires global coordination for it to be effective, building green infrastructure in developing Asia should be a shared objective for international investors. Yet, realization of this goal would first require that the investments be financially viable with reduced uncertainty. The growth of the ESG market itself was based on cumulative research that proved that better adherence to ESG standards does not damage the profitability of investments.[12] Improving the developing economies' conformance to global financial standards and ESG principles, and even further, establishing a credible regional standard to reduce investment uncertainties and risks would be some of the first steps to take in promoting sustainable growth and attracting investments to the region.

ESG NORMS-SETTING AND KOREA

The current ESG evaluation and principles norms-setting process is dominated by Western institutions. As shareholder activism has been emphasized since the global financial crisis, better adherence to ESG principles has become a major corporate evaluation category in Western economies. Both the public and private sector began developing taxonomies for ESG principles incorporated in investing and evaluating ESG-related financial products. ESG-related data, however, are often qualitative and prone to subjective judgments, necessitating sophisticated efforts to standardize the evaluation process and increase the objectivity and reliability of the index. Hence, capable actors such as states or major international credit rating agencies have been developing their own taxonomies and methods for evaluation, using their experience in data collection and evaluation to their advantage. The evaluation data would then be sold to investors that wish to uphold ESG compliance in their investments. Korean rating agencies have also been developing their own indices and rating methods, but their efforts remain at an early stage. Table 3 demonstrates the diversity of the current ESG rating methodology landscape.

Figure 1. Global ESG Bond Issuers and Market Size (2014-2020, $billion)



Source: Climate Bonds Initiative, *Climate Bond Market Data Platform*, 2021; Author compilation

Table 3. Korean and Major International Agencies' ESG Rating Methods

	Institution	Index name	Establishment date	Corporates/ Institutions under evaluation	Evaluation spectrum	Methodology
Korea	Korea Corporate Governance Service	ESG Evaluation	2011	900	S-D	*357 indices *Negative screening method
	Sustinvest	ESG Value	2006	1,000	AA-E	*3 Main Key Performance Indicators (KPIs) per ESG category *Negative screening method
	Daishin Economic Research Institute	-	2017	-		*Qualitative evaluation based on hand collection
International	Thomson Reuters	ESG Scores	2009	6,000	0~100% & A+-D	*Based on (1) ESG Score, (2) ESG Controversy Score
	Dow Jones (in partnership with RobecoSAM)	DJSI	1999	5,900	0~100 (within industry comparison)	*Industry specific criteria applied in evaluation *Evaluation based on surveys
	Morgan Stanley	MSCI ESG Ratings	-	6,000	AAA-CCC	*based on 37 ESG issues Relative to the standards and performance of their industry peers *Negative screening
	Bloomberg	ESG Data	2009	10,000	0~100	*120 indicators, with penalties for lacking information
	RepRisk	ESG Ratings	1998	84,000	AAA-D	* 28 ESG issues, 45 "Topic Tags"
	Sustainalytics	ESG Ratings	2008	6,500	0~100 (within industry comparison)	* 70 indicators and 3 dimensions: preparedness, disclosure, performance

Source: "ESG Evaluation," Korea Corporate Governance Service, 2021; Meritz Korea; Author compilation

Due to the qualitative nature of the evaluation categories, however, the indices are potentially susceptible to a lack of transparency due to cozy relationships that may develop between the rating agency and the rated company, and preferential bias toward larger companies that can better prepare the internal corporate data on their compliance to ESG standards. With the growth of the global ESG market and the dominance of Western credit rating agencies in establishing the foundations of ESG taxonomies and evaluation methods as seen in the table above, developing economies in the Asian region may face further difficulties in receiving much needed sustainable infrastructural investments. Local companies in emerging markets may lack the resources to adequately prepare annual reports that would allow for better ratings. Some agencies, such as Bloomberg, have penalty clauses for data inaccessibility. Furthermore, while access to objective and well-maintained data to extract accurate information per ESG category is key in processing a sound evaluation, governments of developing economies may not be capable enough to serve as an alternative source of data for the rating agencies either. The established taxonomies and evaluation methods may also be too stringent for developing economies to meet, reducing the competitiveness of local companies in attracting new investments.

The public sector has also been actively participating in the ESG norms-setting process. The European Commission has mandated that listed companies and banks with more than 500 employees publicize ESG-related information in their annual reports. The information would include data on environmental protection, social responsibility, accommodations for human rights compliance, and anti-corruption initiatives.[13] The U.S. Securities and Exchange Commission has also released guidelines for publicizing information on climate change and is continuing its efforts to clarify and specify the standards.[14] The Financial Stability Board has also launched a task force for climate-related financial disclosure to recommend that all climate change-related information be included in corporate annual reports.[15] Multilateral institutions such as the International Finance Corporation (IFC) and the Global Sustainable Investment Alliance (GSIA) have additionally been establishing broad guidelines and taxonomies to follow. Yet these initiatives, along with the activities of private-sector agencies in Table 3, have been mostly led by Western economies and institutions. And as the same table demonstrates, these agencies have come up with diverse methodologies for ESG evaluation that potentially raise issues of non-transparency and bias that favor developed economies and larger corporations. The exclusion of developing economies in the public sector's ESG agenda-setting process may further aggravate these issues. Hence, a separate set of indices and regional rating agencies that better meets the interests of developing economies is necessary to foster communication across agencies in different regions and diversify the perspectives involved in the current ESG norms-setting process.

Anchoring from its unique development experience, Korea can serve as a model for developing economies in the region by increasing its commitment to developing its own rating agencies and sharing the know-how and experiences gained in the process to facilitate the region's adoption of ESG principles. For instance, as the Meritz report[16] on Korea's ESG market demonstrates, most of the data for ESG evaluation in Korea are collected by a network of government agencies. This has allowed for better data accessibility for both local and global rating agencies in evaluating the local companies' level of ESG compliance, while reducing the burden of companies in collecting their own data for evaluation. This model can serve as a solution to developing economies trying to adapt to new ESG standards with limited private sector capacity to do so on their own.

The imminent challenges faced by developing economies are often related to efficient governance in both private and public sectors. Korea has achieved economic growth through the improvement of public sector efficiency in the developmental era and corporate governance reforms in the post-AFC era. Its legacy is well-suited to providing tailored technical advice to developing economies and can also serve as a potential model for development. In fact, even the recent push for ESG adherence has been focused on improving corporate governance over other ESG criteria.[17] Hence, state-level knowledge sharing initiatives on government agencies' data collection methods and technical assistance to establish parallel institutions in developing economies would significantly reduce the private sector's burden and contribute to resolving the rating agencies' preferential bias toward larger corporates. To take a step further, the Korean government can also actively partner with existing regional development banks such as the Asian Development Bank (ADB) to develop a regional standard for ESG evaluation and provide alternative perspectives to building ESG taxonomies.

On the other hand, considering Korea's presence in the region as a major creditor, Korea's sustained commitment to ESG investing may also contribute to promoting ESG adherence starting from the private sector as Korean investors improve their compliance to ESG principles. The next section discusses this potential by assessing the currently observable impact of Korea's ESG investments on ASEAN's developing economies.

THE IMPACT OF KOREA'S ESG INVESTING ON DEVELOPING ASIA

Korea has been increasing its financial investments in developing economies in the Asia-Pacific region, as shown in Table 4. Since the New Southern Policy (NSP) was announced by the Moon administration, Korea's engagement with ASEAN's developing economies has noticeably increased. For example, the Korea International Cooperation Agency (KOICA), Korea's official international donor, has announced in 2019 that it will annually increase its ODA to ASEAN economies by 20 percent, doubling its commitment by 2023.[18]

Korea's direct investment in ASEAN accounted for 4.3 percent of the total FDI in the region in 2019. When considering that China's portion accounted for only 8 percent, Korean investors are increasingly becoming one of the most important regional players in those markets.[19] Although the long-term impact of Korea's transition is yet to be observed, the following sections briefly discuss how it can and has been influencing the regional ESG market landscape to date.

The Impact of ESG Adherence to Environmental Issues

The impact of Korea's transition has been most salient in environmental issues. In December 2020, the Export-Import Bank of Korea (KEXIM) signed a co-financing agreement with Japan Bank for International Cooperation (JBIC) to provide project financing to the "Vung Ang II Thermal Power Limited Liability Company (VAPCO), a Vietnamese company invested in by Mitsubishi Corporation and others."[20] The Japanese and Korean governments saw this project as an opportunity to expand the export of their infrastructure systems by encouraging the participation of their private-sector construction and design companies. KEXIM's decision to jointly invest in the coal-fired power plant was a direct act of noncompliance to environmental norms, guided by the Paris Agreement, which required efforts from members of the agreement to limit the global temperature increase. The decision also went against the national policies of the South Korean government, which promulgated environmental policies through the Green New Deal. Eventually, KEXIM announced that it would stop financing coal-fired power plants overseas in the future after this project.[21]

Aside from such negative screening, Korea has released plans to expand its green infrastructure investments abroad as well. The state-owned Korea Power Corporation (KEPCO) has announced that it will issue corporate green bonds worth $176 billion for domestic and overseas renewable energy projects over two consecutive years.[22] While other corporate bonds issued in the private sector have been focused on domestic investments, KEPCO's intention to stretch its ESG investments beyond Korea's borders demonstrates the potential for the further expansion of Korea's ESG influence.

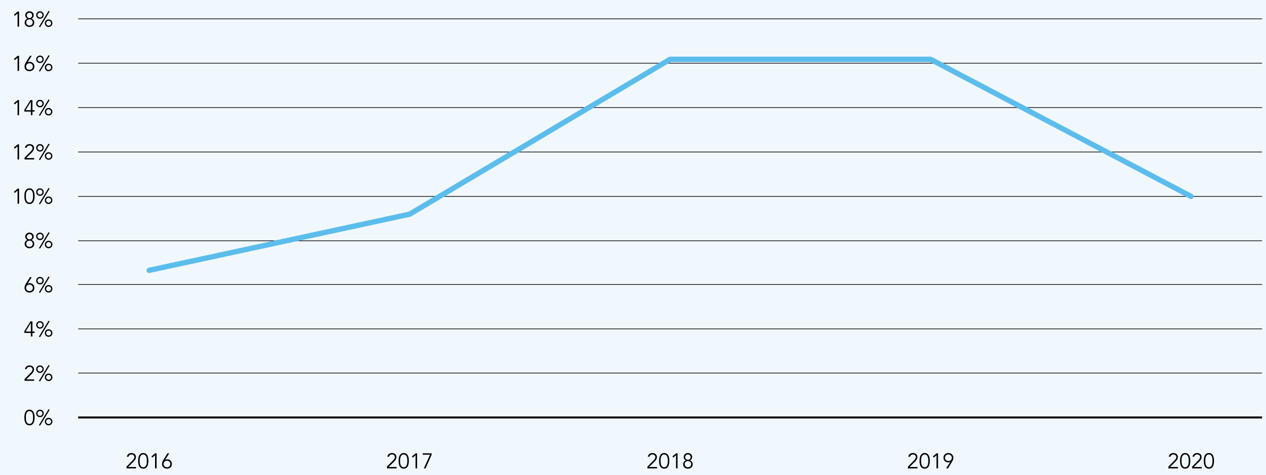
Table 4. Korea's Financial Commitments to ASEAN's Developing Economies

	2016	2017	2018	2019
Korean Companies in ASEAN (in units)	10,965	11,990	13,287	14,680
Investments to ASEAN (in million $)	6,284	5,284	6,495	9,548
Trade with ASEAN (in billion $)	119	147	160	153
ODA to ASEAN (in million $)	457	480	428	473

Source: "ASEAN-Korea Partnership Brochure," ASEAN-Korea Center, 2020; OECD Stat, "Creditor Reporting System Stats," OECD, 2021; Author Compilation

Note: ASEAN's developing economies include Myanmar, Malaysia, Philippines, Vietnam, Brunei, Indonesia, Thailand, and Laos.

Figure 2. NPS's Rate of Opposition Against Board Proposals



Source: Korea Corporate Governance Service, *KCGS Report* 8, no. 10, 2020.

The Impact of ESG Adherence to Governance Issues

Korean institutional investors have been embracing shareholder activism since the introduction of the Stewardship Code. Figure 2 demonstrates that the NPS has been noticeably more proactive in voicing its preferences against board proposals since 2018. Shareholder activism is one of the seven channels to practice ESG investments, according to GSIA.[23] Korean institutional investors have been focusing on enhancing corporate structures through this channel. The NPS' investment portfolio shows that it invests 25.1 percent of its total assets in global equity and 13.2 percent in alternative investments which mostly involve project financing for infrastructure projects. It has also announced that it will further increase its investment in alternative investments.[24] The NPS' shareholder activism in corporate governance issues, therefore, will increasingly have a cross-border impact. Furthermore, given the increasing volume of FDI to developing economies and the number of Korean companies operating in ASEAN, the regional impact of Korea's regulatory transition will be greater if the current trend is sustained.

Korea has also been actively contributing to improving public sector governance through both bilateral and multilateral channels. It has been providing bilateral technical assistance in the form of legal consultations, training services, and expert exchange programs through the Knowledge Sharing Program (KSP) to improve public sector efficiency. It has also strengthened its commitment to related multilateral aid through the ADB. Korea was a major donor to several technical aid projects operated by the ADB for financial governance enhancement.[25] Using its experience of efficiently restructuring non-performing loans (NPLs) and improving financial sustainability in the post-AFC era, Korea has participated as a major donor and consultant in addressing the issue of increasing NPLs among developing economies of the region.[26] This example, along with many others,[27] serves as additional evidence that Korea's developmental legacy can provide meaningful insight and lessons for developing economies.

The Impact of Government Agency-driven Social Bonds

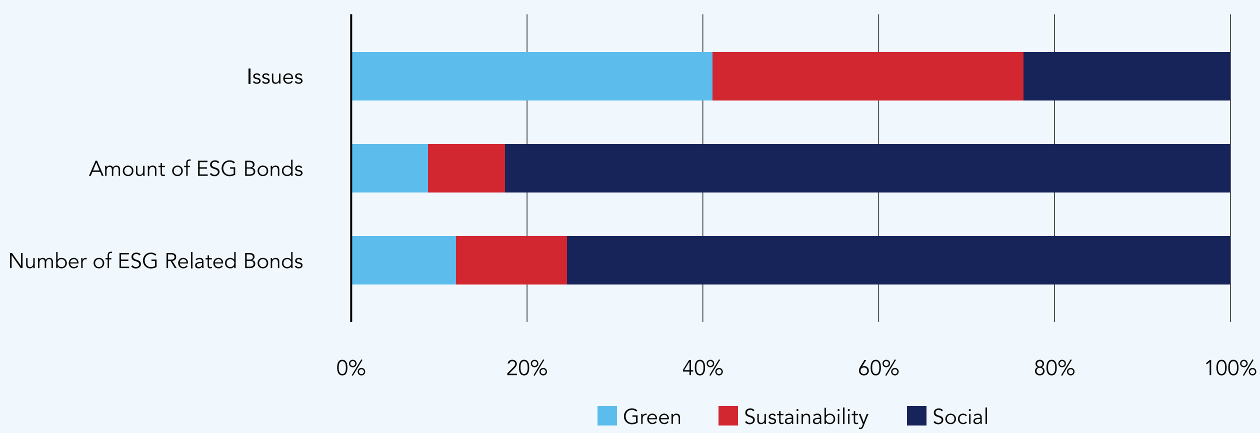
Korea has seen the highest growth in the social bonds market through aggressive government agency investments, making Korea the largest issuer of social bonds in Asia.[28] However, this unusual pace of increase in social bonds has mostly served domestic purposes as part of the pandemic response. For instance, Kookmin Bank issued a $500 million social bond in the public international market to provide emergency credit to domestic SMEs facing difficulties from the pandemic. Shinhan Bank also issued a $50 million COVID response social bond, but its proceeds have been solely directed at providing domestic medical support and SME credit extension.[29] The Industrial Bank of Korea has issued social bonds worth $500 million for the same purpose as well.[30] While the sustainability of the social bond market is questionable in the post-pandemic era, Korea's experience in utilizing social bonds as an extra source of credit in times of crisis may trigger an earnest development of the social bonds market in the Asia-Pacific. But for now, its long-term impact is contingent on the sustainability of the current rate of growth and political interest in the ESG market.

CHALLENGES AND OPPORTUNITIES

Market Growth Sustainability Issues

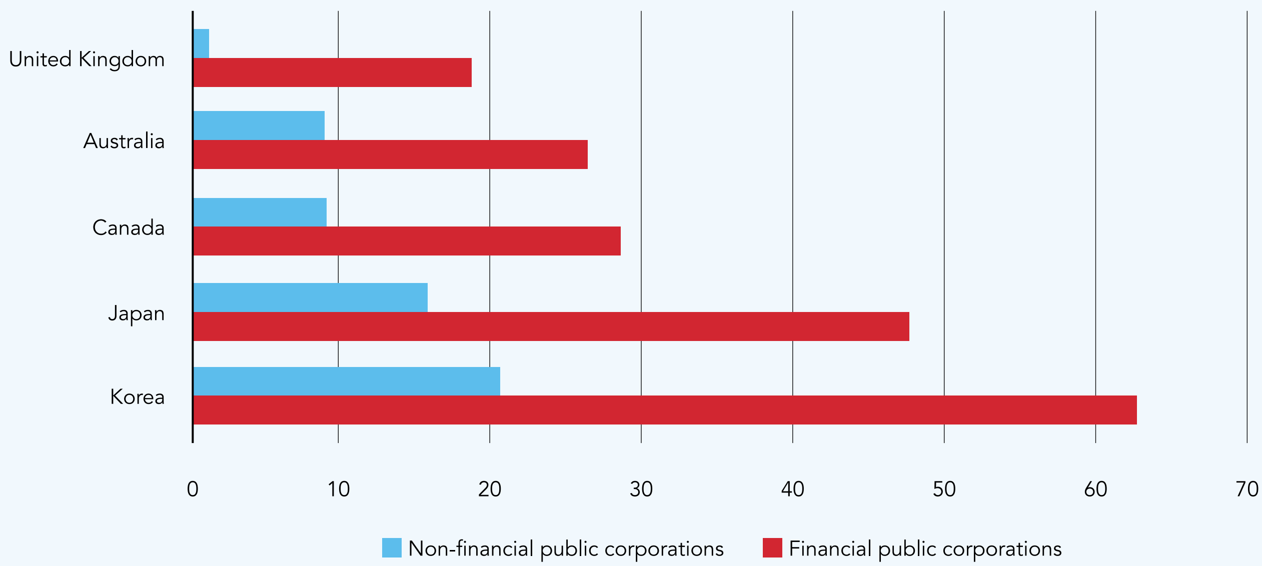
One potential concern is about the sustainability of Korea's ESG market growth, as the bulk of its growth has been derived from the pandemic response. More than 97 percent of the ESG funds are being financed by government agencies and retail funds account for only a small portion of the entire market.[31] Figure 3 demonstrates this market bias. While the number of green bond issuers is the highest among the three types of ESG bonds, its volume is the lowest. On the other hand, social bonds have the lowest number of issuers but the highest volume. This demonstrates that Korea's ESG bond market growth has been driven by a few government agencies that have issued social bonds as part of the pandemic response, with other categories maintaining a modest level of growth. Such uneven development raises questions about the sustainability of the ESG market's growth without the continued commitment from government agencies.

Figure 3. Korea's ESG Bond Market Landscape 2021 (% of Total)



Source: "SRI Bonds," Korea Exchange, 2021.

Figure 4. Major Economies' Public Corporate Debt (% of GDP)



Source: Hwang Soonju, "Public corporate debt and solutions," *KDI Focus*, April 20, 2021.

Political Sustainability Issues

Another concern is the political sustainability of Korea's ESG policies. As Figure 4 shows, Korea's public corporate debt has been a concern for the Korean economy. Its public corporate debt level was the second-highest among OECD economies even prior to the pandemic.[32] With government agencies leading the expansion of the ESG market mainly through dollar-denominated bond issuance in the international public market, the continued accumulation of debt may be opposed by opposition parties and citizens. Indeed, the opposition party has repeatedly voiced its opposition against such excessive public investment in the Green New Deal.[33]

To overcome such challenges, Korea should first encourage private sector participation in the ESG market by increasing support to evaluation agencies and providing financial incentives to companies with high ESG ratings. This would sustain the market's growth in the long run and allow alternative perspectives to be added to the ESG norms-setting landscape currently dominated by Western institutions. Experience gained from this process then can be shared with developing economies in the region in order to develop their ESG compliance capacity and make them more attractive destinations for investments. This would require, however, that new administrations maintain policy coherence and prevent policy backpedaling.

CONCLUSION

There is a clear gap in financing for sustainable infrastructure in many Asian-Pacific developing economies. Improving their attractiveness as investment destinations through promoting better compliance to ESG principles and promoting socially responsible investments in the private sector through shareholder activism is necessary to reduce the future cost of climate change and financial crises from poor governance. In this paper, we propose that Korea has a potentially important role to play in the region, against such challenges. The Korean ESG market has seen remarkable growth in the past few years, and we argue that Korea's developmental legacy has allowed for such growth. The state's sustained strong influence over public financial institutions allowed it to exert influence in the liberalized financial market. The NPS's adoption of the Stewardship Code naturally induced participation from the private sector due to its massive influence in the financial market. Therefore, while the Korean state has retreated to a considerable extent from the direct financial interventions of the developmental era, its sustained strong control over public institutional investors is allowing it to actively and effectively incorporate the state's agenda through market-conforming measures. Through this, we have reexamined the strong role of the state in post-developmental countries.

This legacy may help provide more effective technical assistance to the region's developing economies compared to Western counterparts in promoting ESG compliance and expanding the ESG market. In fact, Korea is already pursuing a similar program through the Knowledge Sharing Program (KSP). Korea's further development of its own evaluation methods and agencies would provide an emerging market perspective on the currently biased landscape of the international ESG norms-setting agenda. We also argue that Korea's increased commitment to ESG principles and ESG bond issuances may naturally induce participation from local private companies in the region given Korea's substantial regional presence as a creditor and exporter.

There are, however, caveats to such developments. The current expansion of Korea's ESG market size is largely a result of the country's ad hoc pandemic response. Also, the questionable financial sustainability of continued government agency reliance in expanding the ESG market also degrades political sustainability as the opposition parties grow increasingly wary of expanding public expenditures. These challenges make the future sustainability of Korea's ESG adherence and ESG market growth uncertain. Yet, given the increasing preference for ESG adherence from investors at the global level, the Korean government is expected to continue its support in developing the market on par with its heightened international status as evidenced by the Seoul Declaration resulting from the 2021 Partnering for Green Growth and the Global Goals 2030 (P4G) summit.[34]

ENDNOTES

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