

OPINION

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Korean Won Internationalization: Assessing Benefits, Risks, and Implications

Since the opening of its capital markets, Korea has significantly enhanced its foreign exchange crisis response capabilities over the past 30 years, evolving into a capital-exporting country. However, its outdated regulatory framework continues to prevent the Korean won from functioning as an internationally convertible currency, limiting the country's ability to fully capitalize on the economic benefits of currency internationalization. Excessive concerns over the potential risks of won internationalization, which are becoming increasingly unconvincing, have hindered progress, highlighting the urgent need for a shift in perception among economic actors. Won internationalization serves as the most efficient safeguard against financial crises while enhancing the won's global competitiveness, fostering capital market development and revitalizing the economy. Policymakers should refine the foreign exchange legal framework to enable the active global trading of won-linked financial instruments, thereby advancing the won's status as an international currency. Likewise, private-sector economic participants should recognize foreign exchange as a new source of revenue and leverage won internationalization to strengthen their capabilities in foreign exchange and international financial operations. The internationalization of the won is no longer a choice but an economic imperative.

It has been more than 30 years since Korea adopted an open economic system by allowing foreign investors to participate in its stock market. During this period, the expansion of trade volumes and capital and financial transactions has significantly driven up cross-border capital flows, leading to continuous measures to liberalize Korea's foreign exchange and capital markets. However, there has been little progress in internationalizing the Korean won, which is often considered the final step in external transaction liberalization. This article examines

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the benefits and risks of the internationalization of the Korean won in light of Korea's current economic conditions, and explores relevant implications.

Levels of currency internationalization

Currency internationalization generally refers to the widespread use of a country's currency not only within its own borders but also in overseas markets. A fully internationalized currency can perform the fundamental functions of a local currency, such as a medium of payment, a unit of account, and a store of value, beyond the domestic economy. At present, only the US dollar fully meets these criteria, making it the world's dominant vehicle currency. The US dollar is the most widely used medium of payment in global trade and capital transactions,¹⁾ serving as a measure of exchange rates for other economies. Also, US treasury bonds constitute a portion of foreign exchange reserves in many countries, and the currency serves as a store of value and an investment vehicle in global financial markets.

The Japanese yen and the euro, which are included in the three major global currencies alongside the US dollar, as well as the British pound and the Swiss franc fulfill many of the essential functions of an international currency, though their roles and influence remain limited compared to the US dollar. For this reason, these currencies are often referred to as quasi-vehicle currencies, as they are included in central banks' foreign exchange reserves thanks to their global acceptability and credibility.²⁾

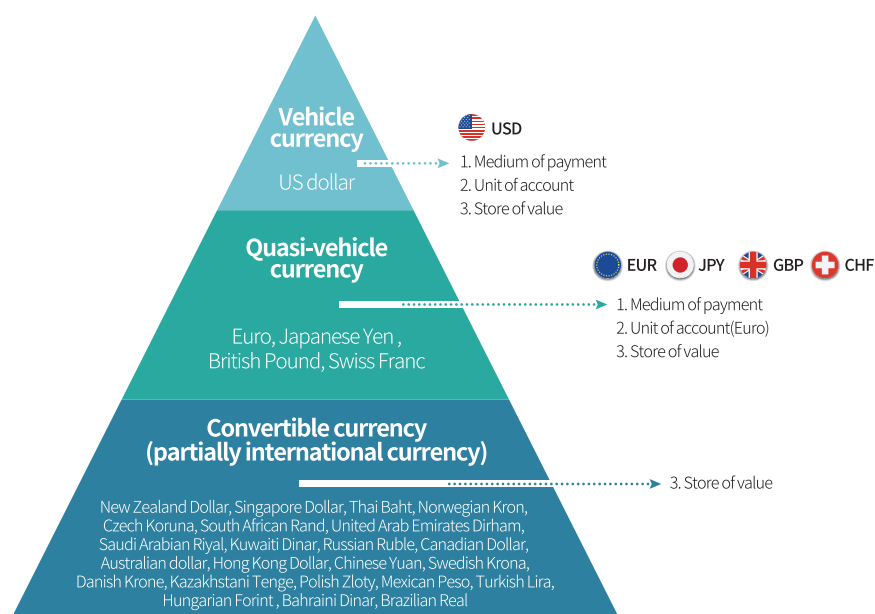
In addition to quasi-vehicle currencies, several other currencies, including the Australian dollar, Singapore dollar, Canadian dollar, and Hong Kong dollar, are freely traded in global financial markets as convertible or partially international currencies. Although their roles as settlement currencies or reserve currencies—primarily constituting foreign exchange reserves—are limited, they serve as important stores of value in global financial centers such as New York and London, where interbank foreign exchange transactions and trading of financial instruments in other currencies are actively conducted. Emerging market currencies such as the Chinese renminbi, Thai baht, Russian ruble, and Mexican peso are also trading as partially

1) According to the BIS (Bank for International Settlements), as of 2022, the US dollar accounted for 50% of global trade, 42% of SWIFT payments, and 60% of global foreign exchange reserves.

2) The composition of the IMF's Special Drawing Rights (SDR) is determined based on a currency's export volume and its status as a "freely usable" currency. As of 2023, the SDR basket consists of five currencies: the U.S. dollar, the euro, the Japanese yen, and the British pound, along with the Chinese yuan, which was newly included in 2016.

international currencies, despite originating from economies with lower levels of financial and economic development than Korea.

Figure. Classification of international currencies



Although not all countries issue (quasi) vehicle currencies that warrant global acceptability, many seek to gain the benefits of currency internationalization by facilitating the free trading and circulation of their domestic currencies or financial instruments denominated in those currencies in global financial markets. Despite Korea's standing as one of the world's top 10 economies, the Korean won has yet to attain convertible currency status. This mismatch raises concerns that the won's global position hardly does justice to the country's economic influence.

Current state of won internationalization

The global use of the Korean won remains minimal, with its limited level of internalization. As of 2022, won-denominated settlements accounted for only 2.3% of Korea's exports and 6.1% of its imports. The won has yet to achieve convertible currency status in the global foreign currency market. Without any won-linked financial instruments traded in global financial markets, it functions primarily as a local currency within Korea. As a result, the won is not

included in the SWIFT (Society for Worldwide Interbank Financial Telecommunication) ranking of the world's 20 most traded settlement currencies. After 30 years of the adoption of an open economic system, Korea has become one of the world's top 10 trading nations and its cross-border capital flows have seen a dramatic increase driven by expanded two-way securities investments by residents and non-residents. Against this backdrop, the lack of global use of the won needs to be addressed. Even as Korea's external transactions grow further, the won's limited use as an international currency inherently hinders Korea's financial internationalization and market development.

Efforts to internationalize the won have already been made. In the mid-2000s, the government included won internationalization as part of its plan for the new Foreign Exchange Transactions Act, initially scheduled to take effect in 2009. However, its implementation has been put on hold in the wake of the global financial crisis. Under the current regulatory framework, Korea lifted restrictions on the use of the won for ordinary transactions, such as exports and imports, immediately following the Asian financial crisis, allowing non-residents to use the won both in Korea and abroad. However, capital transactions remain subject to highly conservative measures due to concerns over greater volatility fueled by abrupt capital flows. Korea continues to regulate the use of the won by non-residents through "free-won accounts", which explicitly specify permitted purposes for deposits and account closures. Banks are required to review transactions in these accounts for compliance. Furthermore, non-residents must report to relevant authorities when borrowing money in the won³⁾ or issuing won-denominated securities.⁴⁾ Funds raised through such activities must be deposited in designated accounts under the names of foreign financial institutions for regulatory oversight, and transfers between free-won accounts held by non-residents are strictly prohibited. These regulatory constraints contribute to foreign investors' perception of Korea's market as having low accessibility.

Given the considerable inconvenience foreign investors face in using the won even within

3) Under Article 7-45, Paragraph 2 of the Foreign Exchange Transactions Regulations, if a non-resident's outstanding balance of won-denominated borrowings exceeds KRW 30 billion, the Governor of the Bank of Korea (BOK) must be notified within three business days from the first day the limit is exceeded. Additionally, any subsequent changes in the borrowing balance above this threshold must be reported to the BOK Governor by the 10th of the following month.

4) The Foreign Exchange Transactions Regulations stipulate that residents (Article 7-29) and non-residents (Article 7-30) seeking to issue won-denominated securities (including won-linked foreign currency securities) overseas must submit a securities issuance statement, including an issuance plan specifying the use of funds raised through the issuance, to the Minister of Economy and Finance.

Korea, its broader use or acceptance in global markets remains unlikely. Non-residents are restricted from borrowing won funds or using them for overseas settlements, and issuing won-denominated bonds requires prior approval from Korea's foreign exchange authorities.⁵⁾ Korea has proactively established a defensive regulatory framework including a mandatory reporting system for monitoring, even before the won's international circulation is fully initiated. Furthermore, the won is not used for interbank transactions in the global foreign exchange market, making it non-convertible. This not only impedes the development and trading of various won-linked financial instruments but also limits the won's function as a store of value. Some argue that pursuing won internationalization is premature due to the lack of overseas demand. However, this view overlooks the role that Korea's regulatory barriers play in restricting the won's acceptability. A more effective approach would involve drawing insights from the experiences of countries with fully convertible currencies.

Economic benefits of won internationalization

Many countries pursue currency internationalization due to its substantial economic benefits. If the won gains wider acceptance in international transactions, several positive effects could be expected.

First, won internationalization would help reduce corporate exposure to foreign exchange risk and lower hedging costs, which is particularly important for Korea's trade-dependent economy. Settling export and import transactions in the won would eliminate exchange rate fluctuation risks and the associated hedging costs. Additionally, companies seeking to raise funds could issue won-denominated bonds in overseas markets under more favorable terms, thereby reducing their funding costs or at least expanding their financing options. Broader international acceptance of the won would also alleviate foreign exchange risks for individuals when converting currencies.

Second, greater global acceptance of the won would enhance the competitiveness of Korean financial institutions and advance the development of the financial services industry. If won-denominated or won-linked financial products are traded in global markets, Korean financial institutions, which hold a comparative advantage in won-based operations, would be

5) However, won-denominated derivatives transactions conducted overseas are permitted. The surge in won NDF transactions among non-residents can be attributed to the absence of regulatory requirements, such as reporting obligations to authorities.

able to expand overseas transactions, generate profits, and strengthen their global presence. In other words, this would facilitate two-way capital flows and enable the global trading of won-linked financial products, thereby enhancing the global competitiveness of Korean financial institutions and the country's capital markets and aligning Korea's financial sector with global standards.

Third, currency internationalization would help minimize the risk of a foreign currency liquidity crisis at the national level. By expanding the foreign exchange market base on a global scale, it would increase market efficiency and improve liquidity supply, bolstering the economy's resilience to external shocks. If the won gains global credibility as a convertible currency, it could serve as an emergency funding source during periods of abruptly surging demand for foreign currencies in times of a global financial crisis. This not only lowers Korea's reliance on foreign currencies but also drives down the costs of traditional crisis responses, such as accumulating foreign exchange reserves. In this regard, won internationalization can be described as a proactive and highly effective strategy for crisis management.

Fourth, internationalizing the won could help address the "Korea discount" phenomenon by improving Korea's sovereign creditworthiness. The absence of an offshore foreign exchange market and the limited market accessibility have long been cited as one of the key obstacles to Korea's reclassification as a developed market in Morgan Stanley's MSCI indexes. Won internationalization would alleviate foreign investors' concerns regarding Korea's foreign exchange liberalization, paving the way for the country's inclusion in the developed market index. This, in turn, would facilitate the stable inflow of long-term foreign investment and enhance Korea's overall international credit standing, leading to a credit rating upgrade.

Finally, won internationalization would support Korea's rapidly expanding outbound financial investments, contributing to stable growth in a current account surplus and an increase in national disposable income. By enhancing the convenience of foreign securities investment for residents and assisting in foreign exchange risk management, it would strengthen Korea's position as a capital-exporting nation. Notably, a steady rise in interest and dividend income from outbound financial investments would play a crucial role in securing retirement income amid slowing potential growth and an aging population. Additionally, it would contribute to the growth of Korea's financial sector, fostering economic vitality. The resulting expansion of income account balances would lead to the stabilization of Korea's current account surplus,

mitigating economic volatility from external uncertainties and reinforcing the economy's resilience to external shocks.

Concerns over potential risks

Despite the significant benefits of won internationalization, progress has been minimal, primarily due to excessive concerns over potential risks. The lingering trauma from the 1997 Asian financial crisis and the 2008 global financial crisis continues to influence the country's economy.

One of the most frequently cited concerns is that won internationalization could invite speculative attacks by non-residents, heightening foreign exchange volatility. The rationale is that the wider use of the won in global markets would increase demand for U.S. dollars in exchange for won, similar to the impact of foreign capital outflows from Korea, thereby driving up the won-dollar exchange rate. However, this concern is largely unfounded given the existing structure of Korea's foreign exchange market, which is already divided into an onshore spot market and an offshore market dominated by non-deliverable forward (NDF) trading. Even now, non-residents have an immediate impact on the won's exchange rate in NDF transactions that do not require physical settlements, implying that speculative activities have long been possible. In fact, the daily trading volume of the offshore NDF market⁶⁾ is about three times larger than that of the onshore spot market. Therefore, concerns over speculative attacks should not justify the passive stance on won internationalization.

Another concern is that increased offshore acceptability of the won could lead to the emergence of multiple offshore foreign exchange markets, potentially making it challenging for Korean authorities to monitor transactions and enforce foreign exchange policies. However, if won internationalization fosters an offshore spot market that can absorb a significant portion of the NDF market, it could actually reduce foreign exchange volatility by curbing speculative NDF trading by offshore non-residents.⁷⁾ In advanced economies, it is a standard practice that a national currency is traded efficiently and continuously around the clock in global financial

6) According to BIS estimates, the daily trading volume of offshore won/dollar NDF transactions ranges between \$50 billion and \$60 billion.

7) At one point, China's CNY NDF market was the largest offshore NDF market among emerging economies. However, following the establishment of the offshore CNH (deliverable) market in 2010, trading volume in the CNY NDF market declined sharply, with transactions being absorbed into the spot market.

hubs. The argument that multiple offshore markets would hinder foreign exchange monitoring and management reflects an outdated mindset that prioritizes administrative control over market autonomy.

Others argue that won internationalization could compromise the effectiveness and autonomy of Korea's monetary policy. The concern is that if the Fed raises interest rates while Korea keeps its rate unchanged, a widening Korea-US interest rate differential could trigger capital outflows, pressuring Korea to follow suit and raise rates, thereby limiting monetary policy autonomy. However, this argument is largely unrelated to won internationalization. Monetary policy decisions in Korea, as in most economies are influenced not only by domestic factors such as economic growth, employment, and inflation but also by external variables, including US monetary policy changes, global uncertainty, and exchange rate trends in neighboring economies. Thus, it is unconvincing to suggest that greater global acceptability of the won would undermine monetary policy autonomy.

Implications

Over the past 30 years since the opening of Korea's capital markets, the country has navigated two major financial crises and significantly strengthened its crisis response capabilities through macroprudential regulatory reforms. With expanded foreign exchange reserves and abundant private-sector foreign currency liquidity, Korea has transformed into a net external creditor. As cross-border trade and capital transactions have steadily increased, the country has established itself as a robust open economy. Notably, its outbound securities investments have approached \$1 trillion in recent years, reinforcing Korea's role as a capital-exporting nation. While concerns over external debt have long faded, the efficient investment and management of foreign capital have become an increasingly critical policy priority.

Despite these developments, Korea remains constrained by the trauma of past financial crises and adheres to outdated regulatory frameworks. As a result, the won has yet to achieve international convertibility, and the benefits of an open economy remain partially realized. While the economic advantages of internationalizing the won continue to expand, the argument for the associated potential risk has lost its validity. Given Korea's mounting structural challenges, such as slowing potential growth and population aging, won internationalization should be pursued as a means to stimulate the economy.

Rather than seeking quasi-vehicle currency status, a more pragmatic strategy is to position the won as a partially international currency with convertibility in major global financial centers. As Korea is a small, open economy highly dependent on external trade, accounting for only 2% of global GDP and 3% of global trade, this approach would minimize potential risks associated with won internationalization.

This highlights the need for a fundamental shift in perception among policymakers and economic actors. For a capital-exporting country like Korea, currency internationalization should be seen not as a risk factor but as the most effective safeguard against crises and a strategy to foster the advancement and global competitiveness of the foreign exchange system. To ensure the won's international currency status, policymakers must reform foreign exchange regulations to lift restrictions on non-residents' won borrowing and transactions while enabling won spot trading in global markets to absorb offshore NDF transactions by non-residents. In parallel with this measure, efforts should be made to promote the active circulation of won-linked financial products in global markets. Korean economic actors should also recognize foreign exchange operations as a new revenue source and leverage won internationalization to strengthen their capabilities in foreign exchange and international finance. The internationalization of the Korean won is no longer a matter of choice—it is an economic imperative.