

# **Prospects for an FTA between Australia and Korea**

by

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## **Abstract**

Since the 1960s, trade opportunities based on complementary economies have driven the Australia-Korea economic relationship. Australia exported raw materials, principally minerals and energy, which Korea processed and subsequently sold on domestic and international markets. In return Australia purchased increasing volumes of Korean manufactures, initially textiles, clothing and footwear and later automobiles. With the onset of the financial and economic crisis in Korea during 1997-98 trade and investment opportunities were severely constrained. However, in the wake of the crisis, and the rapid recovery of the Korean economy underpinned by corporate and financial sector reforms, trade and investment opportunities in traditional areas have re-emerged as well as in new areas. Australia's rapid economic growth has also increased demand for the sorts of consumer products produced by Korea.

The paper analyses trends in Australia's trade and investment with Korea. New areas for trade are also highlighted. Implications for Australian business in Korea and vice versa are also considered, as well as prospects for an FTA between the two countries. This paper argues that emerging trade and investment opportunities will be further enhanced by the two countries establishing a free trade agreement.

## **1. Introduction**

Since the 1960s, trade opportunities based on complementary economies have driven the Australia-Korea economic relationship. Australia exported raw materials, principally minerals and energy, which Korea processed and subsequently sold on domestic and international markets. In return Australia purchased increasing volumes of Korean manufactures, initially textiles, clothing and footwear and later automobiles. However, it was not until Korea's transition to democracy in the late 1980s that the Korea-Australia relationship became more firmly founded. Recognising that growth in bilateral trade was outstripping political and non-government contacts, successive Australian governments have worked to extend trade beyond its narrow commodity base and develop a more mature relationship. Expanding relations in the 1990s reflected a growing commonality of interests, shared focus on the prosperity and security of the Asia-Pacific region and recognition of the benefits of closer cooperation.

During the period of Korea's financial and economic crisis, the Australian government focused upon maintaining trade flows, particularly by expanding export credit facilities when commercial suppliers withdrew. Increasingly, the Australian government has been looking at ways of expanding and developing market opportunities as a result of the crisis and the resulting reforms in Korea, particularly in manufacturing and services due to corporate and financial restructuring, and to press for greater market access, particularly for agricultural products (Australian Department of Foreign Affairs and Trade (1999a).

This paper analyses trends in Australia's trade and investment with Korea. New areas for trade are also highlighted. Implications for Australian business in Korea and vice versa are also considered, as well as prospects for an FTA between the two countries.

## **2. Australia's global trade relationship**

### ***2.1 Importance of trade to Australia***

As a small open economy, trade is a vital ingredient for the country's economic growth and jobs generation. One in five Australian jobs rely on exports. Companies that export pay better wages, on average an additional AUD17,400 per annum, and generate jobs, income and infrastructure. Trade provides Australia with access to a wider range of products at lower prices. Trade is beneficial for local and regional communities. For example, exports provide around a quarter of regional Australia's income and one in four jobs. Exports account for nearly a quarter of Australia's total income. Trade makes Australian companies more competitive by encouraging them to become more innovative and to use new technology, and it also broadens the country's sources of income and thereby also provides greater security against global economic conditions.

### ***2.2 Composition of trade***

In 2003, Australia's trade in goods and services totalled AUD306 billion, accounting for about 1 per cent of world trade. Its largest trading partners are the US, Japan, China and the UK. In 2003 Australian goods and services exports were valued at

AUD141 billion. Australia's top ten merchandise export markets were (in order) – Japan (AUD19.7 billion), US (AUD9.7 billion), China (AUD9.1 billion), New Zealand (AUD8.1 billion), Korea (AUD8.1 billion), UK (AUD7.4 billion), Taiwan (AUD 3.7 billion), Singapore (AUD3.5 billion), India (AUD3.3 billion), and Hong Kong (AUD2.9 billion). The country's major merchandise and service exports in 2003 were: tourism, coal, crude petroleum, non-monetary gold, iron ore, aluminium, education, wheat, bovine meat, aluminium ores, passenger motor vehicles, wool and alcoholic beverages. In 2003 merchandise exports to the APEC region were valued at AUD76 billion, East Asia AUD56 billion, EU AUD15 billion and North America AUD11 billion. In 2003 coal (AUD11 billion), non-monetary gold (AUD56 billion) and iron ore (AUD5 billion) were Australia's largest individual merchandise export items. Service exports reached AUD33 billion in 2003 – 23 per cent of total exports. Australia is the world's fourth largest exporter of wine, after France, Italy and Spain, topping AUD2.4 billion. The country's value of exports of passenger motor vehicles has more than doubled since 1998 to a total of AUD3.1 billion in 2002 – one-third of all vehicles manufactured in Australia are now exported.

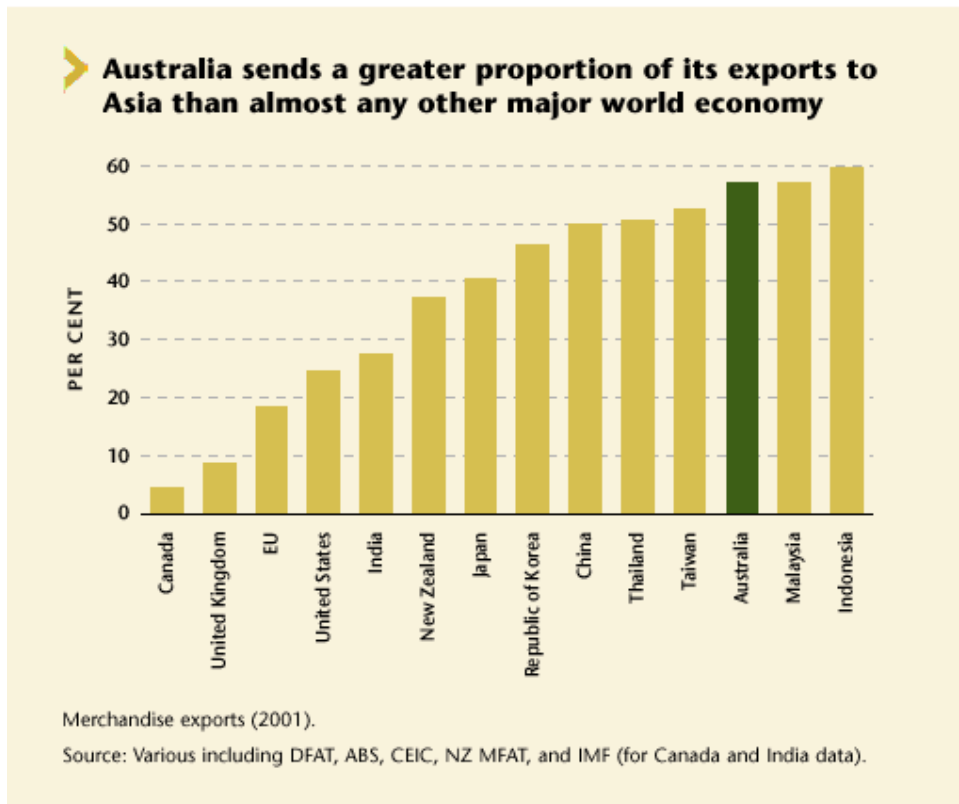
In 2003 imports of primary products were valued at AUD18 billion, imports of manufactures AUD108 billion, other merchandise imports AUD3 billion and import of services AUD33 billion. In 2003 the US was Australia's largest source of imports with AUD20.5 billion, or 15.8 per cent of the total, followed by Japan at AUD16.27 billion and China (AUD14.3 billion). Passenger motor vehicles (AUD10.7 billion), crude computers (AUD4.8 billion) and aircraft parts (AUD4.5 billion) were Australia's largest import items.

The countries of Asia have always mattered to Australia (see Figure 1). Close engagement with them is an abiding priority in Australian external policy (Australian Department of Foreign Affairs and Trade, 1999a). The issue for Australian governments is not what priority to accord Asia, but rather how, as circumstances change, Australia can best advance its national interests in its relationships with Asian countries. This approach recognises Asia's diversity. Asian countries differ in their political and economic systems and their stages of development, as well as in their cultures and traditions.

The Australian government wishes to ensure that the country's foreign and trade policy effort in Asia is conducted carefully, taking account of Asia's changing circumstances and diversity. It will focus effort on those relationships and issues that matter most to Australia's interests - Australia's economic interests and strategies in Asia:

- Australia has a major economic stake in Asia. Asian markets accounted for around 56 per cent (AUD67 billion) of Australia's total merchandise exports in 2002. Seven of Australia's top ten export markets are in Asia.
- More than 40 per cent of Australia's merchandise exports go to North Asia. This includes the country's largest export market, Japan, and its fastest growing major East Asian market, China. South-East Asian markets take more of Australia's exports today than they did before the 1997 - 98 East Asian financial crisis. India is Australia's twelfth-largest merchandise export market and fastest growing major market in Asia.

**Figure 1**



These ties are mutually beneficial. As indicated by Figure 2, Asian countries are buying more Australian goods and services. As a strategic supplier of industrial raw materials and energy to East Asian economies, Australia has contributed directly to these countries' post-war economic growth. Australia's expatriate communities in key business centres of Asia are also integral components of the region's economies. Australia's education system is a significant centre of learning for Asian students, long after the first such students came to Australia in large numbers under the Colombo Plan. Australia's economic strength has boosted its ability to contribute to the prosperity of Asian countries, shown most clearly in its support for regional economies during the financial crisis.

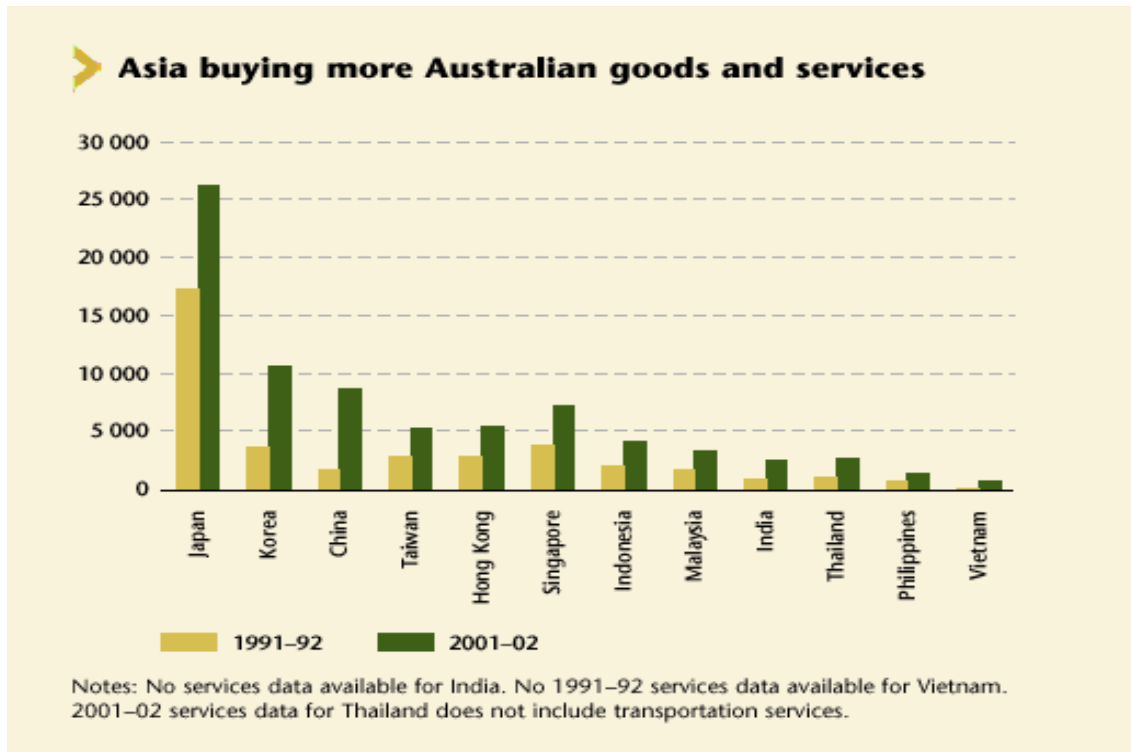
Reflecting this importance the Australian government is seeking new strategic bilateral economic agreements with Japan, China and Korea. In South-East Asia the Government is pursuing strategic trading relationships with key regional economies, including through free trade agreements established with Singapore and Thailand.

### **Asia's Australian education**

A major item of export expansion has been education. Australia's total education exports were worth \$4.2 billion in 2002. Some 188 000 students - about 154 000 from

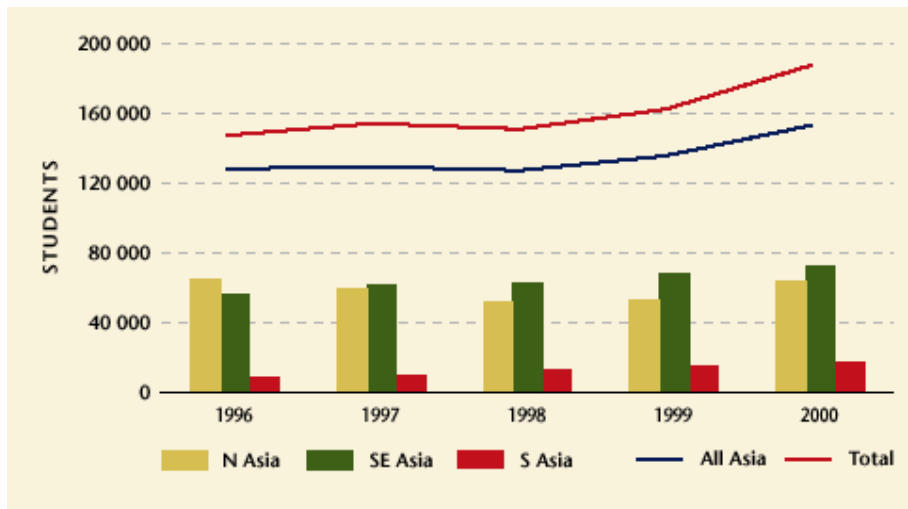
Asia (see Figure 3) - attended Australian institutions (in Australia and abroad) in 2000, a 15.6 per cent increase over 1999.

**Figure 2**



Source: ABS

**Figure 3** Number of overseas students studying in Australia



Source: ABS

Tertiary education accounted for nearly 60 per cent of education exports to Asia in 2000 - or about 89,000 students. One-third of these students attended campuses

established in Asia by Australian universities; the remaining attended institutions in Australia. English language and vocational education made up the bulk of the remaining exports, about 29,000 and 25,000 students respectively. Some 10,000 school-students from Asia studied at Australian institutions. Rising incomes and affluence throughout East Asia, as well as cost advantages in studying in English at an Australian university rather than in the USA or the UK, are key factors behind this rapid growth in educational exports.

Australia's standing as an important centre of education for the rest of the world has been crucial in building people-to-people links. Over the past ten years, more than 800,000 foreign students, mostly from Asian countries, have studied in Australia. After the United States, more students from Asian countries study in Australia than anywhere else.

### **Expanding ties with a growing and more influential China**

China's rising economic, political and strategic weight is the most important factor shaping Asia's future (see Figure 4). China's economic opening has strengthened its international links, but has also presented its leaders with difficult economic and social challenges. As indicated from Figure 5 China is a major recipient of FDI, including that from Australia, Australia's FDI has declined from its peak in 1995, although this is not in isolation as the economies of ASEAN have also experienced a similar decline from 1997.

Building a stronger partnership with a growing and more influential China is an important objective in Australian policy. The Government has worked with China at the highest levels to build a common understanding of how it can manage relations in a way that makes the most of the two countries' shared interests while acknowledging their differences. Our one-China policy will remain a fundamental element of our relations with China - as it is in our considerable economic ties with Taiwan.

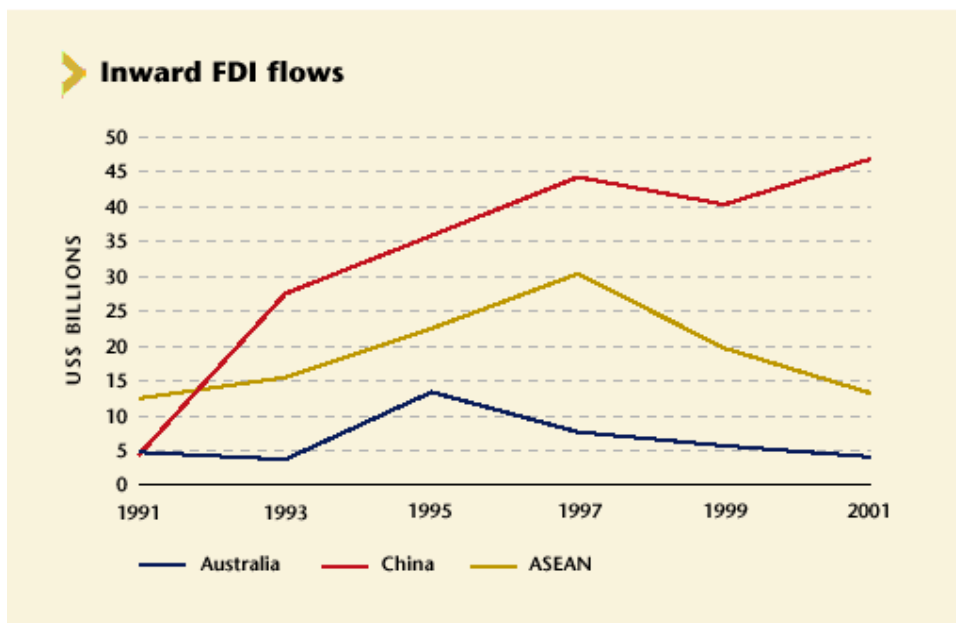
The Australian government is working toward a framework agreement to strengthen the long-term trade and investment relationship. It is building a strategic economic relationship with China similar to those Australia has established with Japan and Korea. The successful tender to supply liquefied natural gas to China's first LNG project is a significant step towards establishing a long-term strategic partnership with China in the energy sector. China is now Australia's third-largest trading partner. Australian merchandise exports to China doubled over the past five years to AUD8.4 billion. China's World Trade Organisation (WTO) accession provides the basis for stronger bilateral trade and investment ties in the longer term, so long as China manages well the implementation and domestic pressures of its accession. China is an increasingly important player in international affairs and in institutions that are important to Australian interests.

Figure 4



Source: IMF

Figure 5



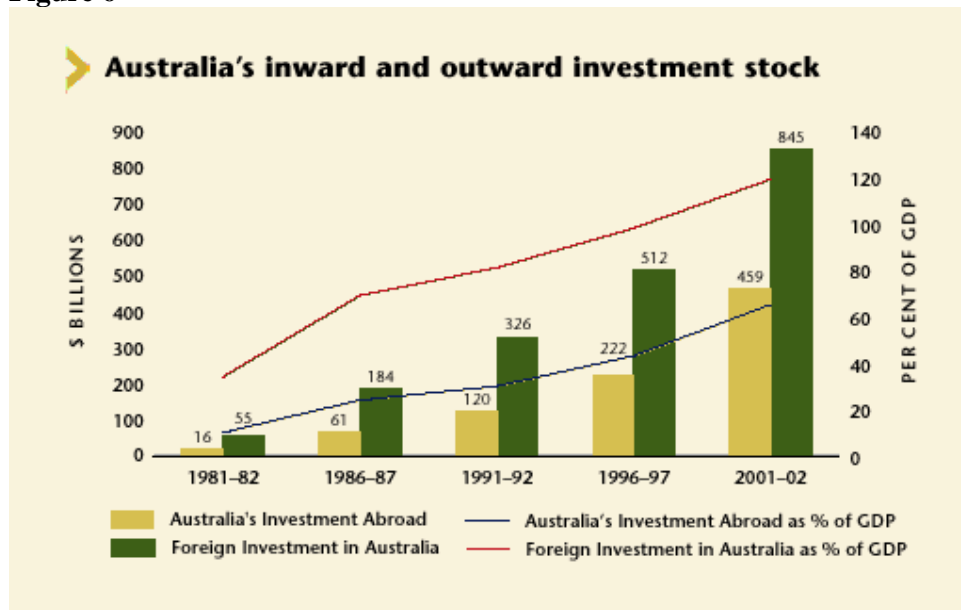
Source: IMF

Australia's prosperity has always depended on its international economic links. A large part of the country's wealth is based on international trade and investment (for the latter see Figure 6). The country's mining and agricultural industries were built on

access to international markets, and many of the industries developed exist because of foreign investment and the international trade that flows from it.

In the past two decades, Australia's trade and investment links have become stronger as a result of extensive economic reform. Barriers to trade have been lowered (see Figure 7). Broader reforms have enhanced productivity - deregulation, taxation reform, the strengthening of competition policies, a more flexible labour market, more efficient provision of infrastructure, a low and predictable rate of inflation and a low interest rate climate that encourages investment. Australia's productivity growth in the 1990s was faster than that of the United States, and the second-fastest of all developed economies.

**Figure 6**



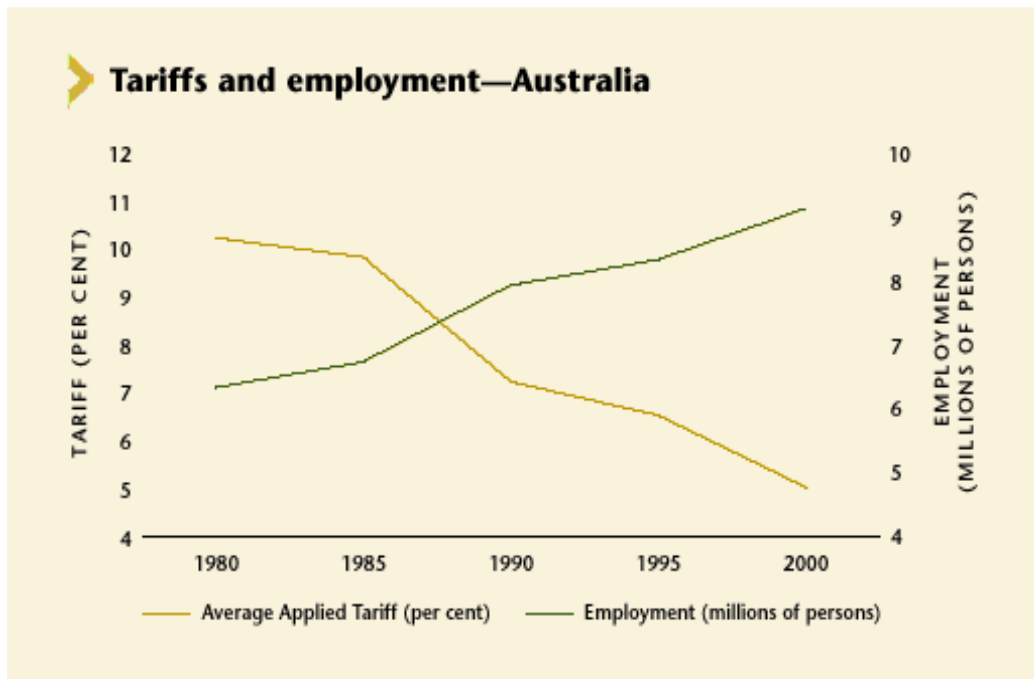
Source: ABS

Australia has been one of the best-performing developed economies in the world. Over the past decade its average annual GDP growth was 4 per cent, one of the highest among developed economies. Productivity growth in Australia during the 1990s was the second-highest among developed economies after Finland.

Privatisation, corporate governance and tax reforms, and development of the superannuation industry have helped deepen Australia's capital market and facilitated share ownership. These reforms have also encouraged greater international investment in Australia, further deepening our capital markets. Australia's ranking in the Morgan Stanley Capital International (MSCI) index of world equity markets climbed to ninth, up from thirteenth in less than two years. In 2001, Australia accounted for 39 per cent of the MSCI's Asia-Pacific index (excluding Japan), well ahead of Hong Kong at 15 per cent and Korea at 13 per cent (see Figure 8). Australia's ranking means that international investment funds are placing a greater proportion of their funds in its capital markets, further enhancing liquidity and reducing borrowing costs for business.

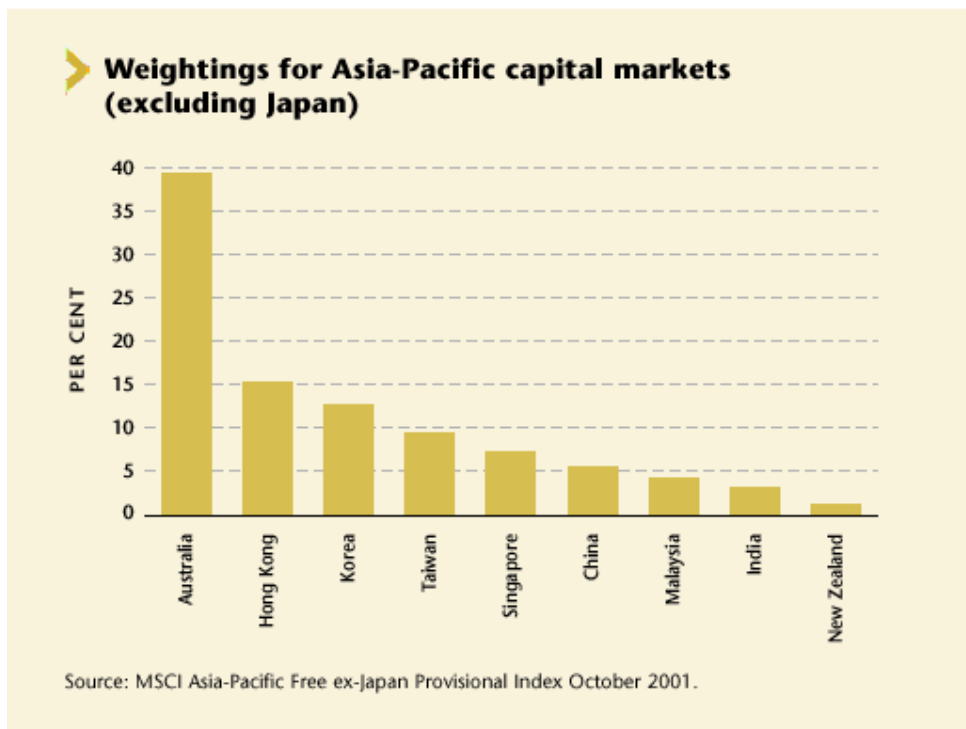


Figure 7



Source: ABS

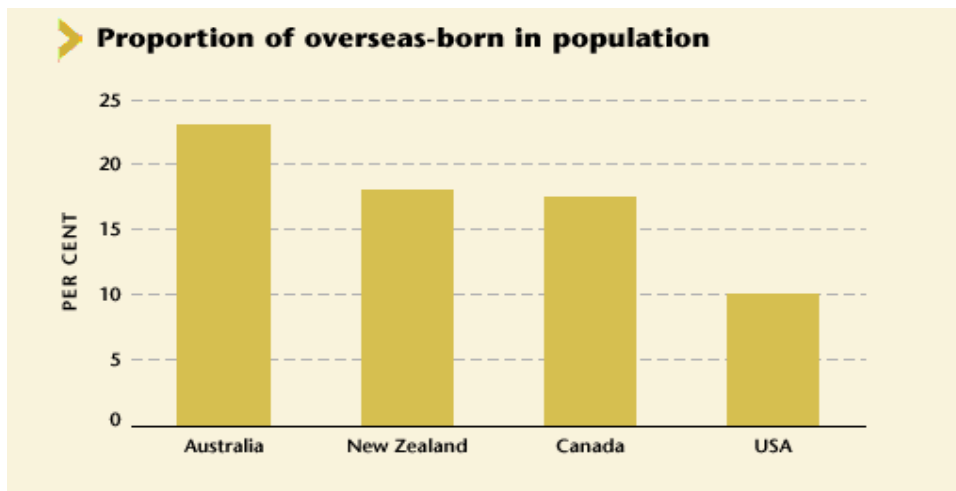
Figure 8



Australia's increasing integration into the global economy and the prosperity that flows from it depend vitally on stable and open rules and arrangements that protect and promote the country's flows of trade and finance. The Australian government is working to overcome the barriers that Australian exporters face, through the World Trade Organisation and bilateral and regional arrangements. Australia cooperates with other governments to ensure the stability and soundness of the global trade and financial systems and to build a more open and transparent global business environment.

Australia's diverse community is a major element in its people-to-people links. According to the 2001 ABS census, 23 per cent of Australians were born overseas (Figure 9) – and almost 5 per cent of all Australians were born in Asia. The second most frequently spoken language in Australian homes is the various dialects of Chinese. Australian society has embraced people from around 200 different ethnic groups and nationalities. As Australians, they and their children retain important links with their places of origin.

**Figure 9**



Source: ABS

### **2.3 Australia's trade policy**

The Australian government's ambitious and wide-ranging trade policy has, as its main goal, the creation of new and more open markets for exports. This goal is pursued at every level:

- Multilaterally through the WTO;
- Regionally through APEC and the Closer Economic Partnership with ASEAN;
- Bilaterally through free trade agreements, such as those with Singapore, Thailand and the US and efforts to expand markets and address market barriers in a range of countries.

## *WTO*

The WTO provides a rules-based system to manage international trade and resolve disputes between trading partners. The Doha Round of international trade negotiations offers great potential for expanding markets for Australia's farmers, manufacturers, miners and service providers. Successful negotiations will mean – more open overseas markets for Australian goods and services; tougher constraints on subsidies and protectionist practices that distort trade flows. If global tariffs dropped by half, Australia would benefit by an estimated AUD7 billion per year.

## *APEC*

APEC promotes trade and investment liberalisation, business facilitation and economic and technical cooperation among its 21 members. Membership of APEC has expanded opportunities to create jobs and incomes. It enables access to over 2.5 billion consumers and over 60 percent of global income in the 21 member countries. The APEC region is the world's most economically dynamic. APEC economies account for nearly half of world trade. They purchase around three-quarters of Australia's merchandise exports (AUD76 billion in 2003).

## *Free Trade Agreements*

Free trade agreements that are comprehensive in scope and coverage generate new trade and investment opportunities for Australia. The Closer Economic Relations (CER) Agreement between Australia and New Zealand has delivered an increase of over 500 percent in total trade in goods since the agreement came into effect in 1983.

The Singapore-Australia Free Trade Agreement offers practical trade and investment benefits for Australia in the professional, financial, and education services sectors.

The Thailand-Australia Free Trade Agreement will see more than three-quarters of current Australian exports receive tariff-free access to the Thai market.

The Australian-US Free Trade Agreement is a landmark in improving Australia's trade relationship with the world's largest merchandise and services exporter and importer. The Agreement will assist in providing opportunities for Australian exporters to a key market as well as significantly enhancing Australia's profile as a destination for US investment.

The Australian government is also engaged in discussions with China, aimed at strengthening trade and economic relations, including a joint study on the feasibility of undertaking a bilateral FTA.

## *Australian government's trade priorities in 2004*

Key priorities identified by the Australian government for 2004 are:

- Achieving greater access in markets worldwide for Australian goods and services.
- Making progress in the Doha Round of WTO negotiations.

- Pursuing opportunities to deliver market access gains through free trade agreements with key trading partners.
- Doubling the number of Australian firms exporting by 2006.
- Continuing to drive APEC work in areas such as trade facilitation and corporate governance.

### 3. Australia-Korea bilateral trade

In 1994, Korea overtook the US as Australia's second largest export market. While this ranking slipped during the economic crisis of 1997-98, Korea still remained Australia's third largest export market after Japan and the US, and fourth largest trading partner. Two way trade grew from AUD6.6 million in 1965-66 to AUD10.3 billion in 1998 (see Table 1). Over the past 30 years, Australia's exports to Korea have grown at an annual average rate of around 25 per cent per year, one of the fastest growth rates recorded amongst Australia's top 16 export markets. Imports from Korea have also grown strongly, although the trade balance, both merchandise and services, remains in Australia's favour (see Figure 10 and Tables 2 and 3).

**Table 1 Australia's Trade with Korea 1993-98**

Trade AUD million	1993	1994	1995	1996	1997	1998
Exports	4,359	4,709	6,062	7,305	6,761	6,099
Exports minus gold	3,893	3,974	4,612	4,423	4,910	4,841
Imports	1,866	1,766	2,257	2,325	2,966	4,175
Imports minus gold	1,866	1,766	2,255	2,323	2,806	3,038
Balance of trade	2,494	2,941	3,805	4,980	3,794	1,924
Balance of trade minus gold	2,028	2,208	2,357	2,100	2,104	1,803
Growth rate (%)						
Exports	19.1	8.0	28.8	20.5	-7.4	-9.8
Export growth excluding gold	17.9	2.1	16.1	-4.1	11.0	-1.4
Imports	22.8	-5.3	27.8	3.0	27.6	40.8
Import growth excluding gold	22.8	-5.3	27.7	3.0	20.8	8.3

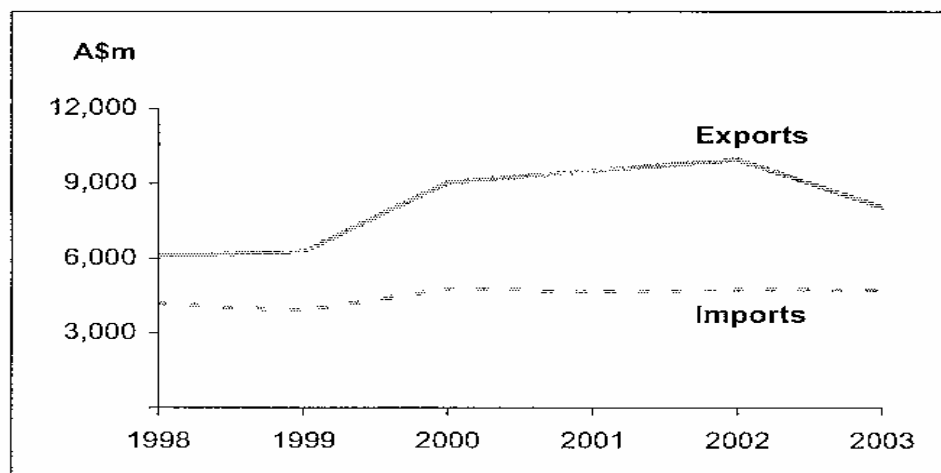
Source: Australian Department of Foreign Affairs and Trade

### *Australian exports to Korea*

Australia's exports which were weakening in 1997, dropped sharply in early 1998 as Korea went into recession. However, Australia's exports of essential raw materials and basic foodstuffs suffered less than most other countries' exports. In US dollar terms, total Korean imports fell 35 per cent in 1998, while Australia's Korean exports were down 22 per cent. Around 75 per cent of this fall was due to declining gold prices, excluding the gold trade. Australia's exports fell only 14 per cent in US dollars, a very good performance given the size of Korea's export contraction. The smaller drop in 1998 bilateral trade relative to other suppliers highlighted the strong complementarities of the two economies, implying demand for Australian exports, particularly raw materials and intermediate inputs, would remain strong over the medium to long terms.

**Figure 10**

#### **Australia's trade with Korea**



Source: Department of Foreign Affairs and Trade

**Table 2 Australian merchandise trade with Korea, 2003**

		Total share (%)	Rank	Growth (yoy)
Exports to Korea (AUD million)	8,084	7.5	5 <sup>th</sup>	-19.0%
Imports from Korea (AUD million)	4,737	3.6	7 <sup>th</sup>	-0.6%
Total trade (exports + imports) (AUD million)	12,821	5.4	6 <sup>th</sup>	-13.1%
Merchandise trade surplus with Korea (AUD million)	3,347			

Source : Australian Bureau of Statistics

**Table 3 Australian trade in services with Korea, 2003**

		Total share
Exports of services to Korea (AUD million)	870	2.7%
Imports of services from Korea (AUD million)	432	1.3%
Services trade surplus with Korea (AUD million)	438	

Source : Australian Bureau of Statistics

Table 4 indicates that Australia's major export items to Korea are coal, crude petroleum, non-monetary gold, iron ore and aluminium. The further inclusion of wool, wood, zinc ore, steel, wheat, sugar and beef account for 75 per cent of Australia's exports to Korea. Hence commodities dominate Australia's exports to Korea, and the demand for which will be strongly influenced by the performance of the Korean economy and global commodity prices. Coal is the most dominant single item, contributing around 13 per cent of merchandise exports, then crude petroleum (11 per cent), non monetary gold (10 per cent), iron ore (9 per cent) and aluminium (6 per cent). These five items alone contributed around 50 per cent of merchandise exports. The export of food and live animals accounted for only around 7 per cent of total merchandise exports, while the export of manufactured goods contributed only 16 per cent.

#### *Commodities*

In the late 1990s, Australia met around 50 per cent of Korea's coking and thermal coal requirements, due to its quality being superior to that from China and transport was cheaper than that from the more distant USA, Canada, South Africa and South America. The demand for coal from Australia is obviously very closely linked to that of the performance of the economy and in particular the production of steel and electricity. Future demand for Australian coal will be influenced by Korea's decision regarding the diversification of supply. Demand for iron ore will also be influenced by the future performance of the economy and, again, in relation to steel production. By the late 1990s, Australia's market share for iron ore in Korea was around 47 per cent. Maintaining this share during the period of economic recovery in Korea presented significant opportunities for expanded iron ore exports. Australia is also an important supplier of non-ferrous metals to Korea, principally zinc and copper. Zinc and copper are used extensively in the construction and automobiles sectors; thus Korean imports of these metals are tied closely to the expected growth rates for these sectors. With the recovery of the Korean economy, the construction and fabrication sector experienced stronger growth particularly in infrastructure and housing.

**Table 4 Major Australian exports to Korea, 2003 (AUD million)**

Coal	1,074
Crude petroleum	919
Non-monetary gold	797
Iron ore	729
Aluminium	506

Source: Department of Foreign Affairs and Trade

While demand for raw materials and intermediate inputs should remain strong over the medium to long term, the Korean market for commodities is likely to become increasingly competitive as foreign investment and privatisation reforms increase the competitiveness of Korean industry; Australia will not be able to take the market for granted.

While Koreans remain sensitive about agricultural food imports, the market is opening slowly to foreign competition and imports comprise over 40 per cent of total food consumed. Australia is a major supplier of meat, grains, sugar, dairy products and wool. Australia's share of this market fell after 1996 mainly driven by falling beef exports. This was due to falling demand in the wake of the financial crisis. However, under the WTO Agreement on Agriculture, Korea agreed to liberalise its beef market, moving from a quota system to a tariff only regime by 2001. Prospects remain good for Australian beef over the medium to long term when full liberalisation takes place.

During the 1970s and 1980s Korea developed a substantial wool textile sector, with Australia supplying 50 to 60 per cent of Korea's wool requirements. However, in the 1990s extensive restructuring of the Korean wool textile industry saw production move offshore as demand in the US and Japanese markets weakened and high labour costs reduced the viability of domestic production. Since 1995, Australia's wool exports to Korea have declined steadily. Bankruptcies and excessive wool stocks threaten the Korean industry and the market has remained depressed.

Korea is also an important export market for sugar and wheat. Australia's share of Korea's sugar market has increased to over 50 per cent. Wheat exports have remained volatile, reflecting drought induced supply problems more than market access problems. By the late 1990s Australia supplied around 20 per cent of Korea's total wheat import market.

### *Manufactures*

Australia's manufactured exports to Korea, valued at around AUD1.5 billion in 2003, comprises both simply transformed manufactures, notably aluminium, and elaborately transformed manufactures, dominated by car engines. The economic crisis of 1998 severely impacted upon Korea's imports of aluminium, although imports from Australia were less severely affected and consequently increased market share. With economic recovery and subsequent public works spending on infrastructures, demand

for aluminium recovered. Demand for Australia exports of aluminium were also affected through reform of the corporate sector in Korea. In the medium term, as excess manufacturing capacity is overcome and housing spending recovers, the construction sector has recovered its growth and increased aluminium demand. Over the longer term prospects for Australia will depend upon Australia meeting the challenge of increased competition, particularly from Russia and South Africa.

Before the economic crisis in Korea, Australia's share of elaborately transformed manufactured imports grew 20 per cent per year from a relatively low base, reaching AUD825 million in 1997. Car engines and parts grew strongest. However, with the onset of the crisis in Korea engine exports halved to just AUD157 million as the Korea domestic market for medium sized cars shrunk and export markets remained weak. Rationalising of the Korean car industry under the government's 'Big Deal' top five chaebol subsidiary swaps policy and improved relative competitiveness of domestically made parts through won depreciation made short to medium term prospects uncertain.

### *Services*

Korea is an important market for Australian service exports, particularly educational and tourism services, but Korea's economic crisis seriously affected both. In 1997-98 Australian service exports to Korea were valued at AUD702 million, a 36 per cent drop on service exports of AUD1,098 in 1996-97. Service imports from Australia were principally freight and shipping.

In 1997, Australia was the third major destination for Koreans studying abroad after the USA and Japan, and Korea was the largest source of overseas students studying in Australia. Almost 20,000 students undertook some form of study at Australian institutions, with some 12,000 attending English language courses. In 1997, Korean students paid approximately AUD350 million to Australian educational suppliers and probably a similar amount to live in Australia. In 1998, however, the economic crisis reduced students applying for visas by nearly 30 per cent (Department of Immigration and Multicultural Affairs, 1998) and the total number of Korean students studying in Australia fell by nearly 40 per cent in 1998. The market has recovered, particularly at the postgraduate level, as Koreans value education, and, until recently, a depreciation of the Australian dollar maintained Australia's competitiveness. Australia will need to maintain its reputation in Korea as a provider of high quality education and, if necessary, adjust programs to retain market share to meet the opportunities from the recovering market.

Until 1998, Korea was Australia's sixth largest source of in-bound tourists and Australia's fastest growing tourism market. In 1997, 233,000 Korean tourists visited Australia, a remarkable increase from the 9,000 visitors in 1998. However, in 1998, arrivals from Korea fell by a massive 72 per cent, to just 66,000. The Australian Tourism Forecasting Council expected arrivals from Korea to recover over the medium to longer term, with visitor numbers returning to their 1997 peak by 2006 although this could occur significantly (Australian Tourism Forecasting Council, 1998). By 2003 tourist figures had returned to around 207,300.



### *Australian imports from Korea*

Korea is, currently, Australia's seventh largest source of imports (after the USA, Japan, China, Germany, UK and New Zealand). Until 1998 manufactures comprised 80 to 90 per cent of Australia's Korean imports, falling to 65 per cent in the crisis year of 1998. By 2003, 74 per cent of merchandise imports were manufactured goods, chemicals 5 per cent, gold 18 per cent and non manufactures 3 per cent. Cars, computers, telecommunications equipment, household electrical and electronic appliances remain the most important Korean exports to Australia (see Table 5). Korea is now second only to Japan as an exporter of passenger vehicles to Australia. This illustrates the potential for market penetration of high quality and competitively priced Korean manufactures. Imports of textiles, clothing and footwear have lost market share to other suppliers, principally China, although they still comprised around 6 per cent of Korean exports to Australia.

From Korea's perspective, Australia remains an important trading partner. It represents the country's eleventh principal export destination and sixth most important source of imports (see Tables 6 and 7). Given the obvious complementarities between the economies the prospect for an expansion of trade is quite apparent.

**Table 5 Major Australian imports from Korea, 2003 (AUD million)**

Telecommunications equipment	965
Passenger motor vehicles	502
Televisions	298
Computers	264
Non-monetary gold	197

Source: Department of Foreign Affairs and Trade

#### **4. Foreign direct investment between Australia and Korea**

Australia-Korea bilateral investment flows have not matched the level of trade. By the late 1990s Korea was only Australia's eighteenth largest overseas investment destination and Korean companies were the sixteenth largest investor in Australia. Australia gives high priority to encouraging increased Korean investment in Australia, particularly in manufacturing, tourism and resources. This policy produced some results, with direct and portfolio investment increasing to around AUD1.5 billion before the financial and economic crisis of 1997-98. The bulk of this was portfolio investment, rather than longer term FDI.

##### *Australian FDI in Korea*

Australia's cumulative FDI in Korea is small. Korean data suggested that by the end of the 1990s Australian cumulative investment stood at US\$38 million, while Australian data suggested that the figure was AUD94 million. Such investment is principally in the manufacturing and service sectors, although the transport, chemicals

and electrical and electronics sectors have also been recipients. Australian FDI into the Korean service sector has diversified with consulting, market research, travel agencies and advertising growing in recent years. In the past, Korean emigrants to Australia also undertook some hotel and trading company investments. Australia's Korean FDI increased with the opening of the service sector, particularly financial services. Investments in consulting and market research has also continued to grow and the Korean market recovered from the crisis.

**Table 6 Korea's principal export destinations, 2003**

1	China	18.1%
2	United States	17.7%
3	Japan	8.9%
4	Hong Kong	7.6%
5	Taiwan	3.6%
11	Australia	1.7%

Source: IMF

**Table 7 Korea's principal import sources, 2003**

1	Japan	20.3%
2	United States	13.9%
3	China	12.3%
4	Saudi Arabia	5.2%
5	Germany	3.8%
6	Australia	3.3%

Source: IMF

A survey conducted by Lee (1998) using 24 Australian and other foreign companies operating in Korea indicated that most surveyed were satisfied with their investment. Of managers surveyed, 75 per cent indicated that their companies were either very or reasonably satisfied with profitability, while 25 per cent were disappointed. The major factors leading these companies to initially invest in Korea were its large domestic market and expected economic growth in new markets (see Table 8). Another important motive for investing in Korea was to develop a local presence with the company's overall globalisation strategy.

Two thirds of surveyed companies considered the major impediment to doing business in Korea were foreign exchange risk, difficulty in dealing with the bureaucracy and problems in obtaining information from government and regulatory bodies. Other major impediments included *chaebol* dominance of the domestic market, Korea's strong nationalism, Korean business culture and corruption. Despite these negatives, 75 per cent of surveyed companies would encourage other Australian companies to invest in Korea.

**Table 8 Survey of why Australian companies wish to invest in Korea**

<b>Description of motives behind the initial decision to invest</b>	<b>Major reason (number of responses)</b>	<b>Per cent</b>
Already a major market and local presence important	16	66
Part of company's globalisation strategy	9	38
Explore a new market	4	16
Establish a beachhead for market expansion	3	12
Approached by Korea partner	1	4
Produce products for export to third market	0	0
Increase productivity by using low cost labour	0	0
Acquire local technology	0	0

Note: Companies were given the opportunity to provide more than one motive behind their initial decision to invest in Korea. Thus, responses add to more than 24 and percentages to more than 100.

Source: Lee (1998)

#### *Korean FDI in Australia*

Korean data indicates that Korean FDI in Australia grew strongly from a low base of about US\$52 million in 1996 to US\$100 million by the end of the 1990s. While such FDI was diversified into many sectors in the 1990s, it mainly secured a stable supply of energy and natural resources. Half of it was concentrated in coal mining, then forestry and fishery (see Figure 11).

Most mining investment is in production sharing joint ventures, but a few wholly owned subsidiaries also operate. Many large Korean corporations in mining-related business, including Samsung, SK, POSCO and KEPCO, have invested in Australia, producing coal for their parent companies in Korea.

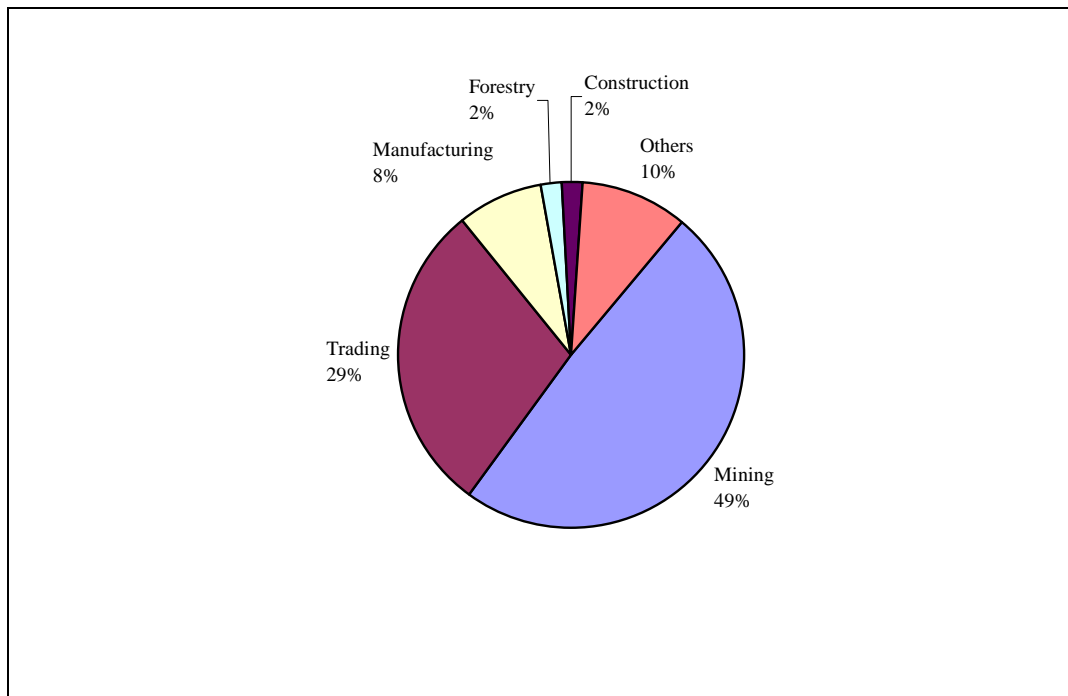
Korea's major general trading companies have also established wholly owned subsidiaries or representative offices in Australia. They import Korean merchandise such as chemical products, steel products, heavy machinery and semiconductors into Australia, and export goods including coal, iron ore, gold, non-ferrous metals and wool from Australia. Other trading companies, mostly *chaebol* subsidiaries, import Korean cars, household white goods and home electronics for wholesale or retail distribution in Australia.

Although investment in the Australian manufacturing sector is still small, it is expanding and diversifying into new products with some major investments in wool and leather processing and chemical products. Other sectors include construction and real estate investments. While these are relatively new areas for Korean overseas direct investment, a substantial amount of such investment is expected in the future.

## 5. Trade and investment prospects and opportunities

From an Australian perspective, Korea's period of economic reform in the wake of the financial crisis has created many new export and investment opportunities, as trade is liberalised and FDI in Korea expands. In addition, improved financial sector and corporate accountability, transparency and the improving regulatory environment make it easier for Korean firms to do business. Market opportunities for Australian firms are opening in technology dependent sectors, such as automotive components, finance and banking, but also in bulk commodity sectors. Since the crisis, with a view to cutting costs, Korean importers have reviewed supply arrangements with traditional suppliers in the USA and Europe. As competition in the Korean marketplace has increased, price and quality rather than traditional relationships will increasingly determine input sourcing. This presents a good opportunity for Australian companies.

**Figure 11 Sectoral distribution of Korean FDI in Australia (cumulative, 1968-98, per cent)**



Note: Based on actual investments

Source: Ministry of Finance and Economy (1998)

The following sectors provide excellent trade opportunities for Australian exporters in the post crisis recovery of the Korean economy:

- Industrial raw materials (energy, raw materials and intermediate inputs). Australian companies meet many Korean import needs for raw materials and basic foodstuffs. Australia's traditional trade in energy resources with Korea, worth \$6 billion, is set to grow as Korea's demand for energy rises. Coal is a critical requirement for Korean industry and LNG is the next strategic fuel for Korea's economic growth. In both energy resources, Australia is a major world

player and has the capacity and experience to be a reliable supplier to meet South Korean energy needs. South Korea's National Energy Plan, which sets out the country's energy policies and requirements until 2011, projects an increase in demand for LNG of 4.8 per cent annually. Australia is in a good position to be able to meet Korea's energy demands well into the future. In January 2003, Australia won a contract to supply South Korea with more than 3 million tons of LNG over seven years. The contract, worth about \$1 billion, is a vote of confidence in Australia's long record as a reliable, stable and competitive supplier of South Korea's energy needs.

- Processed food and beverages. As the Korean economy continues its economic growth demand for beef, especially with full liberalisation, will rise, as with dairy products, wine and beer, seafoods and other western foods. Since August 2002, Australia has successfully exported approximately 3,900 live cattle to Korea in 5 consignments between August 2002 and December 2003. The cattle are prepared in accordance with South Korean import conditions and are being released to local farmers following the mandatory post arrival quarantine period.
- Automotive components. Over the longer term the automotive sector presents many mutually beneficial trade opportunities. Despite Korea's considerable automotive manufacturing capacity, its component sector is relatively weak technologically. The development of an independent automotive technological capacity remains a high priority and Korean firms are seeking strategic technological alliances with other countries, including Australia (Austrade, 1999).
- Information technology and other high technology products and services. Australian suppliers of software applications for the banking and financial services sector could face significant opportunities. Korea's reform and modernisation of its banking system has required a major upgrade of its information technology infrastructure. Australian companies are well placed to take advantage of emerging financial sector IT opportunities, particularly where Australian IT firms have developed leading edge technology in market segments. However, Australia needs to market aggressively these advantages to attract Korean customers who may not be aware that Australia is a major source of financial and professional services. A study commissioned by the Australia-Korea Foundation in 2001, *Australia-Korea: Strengthened Economic Partnership*, showed that there are emerging new fields for strengthening the economic relationship, particularly in public infrastructure development, IT broadband access and technology-based services. South Korea has the highest rate of broadband uptake in the world, with approximately sixty per cent of households using the technology. However while South Korea leads the world in terms of infrastructure roll-out, Australia's expertise in the development of broadband applications would be of great benefit to Korea in its effort to stimulate market demand in industry sectors. In May 2003, a Broadband Summit was held on the Gold Coast which brought together industry leaders from both countries to explore collaboration in information technology and broadband applications.
- Building materials. Opportunities exist in detached residential housing, building materials, project management services, building and urban development services, waste management services and the supply of kit homes.

- Environmental services. Australian environmental engineering companies have experience in industrial waste water treatment in Korea. Water supply and other urban infrastructure projects with strong environmental components are likely to form part of employment creation and macroeconomic stimulus public works projects. In the medium to long term , Korea is likely to increase funding for environmental improvement projects.
- Medical equipment and biotechnology. Since the economic crisis traditional supply channels have forced Korean hospitals to re-assess their purchasing decisions. US products are now more expensive, so alternatives need to be sought. Australian suppliers need to cultivate relationships with purchasing departments of hospitals, distributors and agents, and demonstrate the quality and capacity of Australian products (Austrade, 1999).
- Distribution. In the wake of the financial crisis a new distribution environment is appearing in Korea. Australian exporters have opportunities to supply new multinational retailers by stressing Australian goods as being high quality and value for money products.
- Tourism and education. Tourism and education remain important elements of the bilateral services trade. The South Korean student market is Australia's third largest, and more than 207,300 South Korean tourists visited Australia in 2003.

As mentioned previously, bilateral investments have not been historically strong, but this is also beginning to change:

- In the late 1990s, Korea Zinc invested AUD1 billion in the Sun Metals Corporation refinery in Queensland.
- In 2001, POSCO announced a AUD500 million investment in BHP-Billiton's iron ore resources in WA.
- Australia's Coca-Cola Amatil has an investment of around AUD 1 billion in South Korea.
- Australia's Macquarie Bank manages a portfolio of over AUD1 billion in investment funds in South Korea.
- Australia's largest investment in the Korean leisure industry, the US\$35 million Busan Aquarium managed by Oceanis Australia, was opened in 2001.
- Australian automotive firm, Holden, announced in October 2002 it would assume a role as General Motor's shareholder in a new joint venture in Korea, GM Daewoo. In a significant step in the sale of Australian manufactured goods to South Korea, GM Daewoo has announced that it will begin importing a sedan based on the Holden Statesman and Caprice from 2005. The US\$251 million investment will provide Holden a base for it to capitalise on growing opportunities in the Asian automotive market and allow continued sales of four-cylinder engines from Holden's Broadmeadows plant to GM Daewoo.

From Korea's perspective the Australian market has many potential trade and investment opportunities. Australia has for a number of years been one of the fastest growing OECD economies. Rising incomes and wealth have created a market with considerable opportunities for Korea companies, particularly in terms of telecommunications equipment, passenger motor vehicles, televisions and computers. Australians have a reputation for being willing to try new high tech products that enter

the market. Being able to compete in the Australian market on an equal footing with more expensive Japanese and US products is therefore crucial for Korean companies. The prospect of a free trade agreement between Australia and the US could put Korean companies at a competitive disadvantage.

## **6. An FTA between Korea and Australia**

As discussed throughout this paper, there are many opportunities for expanding trade and investment flows between the two economies that will produce mutually beneficial outcomes. The numerous obvious complementarities between these economies, and their relatively small contribution to each others' total imports suggests that they are ideal partners for a free trade agreement.

An important question for Australian policy towards the region is how it should respond to the evolving East Asian regional architecture centred on the ASEAN+ 3 summit process, which involves the ten countries of ASEAN and the three North Asian powers - Japan, China and Korea. While the process still has a long way to go before its full significance can be determined, it is reasonable to assume that there will be benefit to the region and to partners such as Australia in a process which fosters dialogue and cooperation among the countries of East Asia and thereby contributes to regional stability. It remains to be seen whether or not the ASEAN+ 3 process will lead over time to comprehensive preferential trade arrangements or to other political or economic alignments of lasting significance, but clearly the possibility of this occurring at some stage in the future cannot be ruled out.

From the outset, however, membership of the grouping has been deliberately restricted to East Asian countries. The impetus that motivates the ASEAN+ 3 process has several dimensions: a desire to establish a stronger international identity and profile for East Asia; a desire by the ASEAN countries to compensate for their relative economic weakness by associating more closely with the bigger economies of North Asia; and the aspirations of Japan and China - partly in competition with each other - to establish stronger claims for regional leadership. Above all, and especially in the aftermath of the East Asian financial crisis, there is a feeling that East Asians should be able to demonstrate the capacity to work together to find East Asian solutions to East Asian problems.

Australia has indicated that it would be pleased to be involved in the ASEAN+ 3 process. Australia has registered its interest in joining the grouping if invited at some later stage, and has emphasised the desirability of the process having the character of an open and inclusive form of regionalism. Such an approach should reinforce rather than undermine East Asia's important external links with the United States and Canada, with Australia and New Zealand, and with Western Europe. However, this will be for the ASEAN + 3 countries to decide.

Given these developments, however, Australia is also very interested in developing closer economic ties on a bilateral basis. The Closer Economic Partnership that has been established between Australia and New Zealand and the ASEAN Free Trade Area, the bilateral free trade agreements that have been concluded with Singapore, Thailand, and the US, and the bilateral trade and economic framework agreements that it is discussing with Japan and China are examples of the Australian policy

approach. Based on the discussion presented in this paper, an obvious example for further progress is the establishment of a free trade agreement with Korea. Both countries are at a point where such an agreement would meet the needs of both countries.

## **7. Summary and conclusions**

This paper has provided an extensive overview of the trade and investment relationship between Korea and Australia. From an Australian perspective Korea is its sixth most important trading partner. From a Korean perspective Australia is its eleventh largest export market and sixth most important import source. While Korea's financial and economic crisis of 1997-98 adversely affected trade and investment growth between the countries, the rapid recovery of the Korean economy, thereafter, as well as the strong growth of the Australian economy presents many trade and investment opportunities of mutual benefit.

The two countries appear to be ideal candidates for the establishment of a free trade agreement. Obvious complementarities between the economies, as well as the relatively small contribution each makes to the other's total imports and exports, suggests that serious consideration should be given by the respective governments to the establishment of such an agreement.

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