Australia - Republic of Korea Free Trade Agreement Feasibility Study

A Joint Study by ITS Global and the Korean Institute for International Economic Policy

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Executive Summary

Supporting an important bilateral trade and investment relationship

A free trade agreement between Australia and the Republic of Korea offers significant opportunities to further strengthen our highly complementary and growing bilateral trade and investment relationship, and deliver gains to both countries through closer economic integration.

A complementary relationship

Australia and the Republic of Korea (ROK) are medium-sized economies and stable democracies. Both have demonstrated periods of strong growth, underpinned by structural reforms and sound macroeconomic management: over the long term for Australia; and, for the ROK, following the 1997-98 Asian financial currency crisis.

Australia maintains a transparent trade policy regime, with relatively low tariffs, an open services sector and a liberalised foreign investment regime. The ROK has embarked on significant trade liberalisation since the 1980s, reducing average tariff rates substantially, and significantly liberalising the services and investment sectors, though tariffs in some sectors, particularly agriculture, remain high and restrictions apply across a range of service industries and on investment.

Two-way trade between Australia and the ROK was valued at over A $21 billion in 2006. The ROK is Australia's sixth largest trading partner by value, taking 7 per cent of all exports at a total value of nearly A$14 billion in 2006. Australia's energy and raw materials have underpinned ROK industrialisation. Our major merchandise exports to the ROK, by value, are coal, crude petroleum, iron ore and beef (2006). Education and tourism services have been particularly successful. Australia is the ROK's 14th largest export market, with ROK exports to Australia reaching US$4.7 billion in 2006. Major exports by value in 2006 were automobiles, electronic devices, mineral fuels, boilers and machinery and ships and steel. Services exports are dominated by transportation services.

Despite the dominance of primary commodities in the bilateral relationship, trade is also important across a range of industries, including automotive products, biotechnology, building and construction, dairy products, defence materiel, fruit and vegetables, information and communications technology, seafood, textiles and clothing and wine.

Bilateral investment flows are becoming increasingly important. Although relatively small compared to most of Australia's major trade partners (valued at A$6.9 billion in 2006), Australia's investment in the ROK is twice the size of that in China, and the ROK is the 12th largest destination for Australian investment abroad. Australia is the ROK's sixth largest recipient of FDI abroad, with total accumulated stock of investment as at end of 2006, valued at US$3.1 billion. The ROK has made substantial investments in Australia, particularly in the natural resources sector.

A growing relationship

The Australia-ROK trade relationship continues to grow and has done so significantly since the mid-1990s. There has been continued growth in the value of Australia's exports of both goods and services to the ROK - of more than 100 per cent since 1999, and 13 per cent between 2005 and 2006, surpassing that experienced in traditional Australian markets such as the US, Japan and New Zealand. ROK exports to Australia have also increased in recent years. ROK merchandise exports to Australia in 2006 showed an increase of more than 23 per cent over the previous year. Since 1999 they have increased by over 93 per cent.

Bilateral investment is also growing. Between 2001 and 2006, Australia's stock of investment in the ROK grew at an average of over three times the rate at which total Australian investment abroad grew over the same period. Investment has been concentrated in technology-intensive sectors, infrastructure and utilities, financial services, and education and training. The flow of direct investment from the ROK to Australia was US$51 million in 1996, reaching US$142 million in 2006. Australian energy and mineral resources, wholesale and retail, and manufacturing industries have been particularly important target sectors for ROK investment.

Advancing liberalisation of bilateral trade and investment

While the bilateral trade and investment relationship is significant and is expected to grow, barriers remain in some areas. A free trade agreement (FTA) which reduced or removed those barriers provides an opportunity to increase bilateral trade and investment flows. A liberalised trade and investment environment would also offer potential growth opportunities for mutually beneficial bilateral commercial relationships.

Modelling results reveal that bilateral liberalisation under an FTA would increase trade and investment flows between the two countries.Various simulation models show that there exist positive gains from an FTA between Australia and the ROK. Bilateral trade and investment liberalisation would also increase the total volume of both Australia and the ROK's trade with the Rest of the World.

Reducing regulatory discrimination in services

Services are becoming increasingly important in the bilateral relationship as their extent and importance expands rapidly in both economies. This is true even in the manufacturing sector, where the effects of services on value-added and job creation have become more significant and as trade in both goods and services are linked through global supply chains. Reduction or removal of regulatory barriers which restrict services will support improved trade flows across goods and services of interest to both economies.

Australian service exporters could benefit from greater liberalisation of and access to, the ROK services market through the removal of specific barriers, while ROK consumers could benefit from better access to more sophisticated and competitive services. This would result in benefits for both economies. An FTA with Australia could also help the ROK services sector become more flexible and innovative, to meet the growing challenge from China and India, amongst others. Although deregulation and reform of ROK service industries has continued since the Asian currency crisis, foreign business continues to face restrictive regulations in some service areas, such as financial services, legal and accounting. Econometric modelling estimates that liberalising trade in services under a comprehensive FTA would increase the present value of the stream of deviations from baseline in Australia's real GDP by US$9.8 billion and ROK real GDP by US$14.1 billion over the period 2007 to 2020.

Encouraging investment

There is significant potential for liberalisation of investment to enhance bilateral investment flows, in particular, greater ROK investment in Australia, including in the resources sector, which would enhance ROK's energy and resource security.
An FTA also provides a means to strengthen institutional arrangements in each country and provide a strong base for building flexible commercial relationships supportive of further investment. Greater investment opportunities could be expected to flow through to growth areas such as financial services, IT, automotive and leisure. Econometric analysis estimates that investment facilitation under a comprehensive FTA could add US$5.2 billion to Australia's GDP and US$6.3 billion to Korea's GDP by 2020.

Improving market access for goods

ROK exporters could be expected to gain from reductions in Australia's tariff on textiles and garments, as well as automobiles and automotive parts where ROK exports are globally competitive. The ROK could also be expected to gain from reducing its own levels of tariff protection against imports from Australia that serve as important inputs for local production. This also offers obvious benefits for ROK consumers. Likewise, reductions in Australia's tariffs would not only aid ROK exporters, but also benefit Australian consumers in terms of greater variety and lower prices.

For Australia obvious gains would arise from reductions in ROK agricultural trade barriers, where Australia is a globally competitive exporter. The Australian agricultural sector would benefit from improved market access to the ROK market in meat, dairy, grains, and sugar. Gains could also be expected to arise from tariff reductions in areas where ROK tariffs are more modest, but the bilateral trade is growing and important, such as medicines, chemicals and wine.

The removal or reduction of the non-tariff barriers affecting bilateral trade in goods could offer significant gains for parties, in particular reduced transactions costs and efficiency improvements. Gains would arise from improving the transparency and administration of regulatory procedures affecting trade in goods, such as improved transparency in quarantine and anti-dumping procedures or better coordination and harmonisation of labelling requirements and inspection standards. Greater transparency and improved administration of the tariff quotas could also be important commercially.

Addressing many of these barriers often requires more than simply removing trade barriers and implies some form of regulatory reform in each country or harmonisation of regulations between them. FTAs can assist this process to some extent by setting up regulatory frameworks in which these issues can be addressed or progressed over the longer term.

Delivering economic benefits

Bilateral liberalisation of trade and investment between Australia and the ROK has generally positive economic welfare and efficiency effects for both economies.

Modelling results support the conclusion that a bilateral FTA which is comprehensive in scope and coverage has the potential to deliver welfare gains for both countries. These gains are likely to be well underestimated. Quantitative gains from reducing barriers to trade and investment that are estimated by econometric modelling techniques do not generally capture the full extent of all the efficiency gains that are derived from liberalisation. For example, they cannot fully account for the consumer benefits from the increased choice of goods and services that flow from a reduction in trade and investment barriers. These gains are generally expected to be much larger.

Enhancing economic welfare

Modelling results reveal that comprehensive bilateral liberalisation of trade and investment would generate increased output and trade, and will be welfare enhancing for both Australia and the ROK.

Real GDP increases in both countries could be expected due to increased capital accumulation, improved productivity and a better utilisation of resources. A key factor underlying real GNP increases is improved terms of trade. Liberalisation will enhance the economic partnership between Australia and the ROK by increasing bilateral trade and investment flows between them. On balance, it is also trade creating for the world as a whole, with the volume of world imports increasing from its baseline level as a result of bilateral liberalisation between the two countries.

Deriving efficiency gains

Liberalisation delivered through an FTA can improve the allocative efficiency of the economy by allowing for increased specialisation. Both Australia and the ROK are expected to gain from trade liberalisation as resources are reallocated to those sectors in which each country has a comparative advantage. As a result some industries will contract, while others will expand.

At the sectoral level, the Australian industries which contribute most to increases in Australian output are meat, dairy products, sugar and non-ferrous metals. For ROK the manufacturing industries contributing most to the overall expansion in production include in particular, textiles, metal products, machinery, and motor vehicles and parts industries. The services sectors in both countries will both gain from liberalisation.

Typically the static allocative efficiency gains arising from tariff reductions, particularly in a low tariff environment, are relatively modest compared to the gains that flow from reducing non-tariff barriers including those in services and investment. These are generally much more damaging to economic efficiency than tariffs. Consumer benefits from the increased choice that can flow from a reduction in such barriers can be large, particularly as they can prevent products from even entering the domestic market.

Improving productivity growth

Liberalisation of bilateral trade and investment under an FTA can contribute to faster productivity growth resulting from lower barriers to trade and investment which facilitate access to technologies that are not available from the domestic market and which increase competition in the domestic market.

Dynamic gains in efficiency are achieved as successful innovation generates increased investment in the domestic economy which in turn attracts further foreign technological developments and know how. The gains are more difficult to quantify than the gains in static allocative efficiency but they are generally considered to be potentially much larger.

Theoretically an FTA could operate to increase the competitive pressure on the ROK services sector. Development of the service industry in the ROK has been relatively slow with labour productivity in most industries lagging well behind that in developed countries, including Australia. Greater competition from Australian service providers could serve to assist the ROK develop a more advanced service industry; increase competitiveness of manufacturing and other industries and result in higher productivity and efficiency in the whole economy, with resulting gains in welfare and growth. Australian companies operating in Korea would gain from improved functioning and efficiency of the services sector overall.

Creating trade consistent with multilateral liberalisation

Addressing competitive disadvantages

Recent years have seen a dramatic rise in the negotiation of bilateral FTAs and proposed regional initiatives in the Asia-Pacific region, many involving Australia and the ROK and their major trading partners. At the same time, negotiations for liberalisation at the multilateral level through the WTO Doha Round have increasingly stalled. Both Australia and the ROK have sought deeper and wider economic integration with countries in the Asia-Pacific region through the negotiations of FTAs, pursued simultaneously with the WTO Doha Round.

While FTAs with third parties have opened further trade liberalisation opportunities, the extension of preferential treatment to enterprises in third countries has introduced discrimination against Australian and ROK enterprises in one another's market vis-à-vis their competitors from those countries. Preferential access to the ROK market that would be granted to US producers under the KORUS for example, has the potential to adversely impact on trade in agricultural products between Australia and the ROK. Similarly, competitive disadvantages suffered by ROK exporters of manufactures as a result of preferential treatment accorded to third parties under Australia's FTAs, have adversely impacted on bilateral trade.

A strong case can be made for an Australia–ROK FTA which grants at least equivalent terms of market access, or treatment, to either party in each country to that granted to third countries in other FTAs.

Trade creating, not diverting

Bilateral liberalisation of trade carries a significant risk of diverting trade from third parties and replacing them with imports from the other party to the liberalisation. If the third party countries are lower cost suppliers, then the trade diversion would be welfare-reducing. At the same time, however, bilateral liberalisation will create new trade between the two parties. The key question is, therefore, whether the gains from trade creation outweigh the losses from trade diversion; the answer depends upon the circumstances of each case.

For this reason, recent developments in trade policy underline the need for bilateral trade agreements to create more trade than they divert. The analyses undertaken for this report indicate that, provided the bilateral trade barriers between Australia and the ROK are reduced comprehensively, there will be significant net trade creation. Moreover, they conclude that any trade diversion from such a liberalisation would be minimal.

These results reflect the fact that comprehensive liberalisation heavily favours trade by each country in its areas of comparative advantage. Liberalisation that lowers trade barriers in the ROK in areas where Australia is globally competitive — particularly agriculture and minerals – and lowers them in Australia where the ROK is globally competitive — namely electronics and automobiles — would achieve this end.

FTAs which complement and reinforce the multilateral trading system and which support the elimination of tariffs and non-tariff barriers on imports from all countries, are the simplest and most desirable way to remove the scope for trade diversion arising from FTAs with and among third parties. This consideration underscores the importance of each FTA partner achieving the comprehensive elimination of all its tariffs if it is to derive maximum economic gains from FTAs.

Driving deeper economic integration

A bilateral FTA also offers significant opportunities to strengthen and build on the bilateral relationship to reap mutually beneficial outcomes through closer economic integration, especially in the areas of IT, automotive, communication, education, tourism and financial services.

There is scope for benefits to be derived from cooperation in areas traditionally considered to be 'beyond the border' which are related to trade in services. This includes addressing matters such as mobility of business personnel and recognition of regulatory standards. Consultations with industry suggest there is scope for benefit from an FTA in all these areas in the financial services industry in particular.

The ROK is a key economy in the North Asian region critical to the success of some Australian industries in accessing global supply chains. Strategic alliances between Australian and ROK industry groups could be further strengthened through can FTA so as to maximise the opportunities for global integration.

Greater levels of FDI can also drive further benefits arising from stronger commercial relationships. An FTA can provide a platform for Australian and ROK firms to build stronger, mutually beneficial partnerships, such as those for the development and application of technology across industries. Both ROK and Australian industries will benefit from a synergy effect created by competitive ventures involving cutting-edge technologies. ROK firms are increasingly seeking strategic technological alliances with Australian companies for the development its automotive technological capacity.

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Acronyms and Abbreviations

ABS	Australian Bureau of Statistics
ACIS	Automotive Competitiveness and Investment Scheme
ADB	Asian Development Bank
AEEMA	Australian Electrical and Electronic Manufacturers' Association
AEI	Australian Education International
AFTA	ASEAN Free Trade Area
AKBC	Australia Korea Business Council
AKF	Australia Korea Foundation
ANZCERTA	Australia New Zealand Closer Economic Relations Free Trade Agreement
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
AUSFTA	Australia United States Free Trade Agreement
CGE	Computable General Equilibrium
CODEX	FAO/WHO Codex Alimentarius Commission
CoPS	Centre of Policy Studies
CPA	Certified Public Accountant
DFAT	Australian Government Department of Foreign Affairs and Trade
DIaC	Australian Government Department of Immigration and Citizenship
EBRD	European Bank for Construction and Development
EFS	Export Facilitation Scheme
EFTA	European Free Trade Association
ELICOS	English Language Intensive Courses for Overseas Students
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
EPS	Expandable Polystyrene
ESA	Endorsed Supplier Agreement
ESS	Economic Statistics System
EV	Equivalent Variation
FAO	Food and Agricultural Organisation of the United Nations
FAPM	Australian Federation of Automotive Parts Manufacturers
FATA	Foreign Acquisition and Takeover Act
FBT	Facility-Based Service Provider
FDI	Foreign Direct Investment
FEZ	Free Economic Zone
FIPA	Foreign Investment Promotion Act of the Republic of Korea
FIRB	Foreign Investment Review Board
FSC	Financial Services Committee
FSC	Financial Supervisory Committee
FTA	Free Trade Agreement
FTAAP	Free Trade Agreement of the Asia Pacific
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNP	Gross National Product
GPA	Government Procurement Agreement
GTAP	Global Trade Analysis Project
ICA Korea	International Cooperation Agency for Korea IT
ICT	Information and Communications Technology
IMF	International Monetary Fund
IRA	Import Risk Analysis
KASTEC	Korea Australia Science and Technology Exchange Centre
KFDA	Korea Food and Drug Administration
KFTC	Korea Fair Trade Commission
KIEP	Korea Institute for International Economic Policy

KITA	Korea International Trade Association
KOBACO	Korea Broadcast Advertising Corporation
KONEPS	Korea On-line E-Procurement System
KSE	Korea Stock Exchange
MFN	Most Favoured Nation
MIC	Ministry of Information and Communication
MKE	Ministry of Knowledge Economy
MJTEC	Australia-Korea Ministerial Joint Trade and Economic Commission
MMC	Monash Multi-country Model
MOCIE	Ministry of Commerce, Industry and Energy of the Republic of Korea
MOFAT	Ministry of Foreign Affairs and Trade
MOFE	Ministry of Finance and Economy
MOJ	Ministry of Justice
MoU	Memorandum of Understanding
MRFTA	Monopoly Regulation and Free Trade Act of the Republic of Korea
NACF	National Agricultural Cooperation Federation
NFF	National Farmers Federation (of Australia)
NFFC	National Federation of Fisheries Cooperative
NPV	Net Present Value
OECD	Organisation for Economic Cooperation and Development
PMV	Passenger Motor Vehicles
R&D	Research and Development
RCA	Revealed Comparative Advantage
ROK	Republic of Korea
RoW	Rest of the World
SAFTA	Singapore Australia Free Trade Agreement
SAR	Special Administrative Region
SDR	Special Drawing Rights
SGX	Singapore Exchange
SIP	Strategic Investment Program
SME	Small- to Medium-size Enterprise
SPD	Separation of Prescribing and Dispensing
SPS	Sanitary and Phytosanitary
TAFA	Thailand Australia Free Trade Agreement
TCF	Textiles, Clothing and Footwear
TFP	Total Factor Productivity
TIEV	Total Inbound Economic Value
TRIPS	Trade Related Aspects of Intellectual Property Rights
TRQ	Tariff Rate Quota
TSI	Trade Specialisation Index
US	United States
USTR	United States Trade Representative
VAT	Value Added Telecom Service Providers or Value Added Tax
W	ROK won
WHO	World Health Organisation
WTO	World Trade Organisation

1. Trends in bilateral trade, investment and economic relations

1.1 Australian and the ROK economic relations

1.1.1 Key features of the Australian and ROK economies

1.1.1.1 Economic and business environment

Australia and the Republic of Korea (ROK) are medium sized economies. Globally the ROK ranks 12th in terms of gross domestic product (GDP) and Australia ranks 15th.[1] Australia's GDP is approaching US$800 billion a year, while the ROK's is around US$900 billion. In terms of annual GDP per capita, Australia measures around US$37,000 compared to the ROK at just over US$18,000.[2]

Australia is a stable economy and one of the oldest democracies. Underpinned by structural reforms and sound macroeconomic management, it has shown considerable resilience to economic shocks in recent years and enjoyed a long period of strong growth. Australia's economy has grown by an average of 3½ per cent a year since the early 1990s. While inflation has remained low averaging 2½ per cent over the same period, it has now reached 3 per cent and may rise again in the short-term. Strong growth is expected to continue with growth of 4¼ per cent forecasted in 2007-08, expected to ease to 3½ per cent in 2008-09. The farm sector is not expected to recover fully from drought over the forecast horizon. Farm GDP is forecast to grow by 14 per cent in 2007-08, which is a significantly weaker recovery than seen in previous droughts[3].

After several decades of authoritarian rule, the ROK is now a thriving democracy. Its remarkable economic growth since the 1960s has been described as an "East Asian Miracle", contributed to by its high savings and investment, a highly educated labour force and successful industrialization policy. With the First Five-Year Economic Development Plan, the ROK Government turned its inward-focused growth strategy of import substitution to an outward-looking strategy of export promotion. The 1997-98 Asian financial crisis forced extensive restructuring and opening up of the economy to global market forces, which facilitated a swift recovery.

Since 2002, real GDP growth in the ROK has averaged around 4.8 per cent per year and is expected to continue at around this level in 2007-08. A tight labour market is expected to support growth in private consumption. The current account surplus will contract, owing to a further deterioration in the services account.

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[1] International Monetary Fund (IMF), *World Economic Outlook Database*, October 2007.
[2] These comparisons are on the basis of market exchange rates. Expressed in terms of Purchasing Power Parities, the difference in GDP per capita between the two countries is somewhat smaller but still substantial.
[3] Treasury, *Mid-Year Economic and Fiscal Outlook*, October 2007.

1.1.1.2 Trade policy and investment regime

Australia

Australia maintains a transparent trade policy regime. Tariffs are the main trade policy instrument. Over 95 per cent of tariffs are bound, providing a high degree of predictability. The average applied most favoured nation (MFN) tariff is below 5 percent. The tariff rates applied to agricultural products are much lower (around 1 percent) than those applying to manufacturing products. The highest tariffs apply to passenger motor vehicles (PMV) and textiles, clothing, and footwear (TCF) although most of these are scheduled to fall to 5 per cent by 2010 and 2015 respectively.

Australia's services sector is relatively open, with minimal regulations. Some limited sectors are subject to foreign equity restrictions, including real estate, banking, civil aviation, shipping and telecommunications.

Australia is also open to foreign investment. While some proposals by foreign interests require prior approval, in the majority of industry sectors smaller investment proposals are exempt from notification and larger proposals are approved unless judged contrary to the national interest. In some sectors, legal restrictions on foreign investment remain as noted above.

Australia is continuing to seek deeper and wider economic integration with countries in the Asia Pacific region, including through the conclusion of free trade agreements (FTAs). It has a long standing FTA with New Zealand and has recently concluded agreements with Singapore, Thailand and the United States. It is in the process of negotiating FTAs with China, Japan, Malaysia, the Association of South East Asia Nations (ASEAN; with New Zealand), Chile and the Gulf Cooperation Council (GCC). FTAs have been pursued simultaneously with multilateral trade liberalisation through the WTO Doha Round, which remains Australia's top trade priority.

Republic of Korea

The ROK has embarked on significant trade liberalisation since the 1980s, reducing average tariff rates substantially. The simple average tariff rate in 1982 was nearly 24 per cent, declining to about 10 per cent in 1992. In 2004, the ROK adjusted its trade weighted tariffs to 8.3 per cent. Although there has been serious trade liberalization, South Korea continues to maintain high tariffs on selected goods. According to a 2006 report from the Centre for International Economics (CIE),[4] the ROK imposes the highest tariffs on dairy products, amounting to 40.3 per cent on average. Vegetables, fruits and nuts, cattle, sheep, goats and horses, and beverages and tobacco products also incur higher average tariffs exceeding 20 per cent.

The Foreign Investment Promotion Act (FIPA) of the ROK supports liberalisation of the ROK's investment regime. The ROK's investment regime is applied on an MFN basis and most business sectors are open to foreign direct investment (FDI). Only two

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[4] Centre for International Economics, *Costs to Korea from not entering an FTA with Australia,* Department of Foreign Affairs and Trade, Australia, Canberra and Sydney, July 2006, accessed at http://www.thecie.com.au/publication.asp?pID=86.

sectors are completely closed to foreign investment and another 26 are partially restricted (see Chapter 2 for details).

The ROK Government has launched bilateral FTA negotiations with several countries. The ROK's first FTA was negotiated with Chile and entered into force in April 2004. FTAs with Singapore and the European Free Trade Association (EFTA)[5] followed in 2005, entering into force in 2006. The ROK-ASEAN FTA on Trade in Goods entered into force on 1 June 2007. An FTA negotiated recently with the US is currently awaiting ratification.

1.1.1.3 Comparative advantage/competitiveness

Australia

Australia's large land area and relatively small population mean that it traditionally has had a strong comparative advantage in agricultural commodities, particularly in those that involve extensive livestock and crop production such as beef, sheep, wheat and sugar. It also has a strong comparative advantage in the extraction and refining of minerals and ores. The Australian mining sector has evolved to the point where it is very internationally competitive and is the largest export sector in the economy.

Until the 1980s, Australia's manufacturing sector was protected by a wall of tariffs, was generally fragmented, focused on the domestic market, lacking in international competitiveness and poor at the innovation required for productivity growth. After a severe economic shock in the mid 1980s, border protection was progressively phased out. Over the past 25 years, Australia has made significant reductions in tariffs. As a consequence the manufacturing sector has comprehensively restructured and in doing so has focused on producing those products, in which it has a competitive advantage, such as wine, medical and scientific equipment, specialised industrial machinery, computers and data processing equipment, and telecommunications equipment.

Australia's services market is relatively open. Australia's services exports, dominated by travel and educational services, in large part reflect the attractiveness of Australia's tourism destinations to international visitors, the strength of its education and vocational training sectors, particularly in higher education, and the increasing importance of English in the conduct of international diplomacy, trade and commerce. In addition, microeconomic reforms undertaken by Australia in the 1990s in key services sectors, particularly banking and telecommunications, have improved Australia's international competitiveness in those sectors. These strengths have made Australian services producers in these areas able to compete internationally for business, particularly in East and South East Asia.

Republic of Korea

The Korea Institute for International Economic Policy (KIEP) examined results of the revealed comparative advantage (RCA) index and trade specialization index (TSI) to provide a competitiveness analysis for ROK industries (see Annex 1A for details). This analysis suggests the ROK is less globally competitive in primary, processed primary, processed mineral, wood and paper and leather products Moreover, the global

[5] EFTA is comprised of Iceland, Norway, Liechtenstein and Switzerland.

competitiveness of these industries appears to have declined over the period 2002 to 2005, especially in the cases of leather and primary products industries.

On the other hand, the ROK has a revealed comparative advantage in several manufactured products, including machinery (electrical as well as precision) and transport-related equipment industries. These have demonstrated significant growth in terms of RCA values over the past few years (see Tables 1A.1 and 1A.2 in Annex 1A).

The TSI index also reveals the ROK's relatively strong export specialisation in the machinery (electrical, general and precision) and transport-related equipment industries, and a comparatively higher level of import specialisation in primary and processed primary products (see Table 1A.4 in Annex 1A).

1.1.2 Key features of the bilateral trade and investment relationship

1.1.2.1 The importance of bilateral trade

A complementary trade relationship

Australia and the ROK share a significant and highly complementary trading relationship. Two-way trade was valued at over A $21 billion in 2006. The ROK is Australia's sixth largest trading partner by value. The ROK ranked as the fourth most valuable destination for the exports of Australian goods and services in 2006, taking 7 per cent of all exports, at a total value of nearly A$14 billion. Major exports by value were coal, crude petroleum, iron ore and beef. Currently Australia's seventh largest export market for services, the ROK is one of the fastest growing markets for Australian service exporters. Exports of education and tourism services have been particularly successful.

Australia is the ROK's 14th largest export market, with ROK exports to Australia, mainly electric equipment and motor vehicles, reaching US$4.7 billion in 2006.
Australia continues to be a major supplier of mineral resources and is strategically important country for the ROK given its abundance of natural resources.

Despite the dominance of primary commodities in the bilateral relationship, trade is also important in other industries, including automotive products, biotechnology, building and construction, dairy products, defence materiel, fruit and vegetables, information and communications technology, seafood, textiles and clothing and wine.[6]

A growing trade relationship

The Australia-ROK trade relationship continues to grow and has increased dramatically since the mid-1990s. There has been significant growth in Australia's exports of both goods and services to the ROK (see Figure 1.1). Between 2005 and 2006, the value of goods and services exports grew by 13 per cent, and by more than 100 per cent since 1999. The increase in exports to the ROK between 2005 and 2006 surpassed that experienced in other major Australian markets such as the US, Japan and New Zealand.

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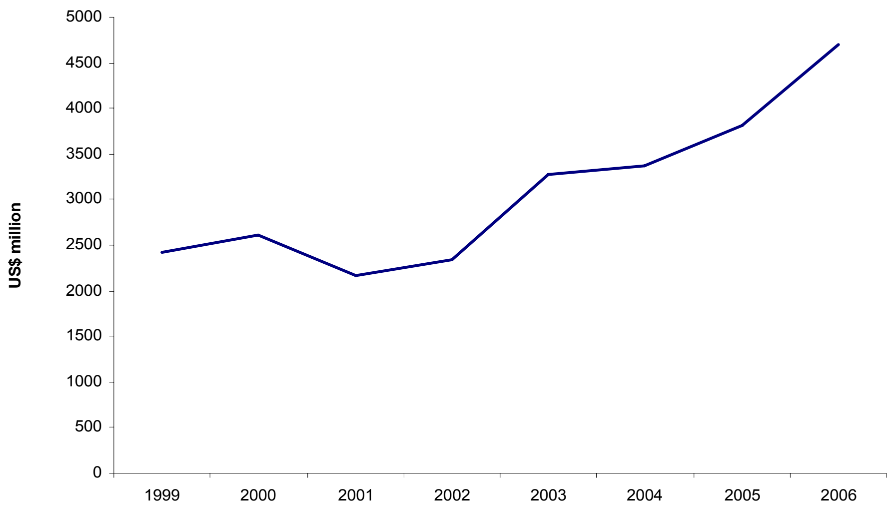
[6] Department of Foreign Affairs and Trade (DFAT), Australia, *Republic of Korea Country Brief*, May 2007, accessed at <http://www.dfat.gov.au/geo/rok/brief_index.html>

Figure 1.1: Australia's exports of goods & services to the ROK, 1999 to 2006 (A$ million)

Source: Department of Foreign Affairs and Trade (DFAT) Australia STARS Database and ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

ROK exports to Australia have also increased in recent years. Merchandise exports to Australia in 2006 showed an increase of more than 23 per cent over the previous year. Between 1999 and 2006, they grew by over 93 per cent (see Figure 1.2).

Figure 1.2: ROK's exports to Australia, 1999 to 2006 (US$ million)



Source: Korea International Trade Association (KITA)

Over the last ten years Australia has maintained a share of around 1.5 per cent of the ROK's total merchandise exports (in value terms). Merchandise trade with Australia has comprised around 2.5 per cent of the ROK's total trade volume (in value terms).

1.1.2.2 The importance of bilateral investment

The ROK is the 12th largest destination for Australian investment abroad. In 2006, the level of Australian investment in the ROK amounted to nearly A $7 billion or 0.8 per cent of Australia's total *stock of investment* abroad (Table 1.5).[7] Although relatively small compared to most of Australia's major trade partners, Australia's investment in the ROK is twice the size of that in China. Much of Australia's investment in the ROK is concentrated in the services and manufacturing sectors, with recent large investments in hotels and real-estate, as well as the transportation machine industry. Macquarie Bank for example, has a significant presence in the ROK market, with diverse investments in the real estate sector as well as the infrastructure and SME sectors. The Australian automotive company, Holden, is engaged in a joint venture with GM Daewoo in the ROK.

In terms of ROK FDI abroad, Australia is the ROK's sixth largest recipient, with total accumulated stock of investment valued at US$3.1 billion as at end of 2006 (Table 1.7).[8] This represents 2.9 per cent of the ROK's total stock of FDI abroad. The ROK has made substantial investments in Australia, particularly in the natural resources sector and is seeking to establish more opportunities for partnership with Australian companies in order to secure a reliable supply of energy and mineral resources.

Bilateral investment is growing. Between 2001 and 2006, Australia's stock of cumulative investment in the ROK grew at an average of more than twice the rate at which total Australian investment abroad grew over the same period.[9] This reflects a growing interest by Australian investors in the ROK, as they seek opportunities afforded by the country's economic reforms. The ROK's economic restructuring has created opportunities for Australian investors in technology-intensive sectors, infrastructure and utilities, financial services, and education and training.[10]

Between 2001 and 2006, the stock of ROK investment in Australia grew by over 29 per cent in total (see Table 1.7).[11] While reasonable, this rate of increase has been less than that in other 'more traditional' investment destinations such as China (171 per cent) and the US (53 per cent). Despite this, the Australian market offers many investment opportunities from the ROK's perspective. 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 ROK companies, particularly in telecommunications equipment, passenger motor vehicles, television and computers.

1.1.3 Key features of the government-level relationship

1.1.3.1 Bilateral cooperation efforts and initiatives

Australia and the ROK share a growing bilateral relationship. This is reflected in the various cooperation efforts and initiatives undertaken by the two economies. The longstanding linkage between the two countries began in 1975 with the signing of the

[7] ABS, *International Investment Position, Australia: Supplementary Country Statistics*, Cat No. 5352.0, 2006.
[8] The Export-Import Bank of Korea, Republic of Korea.
[9] ABS, *International Investment Position, Australia: Supplementary Country Statistics*, Cat No. 5352.0, 2006.
[10] Porter et al, Australia-Korea: Strengthened Economic Partnership, August 2001.
[11] Export-Import Bank of Korea, Republic of Korea.

Agreement on the Development of Trade and Economic Relations.[12] In 1978, the Australia Korea Business Council (AKBC) was formed with the aim of promoting two-way trade and investment and fostering economic cooperation and greater liaison between the respective business communities.

The Australia-Korea Foundation (AKF) was established in May 1992 to strengthen relations and promote sustainable links between the two economies. Some of the activities supported by the AKF include the *Investigating Australia* multi-media study kit, the Australia-Korea Teacher Exchange Program, the Australia-Korea Broadband Summit, and the Australia-Korea collaborative e-health research initiative.

Cooperation between the two countries ranges across a number of key areas. For instance, a bilateral Agreement on Scientific and Technological Cooperation was signed in September 1999. This Agreement led to the establishment of the Korea-Australia Science and Technology Exchange Centre (KASTEC) to promote the bilateral exchange of environmental technologies.[13]

In March 2001 the Australian Federation of Automotive Products Manufacturers (FAPM) signed an agreement for mutual cooperation with the Korea Automotive Technology Institute to promote cooperation in research and development (R&D). FAPM also has a general Memorandum of Understanding (MoU) for cooperation with the Korea Automotive Industries Cooperative Association.[14] Through the operation of the Korea-Australia Technology Cooperation Pilot Fund, two companies from the ROK and Australia succeeded in establishing a joint project in nano-power technology in 2003. Both sides are committed to exploring further opportunities for cooperation between Australia's digital content and software sectors and the ROK IT industry.

The Korea-Australia Joint Committee on Energy and Mineral Resources Consultation and Cooperation, founded in 1990, allows the two countries to share views on trade in energy and minerals and to discuss possible avenues for resources cooperation[15]. The Australian Electrical and Electronic Manufacturers' Association (AEEMA) has signed an MoU with the International Cooperation Agency for Korea IT (ICA Korea) in an effort to exchange information and promote growth of the ICT (Information, communication & technology) industries in the two countries.[16] The AEEMA also has relationships with a number of other ROK agencies, namely the Korean IT Security Association and the Korean Electronics Association; and has recently agreed to sign a MoU with the Korean Electrical Manufacturing Association.[17]

At the regional level, both countries are members of APEC, the East Asia summit, the ASEAN Regional Forum and EMEAP (Executives' Meeting of East Asia-Pacific Central

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[12] Porter et al, *Australia-Korea: Strengthened Economic Partnership*, August 2001.
[13] Porter et al, August 2001.
[14] *Ibid.*
[15] The last meeting of the Korea-Australia Joint Committee on Energy and Mineral Resources Consultation and Cooperation was at the Gold Coast in November 2007.
[16] Australian Electrical and Electronic Manufacturers' Association Limited (AEEMA), *AEEMA Submission to the Inquiry into Australia's Relationship with the Republic of Korea; and Developments on the Korean Peninsula*, Submission No. 4, May 2005.
[17] *Australia's Relationship with the Republic of Korea and Developments on the Korean Peninsula*, Joint Standing Committee on Foreign Affairs, Defence and Trade, Foreign Affairs Sub-Committee, Canberra, June 2006.

Banks).[18] On a multilateral level, both countries are members of the OECD, the WTO, the IMF, the World Bank, the ADB, the EBRD (European Bank for Reconstruction and Development), and the G-20.

Inter-government relations between Australia and the ROK reflect high-levels of exchange. ROK President, Mr Roh Moo-hyun, visited Australia in September 2007 and December 2006, while the former Australian Prime Minister, Mr John Howard, last visited the ROK in 2005. Trade Ministers meet regularly through the Australia-Korea Ministerial Joint Trade and Economic Commission (MJTEC) to discuss issues related to bilateral trade and the overall economy. In August 2006, the then-ROK Minister for Foreign Affairs made a bilateral visit to Australia and in November 2005, the then-Australian Minister for Foreign Affairs visited Seoul.

Australia's Minister for Trade, Mr Simon Crean met his counterpart ROK Minister of Trade Mr Kim Jong-hoon in Bali in December 2007. In February 2008, the Hon Harry Jenkins MP, Australian Speaker of the House of Representative attended the inauguration of the new ROK President, Lee Myung-bak, in Seoul. Mr Jenkins met with President Lee, Prime Minister Han Seung-soo and the Minister of Foreign Affairs and Trade, Yu Myung-hwan.

1.2 Trends in bilateral trade and investment

1.2.1 Trends in merchandise trade

1.2.1.1 Australia's merchandise exports to the ROK

(i) Composition of merchandise exports to the ROK[19]

After a period of strong growth, the ROK has emerged as the third largest market for Australian merchandise exports, in terms of value, after Japan and China. In 2006, the ROK imported around 7.5 per cent of Australia's merchandise exports, at a value of A$12.6 billion. Most merchandise exports were primary and lightly processed commodities for transformation by the ROK's rapidly growing manufacturing sector – see Figure 1.3 and Table 1.1.

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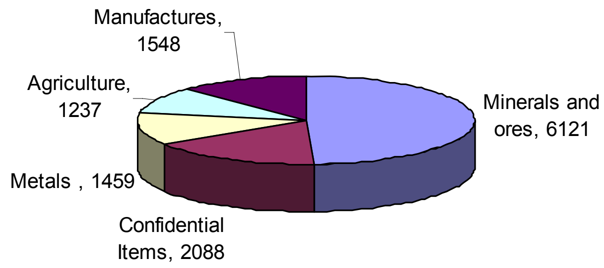
[18] *Australia's International Economic Policy: Keynote Address to the Australia-Korea Economic Cooperation Forum*, 1 December, 2003, Australian National University, by Martin Parkinson, Executive Director, Macroeconomic Group, The Treasury.

[19] The composition of sector groupings used in this report does not necessarily correspond with those used by the Australian Department of Foreign Affairs and Trade or ROK Ministry of Foreign Affairs.

Figure 1.3 Australia's merchandise exports to ROK, by industry sector, 2006 (A$ million)



Source: ITS Global

Minerals, ores, metals and agricultural commodities together made up over 70 per cent of the total value of Australian exports to the ROK in 2006. Minerals and ores dominated with just under 50 per cent of the total value of Australian exports to the ROK in that year, followed by metals with 12 per cent and agriculture with 10 per cent.

Although commodity exports dominate this trade, Australia's manufacturing exports to the ROK are significant in their own right, making up more than 12 per cent of the total value in that year. Confidential items made up nearly 17 per cent of the total value of exports to the ROK in 2006.[20] Major exports by product are noted in Table 1.1 below.

Table 1.1: Australia's top 15 merchandise exports to ROK, by value, 2006

Export product[21]	Value of exports (A$ million)
Coal	1,935
Crude petroleum	1,505
Iron ore	1,490
Unwrought aluminium	798
Frozen beef	588
Zinc ore	538
Sugar	491
Automotive engines	304
Copper ore	269
Fresh or chilled beef	237
Lead ore	206
Medicines	200
Copper	186
Gold	160
Nickel	118
Cotton	102

Source: DFAT

[20] If an Australian exporter makes a significant contribution to a particular product category, they can request the ABS to suppress the release of data to protect themselves from identification.

[21] HS Codes 0201, 0202, 1701, 2601, 2603, 2607, 2608, 2701, 2709, 3004, 5201, 7108, 7403, 7501, 7601, and 8407.

The ROK is the second-largest single-nation consumer of Australian energy, and the third largest consumer of Australian minerals.[22] Australia's most valuable resource exports to the ROK in 2006 were coal and crude petroleum. Coal exports accounted for A$ 1.93 billion, or nearly 16 per cent of all Australian merchandise exports to the ROK. Crude petroleum accounted for over A$1.5 billion (or 12 per cent). Ores accounted for over 20 per cent of merchandise exports to the ROK in 2006. Australia's main metal exports to the ROK in 2006 were in unwrought aluminium (valued at nearly A$800 million) as well as copper[23], gold, certain nickel products,[24] aluminium waste and scrap and lead.

The major exports of manufactures from Australia to the ROK in 2006 were automotive engines[25] (A$304 million) and pharmaceutical products (A$200 million). Exports of other motor vehicle parts and accessories, certain iron and steel products, chemicals and electronic equipment were also significant. Wine exports totalled over A$9 million.

The ROK represents a vitally important market for Australian agricultural commodities and food products.[26] The ROK is the third largest importer of Australian beef[27], which dominates Australia's agricultural exports to the ROK. In 2006, beef exports were valued at A$906 million (including offal), comprising over 7 per cent of Australia's overall exports to the ROK. Australia also exported sugar (A$491 million), cotton (A$102 million), forage products (such as oil seeds, hay, fodder roots and clover) worth A$63 million and dairy products (mostly concentrated milk/cream products and cheese/curd products), which amounted to A$57 million.

Other important exports to the ROK classified as confidential by the ABS were wheat, natural gas, parts of nickel, and some semi-finished iron and steel products. While precise values are not available, estimates can be made on the basis of ROK import data.[28]

(ii) Trends in merchandise exports to the ROK

Buoyant economic conditions have prevailed in both the ROK and Australia since 1997-8. These have seen the ROK recover from the 1997 Asian financial crisis and Australia reap the benefits of the strong global demand for its mining and agricultural resources to underpin the expansion of manufacturing output around the world but especially in Asia.

With the exception of 2003, Australian exports to the ROK over the seven-year period to 2006 have grown strongly both in absolute terms and relative to Australia's overall exports (see Figure 1.4). This strong growth has occurred despite the trend of the Australian dollar to appreciate significantly against the ROK won over the period in question.

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[22] Minerals Council of Australia, *Submission to Australia-Republic of Korea Free Trade Agreement Study*, August 2007, p.3

[23] Refined copper and unwrought alloys of copper.

[24] Nickel mattes, nickel oxide sinters and other intermediate products of nickel metallurgy.

[25] Spark-ignition reciprocating or rotary internal combustion piston engines.

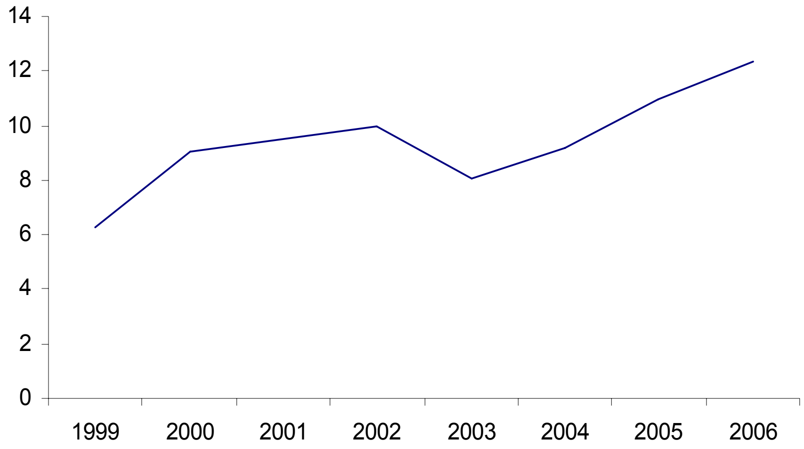
[26] National Farmers' Federation, *NFF Submission to the Australia-Korea Non-Government Free Trade Agreement Study,* 2007, p.9

[27] Meat and Livestock Australia, A*ustralia's Meat and Livestock Trade with the Republic of Korea*, 2005, p.1

[28] ROK import statistics for 2006 indicate that Australian wheat exports were worth US$223 million, nickel exports were worth US$316 million and liquid natural gas exports US$206 million.

Over the seven year period to 2006, merchandise exports to the ROK increased by 96 per cent in value terms, significantly more than Australia's overall export growth of 88 per cent. Again, the growth in Australian exports to the ROK was only outpaced by the growth in exports to China, India and the UK.

Figure 1.4: Australia's merchandise exports to ROK, 1999 to 2006 (A$ billion)



Source: DFAT

Strong increases in world commodity prices have seen the values of mineral and ore exports to the ROK advance strongly over the seven years to 2006. ROK export demand for most mineral and ore products has, nevertheless, not kept pace with the increase in global demand for Australian exports, which may reflect the ROK's shift away from an industrial economy to an economy based more on knowledge-intensive services[29].

The growth in the volume of minerals exports since 1999 was also strong. The volume of crude oil exports to the ROK rose by 30 per cent — whereas total export volume for this commodity decreased by 2 per cent. Coal exports to the ROK also grew 30 per cent in volume, compared to Australia's total coal export growth of 38 per cent. The latter development may reflect a combination of the ROK policy of placing a higher priority on sustainable energy generation, as well as stronger demand from the rest of the world.[30]

In aggregate, Australia's metals exports to the ROK grew by 81 per cent in value over the seven year period to 2006 compared to the increase in its metals exports to all destinations of 112 per cent.[31] Gold exports to the ROK declined dramatically, falling by 73 per cent in value and 88 per cent in volume, despite growth in Australia's total gold exports of 90 per cent over the seven year period.

Australian agricultural exports to the ROK rose in value by 208 per cent between 1999 and 2006, which makes the ROK one of Australia's fastest growing export markets for agriculture over this period. Beef exports (including offal) dominated Australia's

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[29] Robinson, A., Chief Executive, Australian Electrical and Electronic Manufacturers' Association, letter to P. Baxter, First Assistant Secretary, North Asia Division, Department of Foreign Affairs and Trade, 20 March 2007.

[30] World Trade Organisation, *Trade Policy Review: Republic of Korea: Report by the WTO Secretariat*, WT/TPR/S/137, 2004, p. 91.

[31] From 1999 to 2006, there was considerable variation in export volumes amongst the major metal commodities.

agricultural exports to the ROK. The volume of beef exports grew 116 per cent, compared to only 17 per cent for all destinations. Volumes of fresh or chilled beef more than quadrupled. The value of overall beef exports grew nearly 300 per cent, many times more than the increase in the value of exports to the world as a whole, which increased by only 66 per cent.[32]

Australian exports of forage products to the ROK have experienced very high growth in both volume and value since 1999, albeit from a very small base.

In dairy, concentrated milk/cream export volumes grew by 120 per cent, in sharp contrast to the significant decline in Australia's exports of these commodities overall. Their export values more than trebled.

ABARE statistics suggest that, over the period to 2006, the volume of wheat exports to the ROK declined and the volume of sugar exports increased. The changes in world commodity prices imply that their export values had decreased in the case of wheat and increased for sugar.[33]

The trends in manufactured exports from Australia to the ROK over the seven year period to 2006 have been somewhat mixed. Of Australia's major manufacturing exports to the ROK, medicines, automotive engines and industrial textiles have experienced strong growth in both export volumes and values. Over the previous seven years, exports of medicines had shown the strongest growth of any major Australian manufacturing export to the ROK, increasing in value by over fifteen-fold.[34]

Exports of certain flat-rolled iron and steel products also registered very strong growth, increasing more than five-fold in volume and eleven-fold in value.

Automotive engine exports to the ROK grew faster than those to all export destinations. Motor vehicle parts and accessories, the only other automotive exports to the ROK, experienced only modest growth, while exports of electrical equipment to the ROK increased 118 per cent in value—considerably more than the 16 per cent increase in exports to the world.

Wine exports also demonstrated high growth (451 per cent). Wine consumption has traditionally been low in the ROK; however health and lifestyle reasons, accompanied by high disposable income, have accounted for strong recent growth in the market.[35]

Figure 1.5 shows the increase in the value of Australian exports to the ROK, by industry sector breakdown, over the seven year period from 1999 to 2006.

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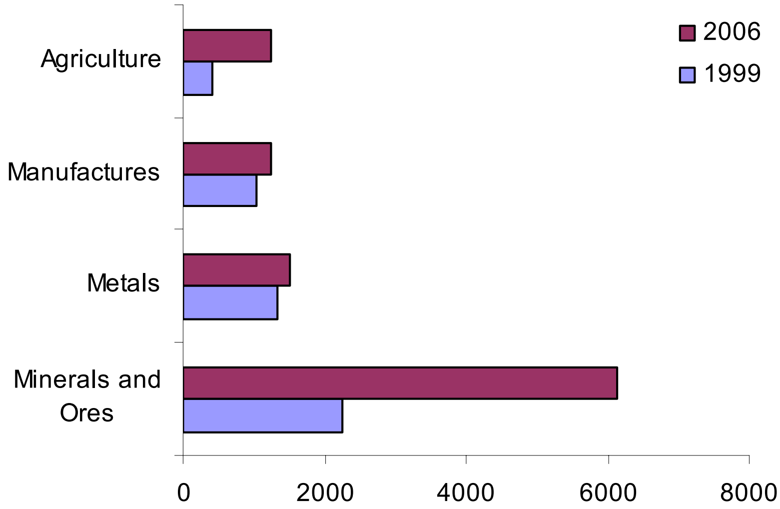
[32] This growth is due to a number of factors, including the ROK government's abolition of the tariff rate quota for beef in 2001, increased ROK beef consumption, reduced domestic production, and the Government's ban on US beef imports following a mad cow disease scare in 2003.

[33] Australian Bureau of Agriculture and Resources Economics, 'Australian Commodity Statistics 2007', 2007, available at http://www.abareconomics.com/publications_html/data/data/data.html.

[34] According to Medicines Australia, in 2006, the ROK was Australia's fourth most valuable market for pharmaceutical exports (*Australian Pharmaceutical Industry – Facts at a Glance*, p.1). A key factor in this export growth appears to be the ROK Government's August 2000 pharmaceutical policy reform, known as Separation of Prescribing and Dispensing (SPD), which caused a large decrease in the prescription of generic medicines.

[35] Australian Wine and Brandy Corporation, Submission to DFAT Australia-Republic of Korea Free Trade Agreement Study, 2007, p.3.

Figure 1.5 Australian merchandise exports to ROK, by sector, 1999 & 2006 (A$ million)[36]



Source: ITS Global

1.2.1.2 ROK merchandise exports to Australia

(i) Composition of merchandise exports to Australia

In 2006, Australia was the ROK's 14th largest export destination Table 1.2 shows the ROK's major merchandise exports to Australia in 2006. Automobiles accounted for over 22 per cent of the ROK's total exports to Australia. Other major export items were electronic devices (20 per cent), mineral fuels (15 per cent), boilers and machinery (9 per cent) and ships and steel (5 per cent). The top ten export products together comprised over 87 per cent of ROK's total exports to Australia in 2006.

Table 1.2: ROK's top ten merchandise exports to Australia, by value, 2005 to 2006

Export Product[37]	2005		2006	
	Amount (US$m)	% change, 2004-05	Amount (US$m)	% change, 2005-06
Total exports	**3,812**	**12.8**	**4,692**	**23.1**
Vehicles and parts thereof	915	37.3	1,065	16.3
Electrical Machinery and parts thereof	1,007	-4.3	955	-5.2
Mineral Fuels, Oils, Waxes	279	121.3	712	155.4
Boilers, Machinery and Mechanical Appliances	464	-7.1	441	-5.0
Ships, Boats and Floating Structures	0.553	22.6	218	>200
Iron and Steel	191	55.8	178	-6.5
Plastics and Articles thereof	185	24.2	177	-4.0

[36] Confidential items not included.
[37] Products categorized in HS 2 digits- HS Codes 87, 85, 27, 84, 89, 72, 39, 48, 40, and 74.

Paper, Articles of Paper Pulp, of Paperboard	146	14.1	140	-4.1
Rubber and Articles thereof	103	1.6	125	-22.4
Copper and Articles thereof	57	51.1	95	66.2

Source: KITA

Based on per capita consumption of ROK's exports, Australia has demonstrated a strong purchasing power for South Korean products. Australia's per capita consumption of the ROK's exports was valued at US$232.9 in 2006. Within the ROK's top 20 export destinations, Australia's per capita consumption was fourth highest, behind only Hong Kong, Singapore and Taiwan.

See Table 1.3 below.

Table 1.3: Per capita consumption of ROK exports 2001 - 2006

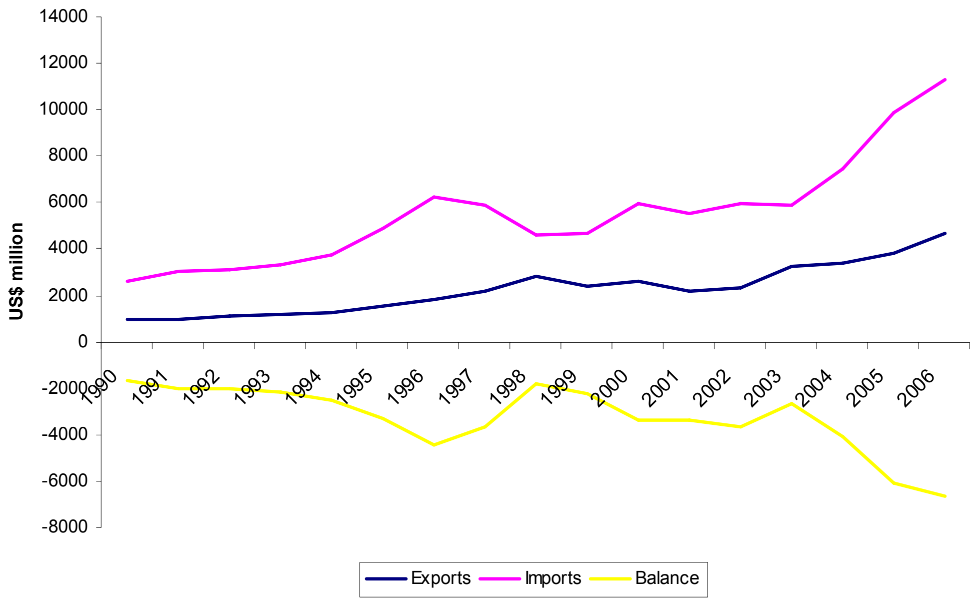
	2001	2002	2003	2004	2005	2006
Australia	107.9	116.1	162.4	167.7	189.3	232.9
Canada	63.7	73.3	84	105.9	107.9	113.3
China	14	18.3	27	38.3	47.6	53.4
Germany	52.4	52	67.9	101	124.9	121.9
Hong Kong	1,390.40	1,492.40	2,155.60	2,666.50	2,284.70	2,791.80
India	1.3	1.3	2.6	3.4	4.3	5.1
Indonesia	15.2	14.5	15.6	17	23.3	22.5
Italy	35.9	38.6	44.6	59.3	74.8	74.6
Japan	129.2	118.6	135.3	169.9	188.1	207.7
Malaysia	103.2	126.4	151.2	175.9	180.9	205.3
Mexico	21.1	21.9	24.1	29.3	37.1	61.6
Netherlands	155.6	157.7	155.8	184.8	224.1	221.8
Philippines	30.3	35.3	35.6	40.4	38.5	47
Russia	6.5	7.4	11.5	16.2	26.8	35.9
Singapore	962.2	995.7	1,093.40	1,333.40	1,746.80	2,238.00
Taiwan	257.2	292.3	310.5	433.9	478.8	572.8
Thailand	28.4	35.9	38.8	49.9	51.9	65.2
U.K.	58.3	71.1	68.4	92.2	89.2	94.2
U.S.	106.2	111.5	116.4	145.8	140.6	146.9
Vietnam	21.1	27.3	31.2	39.7	41.8	47.9

Source: IMF *World Economic Outlook Database*, October 2007
Note: Population of each country was compiled based on the year 2004.

(ii) Trends in merchandise exports to Australia

Between 1990 and 2006 the ROK's exports to Australia have expanded by 391 per cent. Imports from Australia grew by 337 per cent over the same period, the ROK's trade deficit with Australia increasing by 305 per cent. See Figure 1.6.

Figure 1.6 ROK's exports, imports and trade balance with Australia, by value, 1990 to 2006 (US$ million)



Source: KITA

Total ROK merchandise exports to Australia have grown steadily in recent years, increasing by over 23 per cent during 2005-2006. Over the period 2005- 2006, the ROK's exports of mineral fuels, oil and waxes to Australia have seen more than a two-fold increase. The export of ships, boats and floating structures have grown even more dramatically.

Some of the ROK's major exports to Australia, in value terms, have declined in recent years, with the exception of passenger motor vehicles. Exports of rubber, iron and steel, machinery (electrical and mechanician), paper and pulp, and plastic products to Australia declined during 2005-2006. Televisions, refrigerators and washing machines, which have traditionally been the ROK's major exports to Australia, have declined since 2005. ROK exports of passenger vehicles however have remained strong.

See Table 1.4.

Table 1.4: ROK's major exports to Australia, by value, 2001 to 2007 (US$ million)

	2001	2002	2003	2004	2005	2006	2007
Televisions	49	70	147	235	303	272	236
Refrigerators	49	54	73	87	77	79	66
Washing Machines	17	21	28	27	10	4	7
Passenger Vehicles	342	316	359	512	739	922	1,132

Source: KITA. Based on MTI classification

1.2.2 Trends in trade in services

1.2.2.1 Australia's services exports to ROK

(i) Composition of services exports to ROK

The ROK is an important market for Australian service providers. In 2006, services exports to the ROK were valued at A$1,612 million, and accounted for 3.7 per cent of all Australian services exports by value. This made ROK the seventh largest export destination for Australian services.

The largest category of services exported by Australia to the ROK is travel services. This category covers all goods and services acquired for personal use by travellers[38] and foreign workers. Travel services are divided into two components: business travel and personal travel, and personal travel service is further broken down into education-related travel and other personal travel which comprises mainly tourism-related travel.[39] The value of Australian exports of travel services to the ROK represented over 87 per cent of all Australian services exports to the ROK in 2006.

Education and tourism services dominate exports (see Figure 1.7). Education-related travel accounted for 58 per cent of Australia's total travel services exports to the ROK, followed by tourism[40] which comprised 38 per cent and business travel which made up 4 per cent respectively. Transportation, communication and other business services represented the bulk of the remainder, while exports of financial, insurance and construction services were minimal in that year.

In value terms, education services comprised over half of Australia's total services exports to the ROK in 2006, valued at A$815 million in 2006. The ROK ranked as Australia's third largest source of foreign students, with a total of 31,257 student enrolments. The ROK is also the largest source of students enrolled in the English Language Intensive Courses for Overseas Students (ELICOS) program in Australia.[41] ROK students now make up over 8 per cent of international students who are enrolled in Australia.

Exports of other personal travel services (i.e. inbound recreational travel) to the ROK in 2006 were valued at A$529 million, making the ROK the fifth largest recreational travel market for Australia by value. The ROK was Australia's sixth largest source of short-term visitors, with 260,900 South Koreans travelling to Australia in 2006.[42] Over a half of these (67 per cent) were on holidays. Moreover, that year visitors from the ROK accounted for Australia's sixth largest source of total expenditure by visitors, with their short-term visitors spending A$3,794 per head on average.[43]

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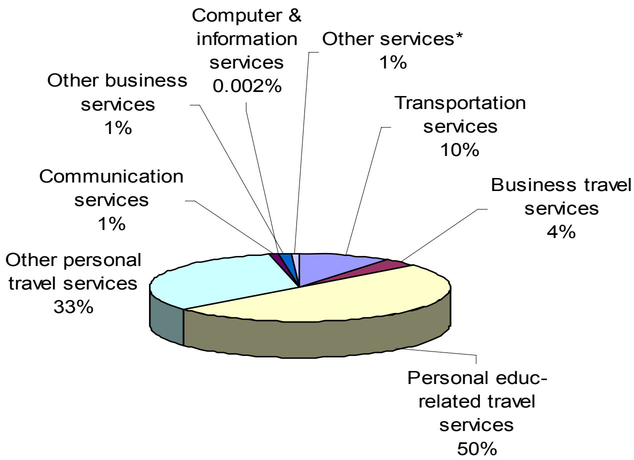
[38] A traveller is defined as individual who stays for less than one year in a country where he/she is not a resident. Some exceptions to this definition apply, for e.g. foreign government diplomats, military officials, students, etc.
[39] DFAT, *Trade in Services Australia*, 2006.
[40] Tourism services refers to 'other personal travel services', which comprises mainly recreational travel
[41] Australian Education International (AEI), *English Australia survey of major ELICOS regional markets*, June 2007.
[42] Includes only international visitors who stay in Australia for one year or less
[43] Tourism Research Australia, *Korea Visitor Profile 2006*, May 2007.

Exports of transport services were also significant at A$160 million, comprising nearly 10 per cent of Australia's total services exports to the ROK in that year. Exports of communications and other business services[44] amounted to A$14 million (representing 0.9 per cent of all Australia's services exports to the ROK) and A$20 million (1.2 per cent of the total) respectively.

Figure 1.7 Australia's major services exports to ROK, by type, 2006 (share of total)



Other services refer to insurance, financial, construction, royalties & license fees, personal, cultural & recreational, and government services

Source: ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

(ii) Trends in services exports to the ROK

The ROK is one of the fastest growing markets for Australian exporters. In terms of value, exports of Australian services to the ROK have seen an almost three-fold increase between 1999 and 2006.

Growth in bilateral services trade has been significant when compared with other trading partners. Of Australia's top seven services exports destinations by value, the ROK had the fastest growth between 2005 and 2006 and the second fastest rate of growth between 1999 and 2006. As a consequence, services exports to the ROK as a share of Australia's total services exports has nearly doubled since 1999, while the shares of Singapore and New Zealand each grew more slowly and those of the US, the UK and Japan fell (Figure 1.8).

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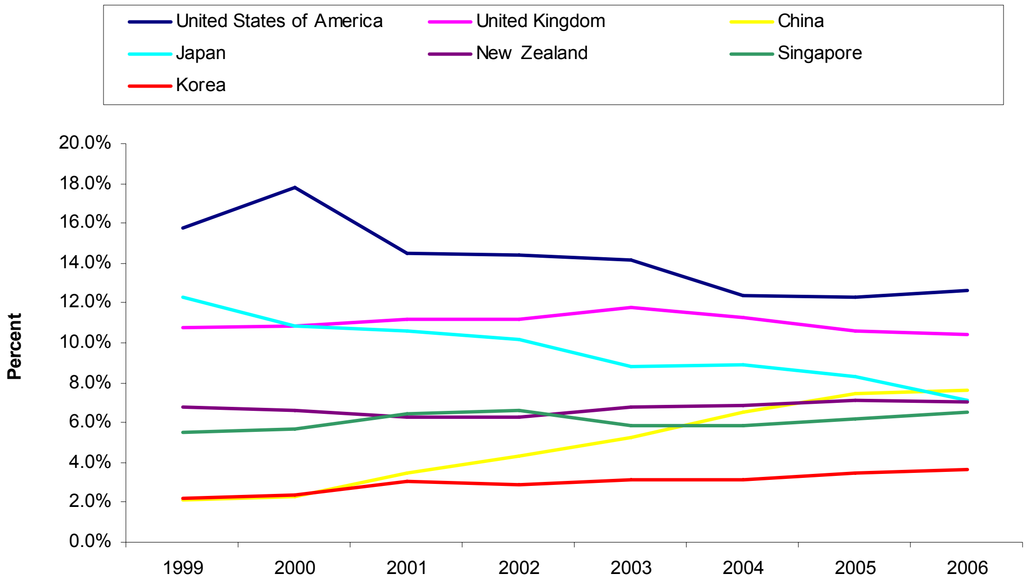
44 These include: merchanting and other trade-related services; operational leasing services; legal, accounting, management consulting and public relations services; advertising, market research and public onion polling services; research & development services; architectural, engineering and other technical services; other business services; and services between affiliated enterprises that are not included elsewhere.

Figure 1.8 Share of Australian services exports, by major destinations, 1999 to 2006



Source: ABS*, International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

Australian exports of education, tourism and transportation services are growing strongly. Travel services exported to the ROK in 2006 amounted to A$1.4 billion, nearly three times the value of such exports in 1999. Within the travel services category, education-related travel services exports to the ROK experienced the highest growth between 1999 and 2006, followed by business travel services exports and tourism services exports respectively.

Exports of education services to the ROK have picked-up since the downturn caused by the Asian Financial Crisis, increasing by over 220 per cent in value between 1999 and 2006. The ROK is now ranked as Australia's third largest destination for education-related travel services in value terms. Furthermore, among the top ten destinations for Australia's exports of education-related travel services, the ROK exhibited the fastest growth rate (over 27 per cent) between 2005 and 2006. Over this period, the number of ROK students who enrolled in educational institutions in Australia increased by almost 19 per cent.

The ROK is also one of Australia's fastest growing tourism markets as well as an important source market for visitor expenditure[45]. A total of 260,900 short-term visitors travelled from the ROK to Australia in 2006 (or about 10 per cent of ROK outbound tourists), compared with 108,600 in 1999 — an increase of over 140 per cent. The Australian Tourism Forecasting Committee has forecast the number of ROK visitors to grow at around 7 per cent a year over the period to 2014 — thus making the ROK the sixth fastest growing market for Australia.[46]

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[45] ROK tourists contributed A$1.3 billion to the Australian economy in 2006, making the ROK the sixth largest market for Australia in terms of total inbound economic value. (TIEV is a measure of the yield for the Australian economy from inbound tourism on total trip spending by international visitors. This measure is broader than the value of the equivalent services recorded in the Balance of Payments, which is used in the rest of this report to value services exports).

[46] Korea Action Plan Implementation Group, *Korea: Building the Framework for Sustainable Inbound Tourism*, Report to the Minister for Small Business and Tourism, 2006.

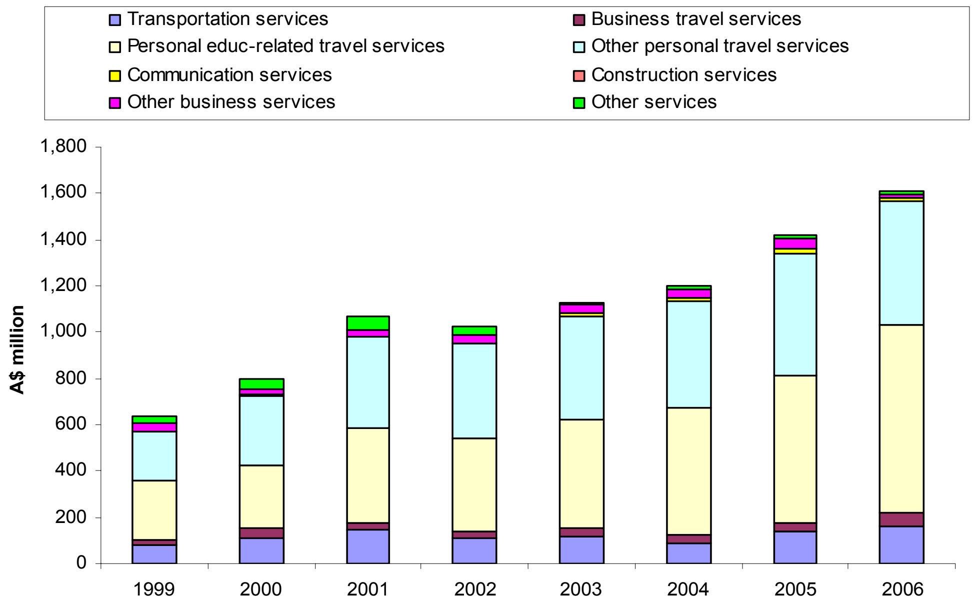
Exports of transportation services to the ROK have more than doubled in value since 1999, peaking at A$160 million in 2006.

In 2006, Australia's exports of communication services to the ROK decreased by 33 per cent over the previous year. Exports of other business services also declined, by about 58 per cent over the same timeframe.

Australian business services companies are active in the ROK – both as exporters to and investors in the ROK. Australian companies are involved in public infrastructure projects, futures trading, consulting and engineering activities in the ROK. Macquarie Bank of Australia has a strong presence in the ROK, with a diverse investment portfolio in sectors such as infrastructure and real estate. Established in the ROK from1996, it now has over 300 staff[47].

A breakdown in the value of Australian services exports to the ROK from 1999 to 2006 is at Figure 1.9.

Figure 1.9 Australia's services exports to the ROK, by sector, 1999 to 2006 (A$ million)



Source: ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

The ROK represents a growing market for Australian service providers. Australia's relatively favourable exchange rate (at least until recently), a greater awareness of Australian capabilities in the ROK and a trend towards global sourcing are some of the factors that have contributed to this growth. Economic reform and liberalisation of the ROK market has been an additional factor promoting trade with and foreign investment in the ROK. In the services sector, the ROK Government has undertaken partial or complete liberalisation in 154 business categories[48] since 1993. These changes go beyond the ROK's OECD and WTO liberalisation commitments.[49]

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47 Macquarie Bank's website <http://www.macquarie.com/kr/en/index.htm>

48 Measured at the five-digit level of the Korean Standard Industrial Classification (KSIC).

49 Kim, June-Dong and Jong-Il Kim, *Korea's Liberalisation of Trade in Services and Implications for Australia*, August 2001.

Growth has been most pronounced in the education and tourism sectors. Originally the ROK was essentially an English Language Intensive Courses for Overseas Students (ELICOS) market for Australian services providers but they have since diversified successfully into other education services in the ROK market. A major factor driving growth in education services has been the mounting interest among ROK youth to gain an international educational experience, which now forms one of the top desirables for this age group.

Although the United States remains the number one choice as an international educational destination for ROK students, Australian institutions now present significant cost-competitive opportunities. Growth areas include: English language, business, certificate-based information technology and internationally recognised financial planning and management courses. The provision of scholarships and work placements for ROK students in Australia together with strong alumni groups in the ROK created by Australian institutions are seen as potential counterweights to the US and other competitive educational destinations.[50]

As the ROK embarks on the transition to a knowledge-based economy with a focus on upgrading its R&D capability and improving its institutions for human resources development, Australia's relative strength in education and training provides the potential to develop a more complementary relationship between the two countries, with Australia becoming a major source of the ROK's R&D capability.

Growth in the tourism sector has been largely driven by increased marketing efforts and activities, focused on a more quality-based, value-for-money holiday experience for the ROK traveller. This includes improvement of the standard of marketing publications, as well as the education and incentivisation of ROK tour planners who are actively involved in the Australian market.

1.2.2.2 ROK services exports to Australia

(i) Composition of services exports to Australia

Since the 1960s, the ROK has pursued export-led economic development focused mainly on manufacturing. It was not until the 1980s that the development of the services sector attracted the attention of policy makers. Since this time, trade in services have expanded rapidly, with more than a five-fold increase in the ROK's services exports over the last 16 years.

Services exports to Australia remain small in terms of total trade volume and as a share of ROK's total services trade, totalling A$419 million in 2006 (according to Australian services import data sourced from ABS) and accounting for around 0.6 per cent of ROK's total services exports in 2006[51]. Transportation services accounted for more than half of these (about 61 per cent), reaching a total value of A$254 million. Exports in transportation services have mainly led the ROK's services exports to Australia during the period 1999 to 2006.

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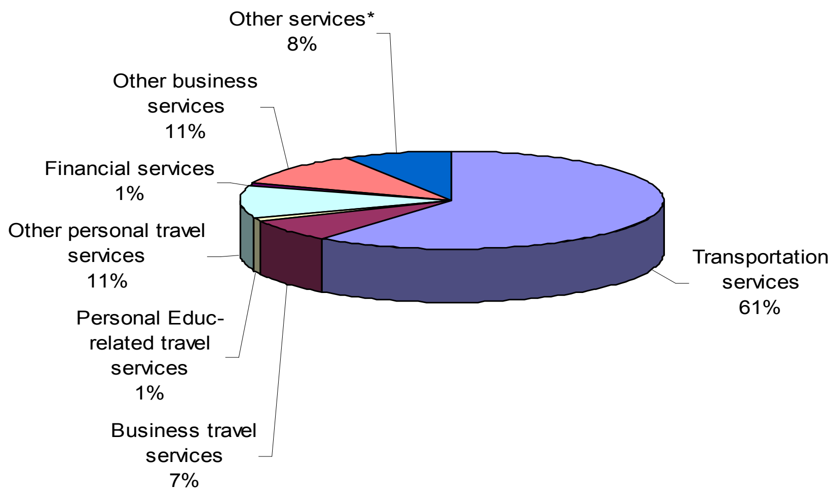
[50] Porter et al, August 2001.

[51] Australian Bureau of Statistics (ABS), *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006.

Travel services were the second largest category of ROK exports to Australia, valued at A$81 million, accounting for over 19 per cent of all ROK services exports in 2006. The bulk of this consisted of personal travel services, which accounted for around 62 per cent of total travel services exports to Australia. Other business services related exports amounted to A$46 million. Services exports to other sectors in Australia have been negligible (see Figure 1.10).

Figure 1.10 ROK's major services exports to Australia, by type, 2006 (share of total)



* Other services refer to communication, construction, insurance, computer & information, royalties & license fees, personal, cultural & recreational, and government services

Note: Due to a lack of ROK services exports data at the sectoral-level breakdown, the data for this graph pertains to Australian import of services from the ROK. It was sourced from the Australian Bureau of Statistics and not from ROK statistical agencies.

Source: ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

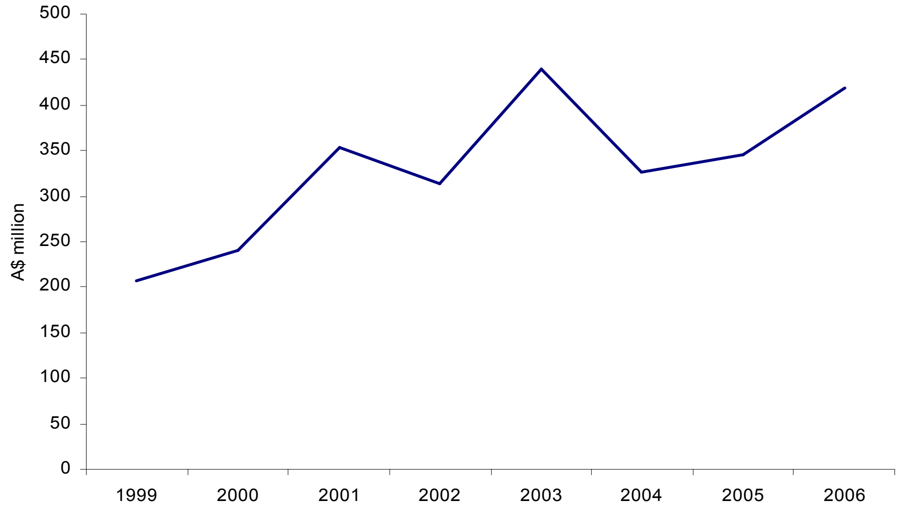
(ii) Trends in services exports to Australia

Although still small, ROK's services exports to Australia are growing. In value terms, services exports from the ROK to Australia more than doubled between 1999 and 2006, increasing from A$207 million to A$419 million (despite a decline in 2002 and 2004). Figure 1.11 illustrates an overall upward trend in services exports to Australia.

The trend in the ROK's services exports to Australia by sector is presented in Figure 1.12. Exports of transportation services to Australia increased from A$41 million in 1999 to A$254 million in 2006, a more than six-fold increase. The share of transportation services to Australia in the ROK's total services exports rose from 20 to 61 per cent over the same period.

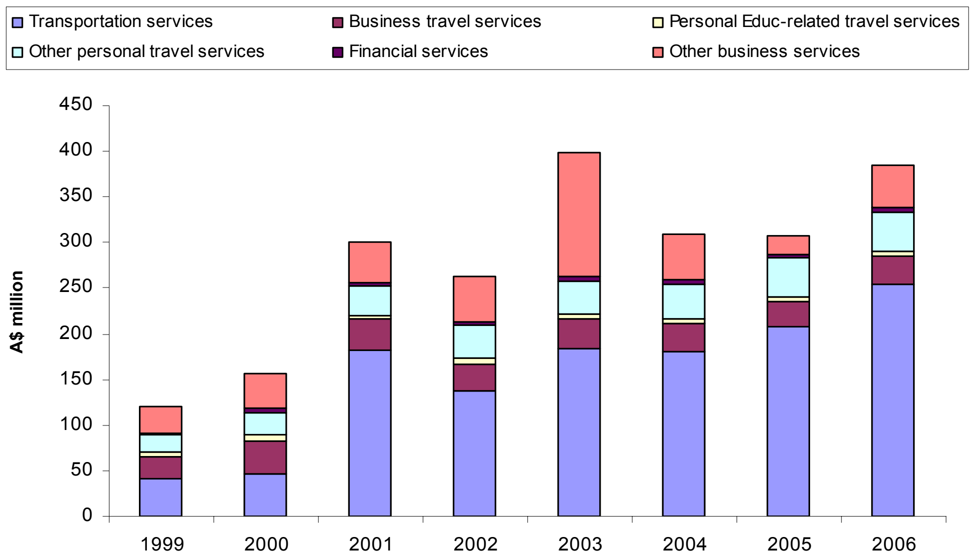
Travel services exports to Australia rose by 69 per cent between 1999 and 2006. The highest growth rates were in "other personal travel" services exports which registered a two-fold increase during this period. Business travel services exports to Australia expanded from A$24 million to A$31 million over the period 1999 to 2006. Other business services exports to Australia registered an increase of more than 58 per cent over the same period. Following a temporary dip in 2005, exports of other business services to Australia have since begun to pick up.

Figure 1.11 ROK's services exports to Australia, 1999 to 2006 (A$ million)



Source: ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

Figure 1.12 ROK's services exports to Australia, by sector, 1999 to 2006 (A$ million)



Source: ABS, *International Trade in Goods and Services, Australia*, Cat No. 5368.0, 2006

1.2.3 Trends in investment flows

1.2.3.1 Australian investment in ROK

(i) Significance of investment flows to ROK

As a foreign investment destination for Australia, the ROK ranked twelfth overall and fourth in Asia, behind Japan, Hong Kong and Singapore. The major destinations for foreign investment by Australia are the US (which had 38 per cent of Australia's total stock of foreign investment at the end of 2006), the UK (16 per cent) and New Zealand (8 per cent) (see Table 1.5 for the details).

The stock of Australian investments in the ROK totalled A$6.9 billion — or US$5.23 billion at the average exchange rate — at the end of 2006. The majority of this stock was held as portfolio investments, which accounted for about 60 per cent of the total stock.

Most of the recent annual FDI flows from Australia to the ROK have gone to the services sector, with the rest concentrated in manufacturing (see Table 1.6). Other major investments in that year went into real estate and leasing services (US$18.1 million) and transportation machine manufacturing (US$4.8 million).

Table 1.5: Stock of Australian investment abroad, by top 12 destinations, as at end of 2006

Destination	2006 (A$ billion)	Share of Total (%)	Change 2001 to 2006 (%)
United States of America	320.8	38.4	45.4
United Kingdom	133.3	16.0	77.2
New Zealand	65.3	7.8	140.6
Japan	39.8	4.8	55.9
Netherlands	31.2	3.7	104.2
Canada	26.1	3.1	262.0
Germany	23.8	2.9	180.6
France	21.7	2.6	--
Hong Kong (SAR of China)	16.0	1.9	27.5
Singapore	14.3	1.7	37.8
Switzerland	14.0	1.7	98.0
Korea, Republic of	6.9	0.8	247.1
Total	**835.6**	**100.0**	**65**

Source: ABS, *International Investment Position, Australia: Supplementary Country Statistics*, Cat No. 5352.0, 2006

Table 1.6: Flow of FDI from Australia to ROK, by industry sector, selected years

Industry Sector	1986 (AU$ million)	1995 (AU$ million)	2005 (AU$ million)	2006 (AU$ million)	Share of All Australian FDI to ROK, 2006 (%)
Agriculture, Livestock, Fishery & Mining	--	--	--	--	--
Manufacturing	**3.2**	**4.6**	**37.4**	**4.1**	**0.59**
Food	--	0.66	--	--	--
Textile, Fabrics & Clothing	--	--	--	--	--
Chemicals	3.15	--	--	0.15	0.02
Pharmaceuticals	--	--	--	--	--
Non-metallic mineral	--	0.57	--	--	--
Metal	--	--	0.04	--	--
Machine & Equipment	--	0.17	--	0.26	0.04
Electric & Electronics	--	0.24	--	0.10	0.01
Transportation machine	0.07	3.04	37.35	3.62	0.52

Industry Sector	1986 (AU$ million)	1995 (AU$ million)	2005 (AU$ million)	2006 (AU$ million)	Share of All Australian FDI to ROK, 2006 (%)
Other manufacturing	--	--	0.1	--	--
Services	--	**0.5**	**1.6**	**692.8**[52]	**99.4**
Wholesale & Retail	--	0.5	0.5	0.6	0.08
Hotels & Restaurants	--	--	0.3	678.0	97.3
Transport & Storage	--	--	0.1	0.2	0.03
Communications	--	--	--	0.2	0.03
Finance & Insurance	--	--	0.6	0.04	0.01
Real Estate & Leasing	--	--	--	13.6	2
Business Services	--	--	0.1	0.1	0.02
Culture & Entertainment	--	--	--	--	--
Public & Other Services	--	--	0.1	--	--
Electricity, Gas, Water & Construction	--	--	--	--	--
Total FDI flow from Australia to ROK	**3.2**	**5.1**	**39.1**	**696.9**	**100**

Note: The flow of FDI from Australia to the ROK by industry sector was obtained from the Korean Ministry of Knowledge Economy, accessed at www.mke.go.kr. These figures were quoted in US dollars. Subsequently the US dollar figures were converted into Australian dollars by ITS Global using period average exchange rates sourced from the International Finance Statistics (IFS) database of the IMF.

(ii) Growth in investment flows to ROK

The annual flow of Australian investment into the ROK has accelerated in recent years. In 2001, the stock of Australian investment in the ROK amounted to A$2 billion, but increased by 247 per cent to nearly A$7 billion in 2006 (see Table 1.5).

At the same time, the stock of Australian investment in the ROK, as a share of its total investment stock abroad, has roughly doubled between 2001 and 2006 (see Figure 1.13). The acceleration in annual investment flows to the ROK in recent years has been dominated by several large investments by Australian companies in the ROK [53]

In contrast to other Asian economies, such as Hong Kong, Singapore and Indonesia, the entry of Australian businesses into the ROK market is a relatively recent phenomenon, which is rapidly changing. In the last decade, investment flows were dominated by a small number of Australia companies,[54] Macquarie Bank has a strong presence and Oceanis Australia developed the Busan Aquarium[55] and has been selected to develop and

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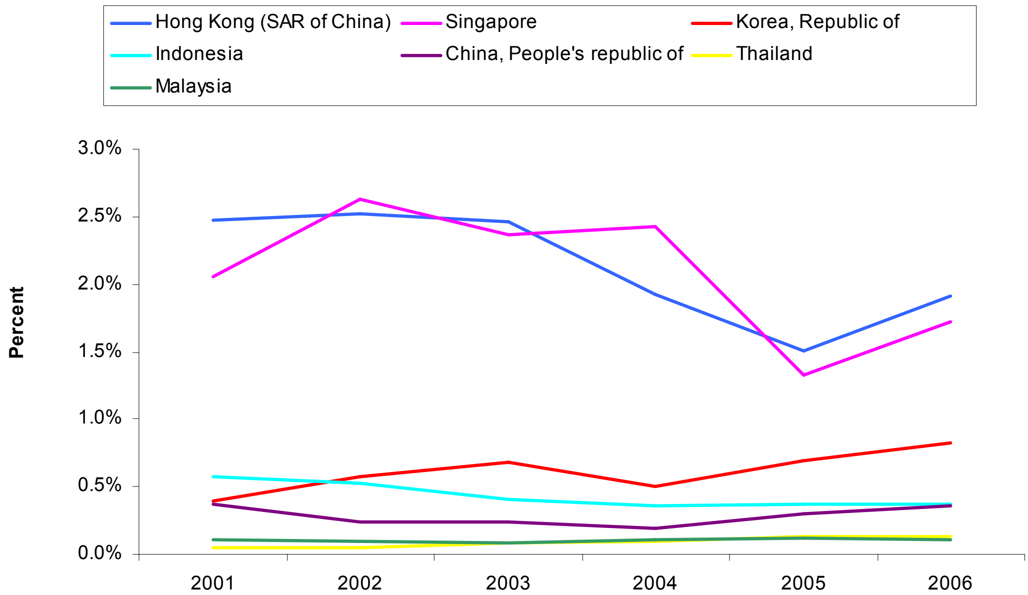
[52] Confidential figure. MOCIE.
[53] DFAT, *Republic of Korea Country Brief*, May 2007, accessed at http://www.dfat.gov.au/geo/rok/brief_index.html
[54] Dr You-Il Lee, *Survey of Australian/Foreign Investment in the Republic of Korea* http://www.dfat.gov.au/publications/korea_rebuilds/survey.pdf
[55] DFAT, *Republic of Korea Country Brief*, May 2007

operate a second facility in the ROK.[56] Australia has also made successful investments in the automotive and IT industries.[57]

Figure 1.13 Share of stock of Australian investment abroad, by selected economies in Asia, 2001 to 2006



Source: ABS, *International Investment Position, Australia: Supplementary Country Statistics*, Cat No. 5352.0, 2006.

Major factors driving the growth in Australian investment in the ROK have been its relatively large domestic market (over 48 million people with a high propensity to consume[58]), relatively high levels of income per capita and high rates of economic growth. Other factors encouraging investment have included a need to develop a regional presence in East Asia as part of a business globalisation strategy. With its central location in the region, the ROK serves as a gateway to major markets in Japan and China.

Investors are also attracted to the ROK's state-of-the-art infrastructure, strong logistics system with good overseas links and excellent telecommunications infrastructure, including high quality broadband services.

Since the Asian Financial Crisis the ROK Government has eased restrictions and embarked on an extensive reform agenda to attract foreign investment.[59] This has opened up most sectors of the ROK economy to all forms of FDI, including the establishment of new business, mergers and acquisitions, long-term business loans and acquisition of equity in existing businesses. The Government also offers a range of incentives to attract FDI, including tax and customs duty reduction or exemption, as well as cash grants, reduced rental on government properties and designated special economic zones.

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[56] Oceanis Holdings Ltd , *Submission No. 27,* Submission to Inquiry into Australia's Relations with the Republic of Korea and Developments on the Korean Peninsula by the Joint Standing Committee on Foreign Affairs, Defence and Trade of the Australian Parliament, 2005.
[57] *Ibid.* Submission No. 18: Embassy of the Republic of Korea.
[58] Invest Korea, *Why Korea.*
[59] *Ibid.* Submission No. 21: Department of Foreign Affairs and Trade, Australia.

1.2.3.2 ROK investment in Australia

(i) Significance of investment flows to Australia

During the 1990s, ROK's outflows of FDI exceeded inflows. Strong outflows were mainly attributed to rising domestic wages in the early 1990s, which drove ROK firms to search for new production sites abroad. The Asian Financial Crisis caused the ROK's outward FDI to contract for three consecutive years. However, since 2000, the ROK's outflows of FDI have grown to exceed pre-crisis levels, with total stock of ROK investment reaching US$18.5 billion in 2006.

Historically, Australia-ROK investment flows have not been as strong as the trading relationship. China remains the major destination for ROK's stock of FDI abroad, comprising over 24 per cent of the ROK's total outflow of FDI. This is followed by the US (19.5 per cent), Vietnam (4.7 per cent) and Indonesia (4.5 per cent). Based on cumulative stock of FDI as at end of 2006, Australia ranked sixth as a foreign investment destination for the ROK, with investment in Australia accounting for nearly 3 per cent of its total outward FDI – see Table 1.7 below.

The ROK's flow of direct investments to Australia are concentrated in the areas of wholesale and retail trading, resource development, and some manufacturing sectors, such as automobile and electrical appliances. Direct investment flows in the wholesale and retail trade sector (based on investment amount) accounts for 38 per cent of total direct investment, while the manufacturing and mining sector account for around 18 and 17 per cent respectively. See Figure 1.14.

Korea has a number of significant investments in Australian resource projects. Most Korean investments in mining are in joint ventures, but some are through wholly owned subsidiaries. The Korean steel company POSCO holds an 11 percent interest in Murchison Metals Limited, an iron ore company in the Mid West region of Western Australia. Korean companies have also invested in a number Australian coal projects in New South Wales and Queensland, and Korea Zinc has been operating its zinc refinery in Queensland since 1996. In April 2002 POSCO entered into a joint venture with Japanese ITOCHU, BHPB and Mitsui, to develop the iron ore mine 'Mining Area C' in the Pilbara.

Table 1.7: Cumulative Stock of ROK FDI abroad, by top ten destinations, 1968 to 2006

Destination	FDI Outflow: 1968-2006 (US$ million)	Share of Total, 2006 (%)	Change 2001 to 2006 (%)
China	25,466	24.0	171.3
US	20,670	19.5	53.3
Vietnam	4,978	4.7	257.1
Indonesia	4,780	4.5	20
Hong Kong	4,330	4.1	104.8
Australia	3,042	2.9	29.2
Netherland	2,971	2.8	36.4
UK	2,787	2.6	33.3
Canada	2,559	2.4	73.3
Bermuda	2,160	2.0	46.7
Total all countries	**105,952**	**100**	**80.6**

Source: The Export-Import Bank of Korea, Republic of Korea

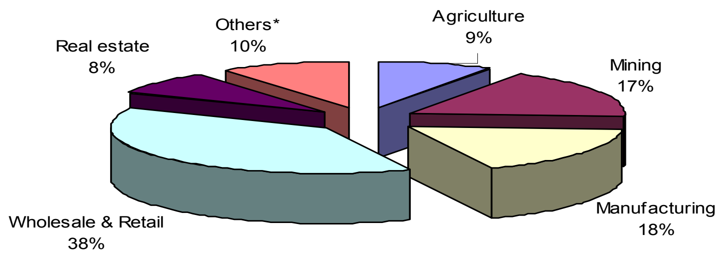
Many large ROK corporations in mining-related businesses, including Samsung, SK, and POSCO, have invested in Australia, including to produce coal for their parent companies in the ROK. Korea Resources Corporation (KORES) provides technical and financial assistance for private sector investment in resources projects. On 3 March 2006, KORES and the then Invest Australia signed a MoU aimed at "mutual cooperation for the exchange of information on mineral resources investment opportunities in Australia". Invest Australia opened an office in Seoul in February 2007. Hansol PI has also successfully invested in forestry in Western Australia since 1993 and now operates a woodchip plant. (See Table 1B.2 in Annex IB for local ROK subsidiaries currently operating in Australia).

The ROK's major trading companies have also established wholly owned subsidiaries and representative offices in Australia. They import ROK merchandise, such as chemical products, steel, 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 ROK cars, household white goods and home electronics for wholesale or retail distribution in Australia.

Since 2005, investment in the Australian manufacturing sector has been rapidly expanding and diversifying into new products with some major investments in wool and leather processing and chemical products. Other investment sectors include agriculture and real estate. While these are relatively new areas for ROK direct investment overseas, such investments are expected to increase in the future.[60]

[60] Based on the views of KIEP researchers.

Figure 1.14 Direct investment flows from ROK to Australia, by sector, 2006



Others include the following sectors: Services, transportation, construction and hotels

Source: The Export-Import Bank of Korea, Republic of Korea

(ii) Growth in investment flows from the ROK

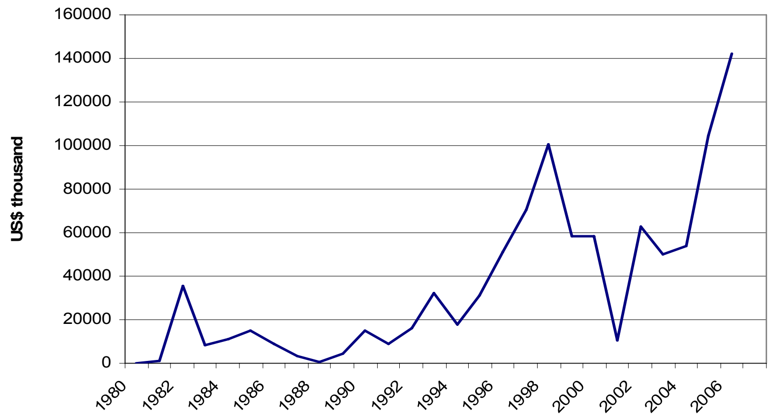
Bilateral investment flows have increased markedly in recent years, reflecting a maturity and sophistication in economic ties between the two countries.

The flow of direct investment from the ROK to Australia has increased substantially over the period 1980 to 2006 (see Figure 1.15) Outflows of FDI from the ROK to Australia first started in 1980, totalling US$72,000. They grew to US$51 million in 1996, reaching US$142 million in 2006 (see Table 1B.3 in Annex 1B for more detail).

Among the various sectors in Australia, energy and mineral resources, wholesale and retail, and manufacturing industries have been particularly important for ROK investment. Investment flows from the ROK to Australia in the wholesale and retail sector have increased more than eight-fold since 1995 as ROK companies like Samsung, Hyundai, Daewoo and Ssangyong sought to build market share. Flows increased by nearly three–fold in the mining sector between 1995 to 2006 as ROK companies moved to secure stable supplies of energy and natural resources in Australia. For example, POSCO has entered into joint mining ventures with BHP Billiton. Investment flows from the ROK to Australia in manufacturing sector increased by more than seven-fold over 2005 to 2006 (see Figure 1.16).

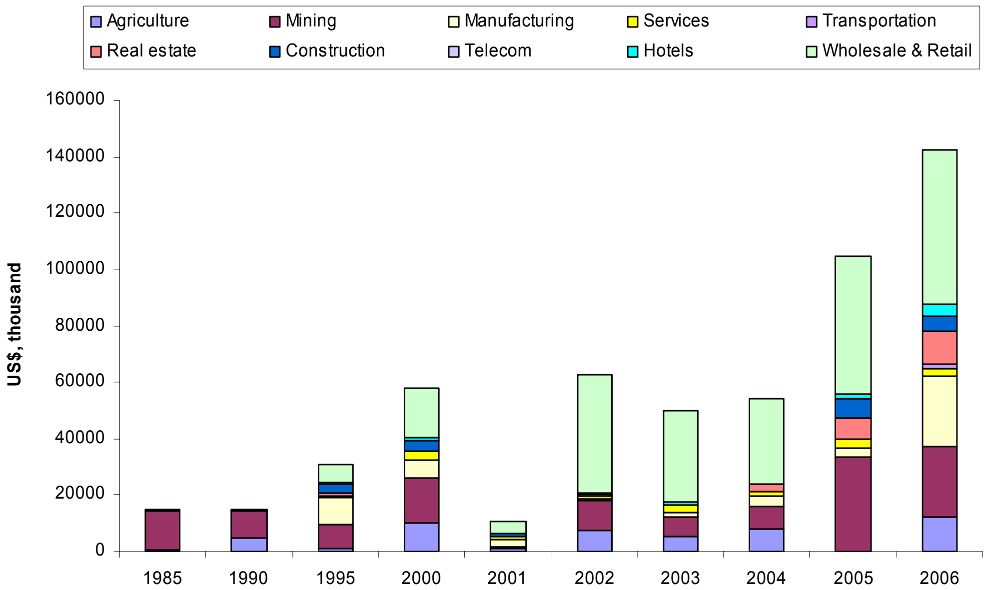
Australia is a country with which the ROK foresees continuing a strong and sustained partnership. This is driven to a large extent, by the ROK's need to achieve a stable supply of natural resources. Australia's abundant mineral and energy resources supply, stable political situation, sound infrastructure and the know-how in exploiting and developing resources make it an attractive investment market for the ROK. The ROK's FDI flow to Australia is expected to increase further fuelled by its strong demand for natural resources.

Figure 1.15 Direct investment flows from ROK to Australia, 1980 to 2006 (US$ thousand)



Source: The Export-Import Bank of Korea, Republic of Korea

Figure 1.16 Direct investment flows from ROK to Australia, by sector, 1985 to 2006 (Investment amount, US$ thousand)



Source: The Export-Import Bank of Korea, Republic of Korea

2. International trade policy developments impacting on the bilateral relationship

2.1 Trade and investment policy developments in the region

2.1.1 General trends

Recent years have seen a dramatic rise in the negotiation of bilateral FTAs and proposed regional initiatives in the Asia Pacific Region, many involving Australia and the ROK. Over 30 agreements have been concluded as of December 2006. Many more are in prospect. FTAs have involved many of the members of the Asia Pacific Region, including the US, China, Japan, Canada, Chile, Mexico, New Zealand and ASEAN. Nine of these have included Australia or the ROK.

FTA initiatives in the region have been dominated by US, which now has nine FTAs with 15 countries. An agreement with Australia entered into force in 2005. The ROK signed an FTA with the US in 2007. The US has signed agreements with Singapore and Chile. Five further agreements are awaiting approval by the US Congress or implementation, including that with the ROK (which was submitted to the ROK National Assembly on 7 September 2007 for ratification). Negotiations are underway with four other countries including Thailand and Malaysia.

China has been active in concluding trade agreements with Chile, Pakistan, Thailand and ASEAN. It is currently negotiating FTAs with Australia, New Zealand, the GCC, and Singapore. FTAs with the ROK and Peru are under consideration.

Japan likewise has signed FTAs with Mexico and several ASEAN countries including Thailand, the Philippines, Malaysia and Singapore. Both the ROK and Australia have commenced FTA negotiations with Japan, along with Chile, the GCC and ASEAN.

ASEAN nations such as Thailand and Singapore have been active in pursuing bilateral agreements with developed country partners, such as Japan, Australia, New Zealand, the US, Canada and the ROK. The ASEAN nations as a group already have FTAs on merchandise trade with China and the ROK (with the exception of Thailand). ASEAN countries are also pursuing negotiations with Australia and New Zealand (AANZFTA).

Along with the trend towards bilateral agreements, numerous plurilateral trade initiatives have also been proposed in the region. They include:

- China, Japan and the ROK;
- ASEAN plus 6 (China, Japan, the ROK, Australia, New Zealand and India)
- ASEAN plus 3 (China, Japan and the ROK).

Recently at the APEC Ministerial Summit in Sydney in September 2007, APEC members agreed to examine the options and prospects for a possible Free Trade Agreement of the Asia Pacific (FTAAP).

The growth of agreements at the bilateral and regional level has paralleled the difficult and uncertain progress in the multilateral trade negotiations for the Doha Round of the

World Trade Organisation (WTO). Although the Doha Round negotiations are proceeding, the immediate prospects for multilateral liberalisation are uncertain.

While many countries in the region have FTAs in common, they have taken different approaches to trade liberalisation in their various agreements. FTAs vary considerably in the degree and scope of liberalisation they seek to achieve.

The US approach has been to negotiate comprehensive free trade agreements which build upon WTO commitments and which extend to goods, services and investment as well as a broader range of 'beyond the border' measures[61] including intellectual property, competition policy, and standards and conformance.

To date China, Japan, and ASEAN nations have tended to focus on liberalisation of merchandise trade in their FTAs through reductions and/or elimination of tariff barriers. In several cases, agricultural products were excluded from the negotiated cuts in protection. In many cases, commitments to liberalise services and investment were not included initially, but are to be negotiated at a later date. Coverage of 'beyond the border' issues, which affect the conduct of business in the partner country market, has been less common.

2.1.2 Bilateral developments

2.1.2.1 Bilateral FTAs with Australia

FTA policy and approaches

Australia has pursued bilateral free trade agreements with major trading partners simultaneously with its participation in the multilateral negotiations under the Doha Round. Agreements were concluded first with New Zealand[62] followed by Singapore (2003), Thailand and the United States (both 2005). Since 2005, negotiations have been launched with ASEAN, Malaysia, China, Japan, Chile, and the GCC.

Australia's policy on FTAs has been to negotiate agreements which are comprehensive in scope, consistent with WTO obligations, and build upon the degree of liberalisation achieved at the multilateral level – often referred to as 'WTO plus' Agreements. All the agreements generally provide for legally binding commitments for liberalisation across goods, services and investment, and address trade in areas of intellectual property, competition policy, government procurement, technical standards and e-commerce. Some also facilitate deeper levels of integration with partner countries through provision for mutual recognition of qualifications, standards and conformance, temporary entry of non-citizens and other 'beyond the border' measures.

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[61] In this report 'beyond the border' measures include intellectual property, government procurement and other regulatory measures affecting trade and investment not otherwise captured by those measures canvassed in Chapter 3.

[62] The Australia and New Zealand Closer Economic Relations Trade Agreement was concluded in 1983 and represents a major expansion of a more limited bilateral agreement, which had been in place since the 1950s.

Current FTAs

To date Australia has concluded FTAs with New Zealand, the US, Singapore and Thailand. Although all are comprehensive and build on WTO commitments, the scope and degree of liberalisation achieved differs among agreements. Australia's earliest FTA, with New Zealand came into force prior to the existence of the WTO. It has achieved a high level of economic integration between the two economies, covering services (through a Protocol added in 1989) as well as goods liberalisation.

Australia then concluded a bilateral FTA with Singapore in 2003, which eliminated all tariffs between the two economies and built on WTO commitments in services, as well as covering investment, government procurement, competition policy, temporary entry of business persons and intellectual property. The feasibility study which preceded the negotiations estimated the FTA would deliver economic gains to Australia of up to A$60 million in additional exports, with potential benefits in the financial services sector of between A$8-20 million per year and around A$50 million per year in additional education services exports.[63]

The FTA with Singapore was followed by the negotiation of a free trade agreement with the US. It was comprehensive in its scope and covered liberalisation in goods, services, investment, intellectual property, government procurement and also many 'beyond the border issues' such as competition policy and recognition of professional qualifications. It came into force in 2005. A study conducted after the agreement was signed estimated it would increase Australian exports, compared to what would have happened without it, by around 0.9 per cent in 2005, rising to nearly 1.3 per cent in 2025. Real GDP was estimated to increase by $6.1 billion per year a decade out, nearly 0.7 per cent above what was otherwise expected.[64]

The Australia-Thailand Free Trade Agreement (TAFTA) entered into force on 1 January 2005. This agreement built on liberalisation in goods and services achieved in the WTO and provided for greater economic integration in areas including temporary movement of personnel. The estimated economic gains for Australia were in the order of US$2.4 billion in additional GDP in net present value terms over 20 years compared to levels that might be expected without an FTA.[65]

The scope of these agreements is outlined in further detail below.

Prospective FTAs

Prospective FTAs are currently being negotiated by Australia with China, ASEAN (jointly with New Zealand), Malaysia, Japan, the GCC and, most recently, Chile. Negotiations with Malaysia, ASEAN (jointly with New Zealand), and China commenced in 2005 and have since advanced through a series of negotiating rounds. Bilateral agreements with the ROK, Indonesia and India are being considered.

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[63] Access Economics, *The Costs and Benefits of a Free Trade Agreement with Singapore*, DFAT, Canberra, 2001

[64] Centre for International Economics, *Economic analysis of AUSFTA Impact of the bilateral free trade agreement with the United States*, DFAT, Canberra, 2004.

[65] Centre for International Economics, *The Australia-Thailand Free Trade Agreement: economic effects*, DFAT, Canberra, 2004.

Australia commenced negotiations with China in 2005. The feasibility study into the proposed agreement estimated that full liberalisation under an FTA would boost Australia's real GDP by US$18 billion in net present value terms, and increase China's GDP by US$64 billion, over the subsequent decade and increase bilateral trade in 2015 by US$5.4 billion.[66] To date ten negotiating rounds have taken place.

Several rounds of negotiations on the AANZFTA have taken place since 2005. Progress is continuing on goods, services and investment liberalisation. The negotiating parties have agreed to conclude the agreement by the middle of 2008. It is estimated that the agreement will result in an increase in collective GDP of US$48.1 billion over the period 2000 to 2010, of which US$ 25.6 billion is estimated to accrue to the ASEAN countries and US$ 22.5 billion to Australia and New Zealand.[67]

Negotiations with Malaysia commenced in 2005. The Agreement is expected to boost Australia's real GDP by A$1.9 billion and its real consumption[68] by A$1.4 billion in net present value terms over the next 20 years.[69]

Negotiations with Japan, the GCC[70] and Chile are more recent, beginning in 2007.

The Australia-Japan joint government study conducted prior to the commencement of negotiations with Japan, estimated an FTA would add $A39 billion to Australia's GDP, and $A27 billion to Japanese GDP over 20 years[71].

Table 2.1: Current Status of Australia's FTA Initiatives

FTAs concluded/signed	FTAs under negotiation	FTAs under consideration/proposed
ANZCERTA (entry into force 1983)	ASEAN-Australia-New Zealand (from February 2005)	Indonesia
Singapore (entry into force July 2003)	China (from May 2005)	India
United States (entry into force January 2005)	Malaysia (from May 2005)	Mexico*
Thailand (entry into force January 2005)	Japan (from April 2007)	Republic of Korea (from December 2006)
	GCC (from July 2007)	
	Chile (from August 2007)	

* Mexico and Australia are currently examining ways to strengthen the bilateral relationship.

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66 DFAT [Australia] and Ministry of Commerce [China], *Australia-China Free Trade Agreement Joint Feasibility Study*, 2005, p4. Available at www.dfat.gov.au.

67 Centre for International Economics, *Economic benefits from an AFTA-CER free trade area, Year 2000 study*, DFAT, Canberra, 2000.

68 Real consumption was used as the proxy for economic welfare.

69 DFAT, *An Australia-Malaysia Free Trade Agreement: Australian Scoping Study*, 2005.

70 The GCC is comprised of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

71 DFAT (Australia) and MOFA (Japan), *Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility and Pros and Cons of a Free Trade Agreement*, December 2005, p8. Available at www.dfat.gov.au.

Liberalisation commitments under FTAs

Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA)

ANZCERTA is Australia's oldest free trade agreement and the one that has arguably achieved the greatest level of trade liberalisation in both goods and services, extending far beyond that achieved through the WTO. Under ANZCERTA, Australia and New Zealand have realised a very high (but not complete) level of economic integration.

ANZCERTA provides for comprehensive liberalisation in both goods and services. All tariffs on goods were eliminated by 1988 - only five years after the Agreement came into force. The agreement prohibits quantitative restrictions and non-tariff measures such as tariff quotas.

A Trade in Services Protocol to ANZCERTA was signed in 1988 and came into effect on 1 January 1989. Liberalisation of services adopts a 'negative list' approach, whereby trade in all services is liberalized except those sectors explicitly listed in the schedules to the Protocol as being exempt. It applies the basic principles of national treatment and market access to all but specifically excluded sectors. Exceptions are minimal. New Zealand retains two exceptions (air services and coastal shipping) and Australia six (air services, broadcasting and television, third party motor vehicle insurance, postal services and coastal shipping). MFN treatment applies to these.

ANZCERTA has no specific provisions on investment. At present, investors and investments of each party are subject to the general foreign investment policies and requirements of the other country. Despite this, neither country has rejected an investment proposal from the other country for at least 10 years. In February 2006, Australia's Treasurer and New Zealand's Finance Minister agreed to commence negotiations on an Investment Protocol to form part of ANZCERTA.

Some areas not dealt with in ANZCERTA. There are no provisions on intellectual property, environment or labour issues.

ANZCERTA has facilitated a considerable degree of economic integration in other areas, which have been addressed through subsequent further agreements between the two parties. These areas have included labour mobility and harmonization, and mutual recognition of standards and conformance. The Trans Tasman Travel Arrangement allows for Australian and New Zealand citizens to visit, reside and work in each other's country without restriction. Australia and New Zealand have also achieved complete harmonization of food standards, which are enforced by a Trans-Tasman (bi-national) regulatory agency.

ANZCERTA also provides for the harmonization of business law by requiring the two governments to harmonize their companies and securities laws, competition policy and consumer protection laws. To date each country continues to maintain its own competition laws, but domestic competition law prohibitions on the misuse of market power have been extended to the Trans Tasman market. In reality there are not great differences in their competition law regimes, with both countries maintaining robust systems to address anti-competitive practices.

Notably both countries agreed to eliminate the possibility of taking anti-dumping actions against each other upon agreement that dumping could be adequately dealt with under competition policy and laws directed at predatory pricing.

Australia-United States Free Trade Agreement (AUSFTA)

Australia's FTA with the United States (AUSFTA) is comprehensive. It includes detailed obligations for the liberalisation of goods, services and investment, as well as intellectual property, competition policy, government procurement, e-commerce and technical standards and regulations. Most commitments to liberalise expand upon the parties' WTO commitments. For example, liberalisation of merchandise trade under AUSFTA goes beyond WTO commitments. The agreement eliminates nearly all tariffs either immediately or gradually over time, as set out in schedules to the Agreement.

Two-thirds of U.S. tariffs on Australian agricultural products were eliminated upon the agreement entering into effect, a further 9 per cent of the tariffs eliminated within four years, and the remainder (with the exception of some dairy products and sugar) to be phased out over periods of 10 to 18 years starting in 2005. Three years into the Agreement, the US import quota on Australian beef was increased by 20,000 tonnes per year, slated to reach a total of 70,000 additional tonnes by 2023. The in-quota duty was eliminated and over quota tariffs were agreed to be phased out over 18 years.[72]). It further specifies the creation of duty free tariff rate quotas for certain agricultural products, including tobacco, some dairy products, cotton, peanuts and avocados.

An Annex on pharmaceutical products contains agreed principles on innovative pharmaceuticals and facilitating high quality healthcare and commitments on transparency in the listing of pharmaceutical products for reimbursement by the Parties' federal healthcare authorities. This is supported by a side letter which sets out specific commitments Australia has made in relation to existing processes for the listing of medicines on the Pharmaceutical Benefits Scheme.

Services liberalisation commitments in AUSFTA expand upon those under the General Agreement on Trade in Services (GATS). AUSFTA ensures that service suppliers from each party receive national treatment or most favoured nation treatment (which ever is better) from the other. AUSFTA adopts a liberal 'negative list' approach to liberalisation. It prohibits the parties from placing market access and national treatment restrictions on each other, subject to certain 'non-conforming' measures which are identified in schedules to the agreement contained in Annexes.

Non-conforming measures listed in the first of the two annexes (of reservations) to AUSFTA cannot be made more restrictive and are subject to a 'ratchet mechanism'. This mechanism seeks to ensure that if a measure is subsequently unilaterally liberalised, it cannot be returned to the original measure. This ensures measures become 'bound' as liberalisation commitments as they are progressively liberalised.

Under the AUSFTA Australia granted additional access to US service suppliers across a range of services (including certain professional services, computer and related services, research and development services, real estate services, rental/leasing services without operators, other business services, postal services, courier services, on-line information

[72] DFAT, Australia, *The Australia-United States Free Trade Agreement: Facts At a Glance*, Australia, 2006.

and/or data processing telecommunications services, construction services, educational services, financial services, health related and social services, recreational, cultural and sporting services and transport services). Australia also liberalized commitments in some sectors, with respect to Australia's foreign investment policy (see below) and in the financial services sector, where Australia agreed to provide new rights for life insurance branching and agreed to exempt new financial services investments from investment screening.

AUSFTA includes a separate chapter on investment which provides for national treatment and most favoured nation (MFN) treatment for each party. It applies a 'negative list' approach with exceptions listed in annexes to the Agreement, as for services. Although Australia retained a right under the Agreement to review all foreign investment proposals for consistency with the national interest, it agreed to lift the threshold for screening of proposed US investments in existing Australian businesses in non-sensitive sectors and in developed commercial real estate to A$800 million, indexed annually (in 2007 this screening threshold is A$871 million). Proposed U.S. investments in existing Australian businesses in sensitive sectors (such as transportation, telecommunication and defence investments) and all other types of real estate, as well as U.S. government investments, are subject to the same rules that apply to non-U.S. investors, generally a screening threshold of A$100 million.

AUSFTA includes obligations in relation to competition law and anti-competitive business conduct, designated monopolies, state enterprises, cross-border consumer protection and recognition and enforcement of monetary judgements. The only obligations in the competition chapter subject to dispute settlement are related to monopolies and state enterprises. AUSFTA also includes a separate Chapter on intellectual property, which affirms and strengthens WTO TRIPS rights and obligations.

AUSFTA also goes some way toward enhancing deeper integration between the two economies in financial services, the recognition of professional qualifications, and competition law. The Parties agreed to an in-built agenda in these areas aimed at further economic integration in the future.

For example, AUSFTA establishes a joint Financial Services Committee (FSC) to supervise the implementation of the Financial Services Chapter of the Agreement and to examine issues for further integration of the financial services sectors of the two countries. Side letters clarify the application of current policies to the sector and form part of the mandate for cooperation and discussion in the FSC.

Under AUSFTA, the US and Australia agreed to encourage the relevant national and sub-national bodies within their jurisdictions to develop mutually acceptable standards and criteria for licensing and certification of professional services suppliers and to provide recommendations on mutual recognition to the Joint Committee. A Working Group on Professional Services was also set up to facilitate mutual recognition. To date progress has been achieved in improving access for Australian lawyers to the US market.

Focus for further cooperation under AUSFTA arises out of the establishment of a Working Group on competition issues, which is responsible for examining the scope for strengthening cooperation on the effective enforcement of competition laws and policies between the two countries. A side letter is aimed at reaching a common view on cooperation and appropriate steps to enhance legal and regulatory regimes on competition related matters.

The AUSFTA also provides for the consideration of mutual recognition of technical regulations and testing procedures between the two economies.

On quarantine matters, the agreement establishes a bilateral Sanitary and Phytosanitary (SPS) Committee to enhance cooperation on SPS measures and the regulatory process, and sets up a Standing Technical Working Group on Animal and Plant Health to address technical quarantine issues.

Singapore-Australia Free Trade Agreement (SAFTA)

SAFTA provides for comprehensive commitments for liberalisation of trade in both goods and services. All tariffs were eliminated upon entry into force of the agreement. Quantitative restrictions are prohibited.

The services chapter covers both cross-border trade in services and commercial presence related to the provision of services. Services commitments also use a 'negative list' approach. Both countries extended national treatment to the other's service providers, but there is no commitment on MFN. Market access provisions were also included. Reservations against national treatment and market access are listed in an Annex.

The services chapter also covers financial services. Both parties committed to providing market access and national treatment across a range of financial services, including banking, insurance and capital markets. Although these expand upon the parties' GATS commitments, they do not go as far as those provided in AUSFTA. Some restrictions remain, particularly in the Singaporean market regarding the establishment and operation of foreign banks.

The investment chapter requires the parties to accord national treatment (but not MFN) to the investors and investments of the other, with reservations listed in an annex. It includes provisions on expropriation, transfers and a mechanism for the resolution of disputes involving investors. [73]

Deeper integration is provided for domestic regulation of telecommunications, mobility of business persons and mutual recognition of standards and conformance.

SAFTA establishes disciplines for domestic telecoms regulation by both countries. It provides greater transparency of decision-making, rights of appeal, effective enforcement by the regulator, non-discriminatory pricing for interconnection and consultations with industry in development of standards and policy. The regulators must operate in a transparent manner and properly explain decisions in relation to such matters as the approval of commercial terms and conditions and standards and the adjudication and resolution of disputes. Telcos having major supplier status in a particular segment of the market must provide other suppliers with interconnection on terms that are non-discriminatory terms, in a timely fashion, and cost-oriented rates. Both governments also

[73] These are conducted under the International Centre for Settlement of Investment Disputes (ICSID) pursuant to the Convention on the Settlement of Investment Disputes or the rules of the United Nations Commission on International Trade Law (UNCITRAL).

committed to maintaining effective sanctions to enforce competitive safeguards and regulatory decisions, and to facilitate consultation with industry participants, including in the development of industry standards.[74]

SAFTA eases entry restrictions for the temporary stay of business personnel and longer term business residents and their spouses. It provides a framework for Australian professional bodies to negotiate mutual recognition agreements with their counterpart bodies in Singapore[75] and provides for greater recognition of Australian law degrees in Singapore. Residency requirements for Australian professionals such accountants and auditors were also removed or eased.

SAFTA builds on the Australia-Singapore Mutual Recognition Agreement on Conformity Assessment. It encourages the two parties to work towards harmonization of their technical regulations and sanitary and phyto-sanitary (SPS) measures.

Competition law and policy is addressed in SAFTA but it does not include any legally binding measures. It focuses on cooperation between the parties in addressing anti-competitive practices.

Chapter 13 of the Singapore Australia Free Trade Agreement deals with intellectual property matters.

Thailand-Australia Free Trade Agreement (TAFTA)

TAFTA provides for elimination of all tariffs, albeit not immediately in all cases.

Coverage of services adopts a 'positive list' approach, which does not extend much beyond the two Parties' GATS liberalisation commitments. Key obligations of national treatment and market access are provided to services as specified in an annex. The Agreement mandates future negotiations to extend its commitments to liberalise services within three years from entry into force. However, these have yet to take place.

TAFTA also includes limited provisions on investment. These are handled though a 'positive list' approach. The parties commit to national treatment for investors and investments of the other party in those sectors that are listed in an annex to the Agreement. The Agreement provides for investors to resolve disputes over covered investments through the laws of the disputing party or through international arbitration panels.

TAFTA includes commitments on mobility of business persons with rules to streamline the movement of business personnel between the two countries for short term and longer term temporary entry. It also has some commitments for facilitating trade through mutual recognition of technical regulations and conformity assessment procedures.

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[74] There are provisions in the Singapore Australia Free Trade Agreement that deal with (1) endeavouring to work towards harmonisation of mandatory requirements in accordance with respective international rights and obligations; (2) favourable consideration of equivalence of each other's mandatory requirements; and (3) arrangements to ensure that differences in each Party's arrangements for conformity assessment procedures do not unnecessarily impede trade between the Parties.

[75] Australian architects and engineers are currently seeking to conclude mutual recognition agreements covering registration of professionals and recognition of their qualifications.

The provisions in the TAFTA on competition law and policy focus on cooperation in addressing anti-competitive practices and ensuring effective enforcement of competition laws and policies.

On intellectual property, the parties affirmed the TRIPS Agreement but go further and agree to take other measures to prevent the export of goods that infringe IPR.

TAFTA provides for further negotiations on services, investment, business mobility, competition policy, and government procurement.

2.1.2.2 Bilateral FTAs with ROK

FTA policy and approaches

Like Australia, the ROK is also currently pursuing several FTAs simultaneously under a multi-track approach. The ROK formulated an FTA Roadmap in September 2003 (revised in May 2004) which forms the basis of its FTA agenda.

The ROK seeks to conclude FTAs that are consistent with the WTO rules and are comprehensive in coverage, extending to a wide range of areas such as services, investment, government procurement, intellectual property rights (IPR), sanitary and phyto-sanitary measures, and technical barriers.

Although the FTAs that the ROK has concluded so far cover a wide range of issues, the elimination of tariffs is at the heart of most of its FTAs, comprising more than half the content of the relevant agreements. Due to concerns about the potential impacts of liberalisation on its agricultural sector, the ROK has sought to minimise market opening in sensitive agricultural products and to maximise the liberalisation of industrial goods in its FTA negotiations.

The ROK's multi-track approach aims to enable the ROK to become a much larger force in the world economy. FTAs will provide the ROK with a great opportunity to strengthen its industry competitiveness, to adjust its industrial structure, and to gain greater access in foreign markets. Making optimal use of the well-equipped infrastructure of FTAs, ROK firms will be better able to break into new world markets.

In order to obtain wider public endorsement of its FTAs, the ROK Government has also made a concerted effort to explain the process and outcome of individual FTA negotiations to the National Assembly, industrial associations, and the public throughout the negotiating process.

Current FTAs

The ROK-Chile Free Trade Agreement was the first bilateral market liberalisation initiative of the ROK Government and was concluded in October 2002. After difficult debates on the future of the ROK agricultural sector, the Agreement was ratified by the National Assembly in February 2004, and it entered into force on 1 April 2004.

Contrary to initial concerns, the Agreement has brought about a substantial increase in bilateral trade without any significant effect on the agricultural sector. As a result of the Chilean FTA, South Koreans have become more confident about the benefits of pursuing economic liberalisation through FTAs. The Agreement has helped the public to realize that the promotion of FTAs is essential for the country to maintain its position as a global exporter in the world market. It served to pave the way for the ROK to engage FTA negotiations with much larger economies, such as the US and the EU.

The ROK concluded an FTA with Singapore in 2006. The Singaporean FTA goes beyond tariff elimination to include provisions on services, investment, information and personnel. It includes a provision to recognize the goods produced in the Gaesong Industrial Complex in North Korea as originating in the ROK.

The ROK also concluded a comprehensive FTA with the European Free Trade Association (EFTA) in 2006.[76] The Agreement covers not only the elimination of tariffs on industrial goods but also the liberalisation of agricultural products, services, investment and government procurements. The ROK-EFTA FTA is expected to provide the ROK with opportunities to enhance the competitiveness of its service sector and to expand its export market into Europe. KIEP, a government-run think tank, estimated that the ROK-EFTA FTA would increase the ROK's GDP by between 0.02 and 0.05 per cent.

In addition, the ROK and nine out of the ten ASEAN member states — Thailand was the exception — concluded an FTA on goods only in 2007. The Agreement aims at liberalizing merchandise trade by 2010. According to KIEP's analysis, the FTA would boost the ROK's GDP by US$14.6 billion over short term and $18.2 billion over the long-run. The ROK and ASEAN concluded an FTA on services and investment in November 2007.

In 2007, the ROK concluded an historic trade agreement with the US. The Korea-US FTA (KORUS) will be the ROK's most significant FTA. The comprehensive Agreement will eliminate tariffs and other barriers to trade in goods and services, promote bilateral investments, and enhance transparency of institutions. The FTA with the US will bring significant and tangible economic benefits to both countries by promoting bilateral trade and investment. According to estimates by KIEP, the FTA would increase the ROK's GDP by between 0.32 and 5.97 per cent. The FTA is awaiting ratification by both countries.

Prospective FTAs

The ROK is currently engaged in FTA negotiations with ASEAN, Canada, the European Union (EU), Mexico, and India.

Exploratory discussions on an FTA with Canada were concluded in May 2005, and negotiations were launched in July that year. KIEP estimated the FTA with Canada would increase the ROK's economic welfare by approximately US$1.5 billion.

The ROK and the EU have commenced negotiations and the first round was held in May 2007. The removal of tariffs and barriers to merchandise and services trade, the liberalisation of investment and the administration of customs have been discussed. According to the analysis by KIEP, the ROK's GDP would increase by 1.3 per cent in the short run to 1.9 per cent in the long run due to an FTA with the EU.

76 The EFTA is comprised of Iceland, Norway, Switzerland, and Liechtenstein.

The ROK and Japan have so far held six rounds of negotiations on an FTA between them. The talks, however, have been deadlocked due to differences over the levels of the market opening in the agricultural sector and diplomatic difficulties over Japan's territorial claim over Dok Island. Resumption of the talks relies heavily on political will in the two countries.

The ROK launched FTA negotiations with Mexico and India in 2006. The ROK is also reviewing possibilities for an FTA with its major trading partners such as China, MERCOSUR and the GCC. A joint study on a ROK-MERCOSUR FTA was completed in November 2006. A study on a ROK-China FTA is currently under way. Current negotiations with ASEAN are aimed at liberalizing investment.

Table 2.2: Current Status of ROK FTA Initiatives

FTAs concluded/signed	FTAs under negotiation	FTAs under consideration/proposed
Chile (Entry into force April 2004)	The EU (May 2007)	China
Singapore (Entry into force Mar. 2006)	ASEAN(investment Feb. 2005)	MERCOSUR
EFTA(Entry into force Sep. 2006)	Canada (July 2005)	GCC
ASEAN(goods)(Entry into force June 2007)	Mexico (Feb. 2006)	Australia
United States (Concluded April 2007)	India (Mar. 2006)	Russia
ASEAN (services, signed Nov. 2007)	Japan (Interrupted)	New Zealand

If the ROK's FTA negotiations go ahead as scheduled, it will succeed in pursuing FTAs with bridgehead countries in every continent, its major trading partners, and emerging economies in the Asia Pacific region.

Liberalisation commitments under FTAs

ROK-Chile FTA

Negotiations on manufactured goods, forest and fisheries products were completed at a relatively early stage. The ROK agreed to eliminate 99.9 per cent of its tariffs on manufactured goods originating from Chile when the FTA entered into force.

The agreement on agricultural products identified ten different types of schedules for the elimination of tariffs:

- immediate elimination;
- elimination over either five, seven, ten, or sixteen year periods;
- seasonal tariffs to be liberalized over a transitional period of ten years on a seasonal basis;
- tariff quota plus negotiation after Doha Development Agenda (TRQ+DDA);

- discussion after the DDA negotiations; and
- liberalisation exemptions.

The immediate and the five-year elimination schedules cover products such as mixed feeds, pure-bred breeding animals, and silk fabrics, which barely affect ROK industries. The 7 – 16 year elimination schedule covers items such as processed fruits, food and groceries, which will ultimately not be subject to tariffs, but which should go through a period of adjustment. The seasonal tariff schedule eliminates tariffs on Chilean grapes over a ten-year period from November to April when no grapes are harvested in the ROK.

The TRQ+DDA schedule includes beef, chicken, whey, and plums, certain amounts of which will be imported tariff free. Imports exceeding the predetermined volume will be subject to the existing tariff rate and renegotiated after DDA. Items to be negotiated after the DDA include garlic, onions, peppers and certain dairy products, which are currently subject to high tariff rates. They will be treated as exceptions temporarily and put on the agenda for discussion after the DDA negotiations of the WTO.

Liberalisation of investment under the ROK-Chile FTA requires both parties to provide national and most-favoured-nation treatment to the investments from the other party, and not to set nationality requirements for senior management. The scope of investment is to be expanded to include all kinds of investment, direct and indirect. Negotiations on investment protection for financial institutions such as banks, insurance companies, and savings and finance companies will be reopened four years after the FTA takes effect.

In services, an institutional system will be implemented to ensure national treatment for service providers, to prohibit restrictive measures and to facilitate service trade between the two parties. This is only applicable for cross-border services and not for services that are provided by carriers residing in the other country. The following areas are also excluded from the Agreement:

- non-commercial public services;
- financial services;
- air services;

ROK-Singapore FTA

Under the ROK-Singapore FTA, the ROK agreed to remove tariffs on most of Singapore's exports to the ROK. Certain products which pose competitive challenges to ROK industry have their tariffs phased out over a period of either five or ten years. Almost 75 per cent of Singaporean exports to the ROK enjoy immediate tariff elimination. This includes products ranging from freshwater ornamental fish to woven cotton fabrics as well as electronics, electrical equipment and chemicals. Agricultural products were included in the FTA given Singapore's keen interest in the processed food industry. Products such as three-in-one coffee mixes, chocolate confectionery, flour and tea concentrates will benefit from tariff reductions under the ROK-Singapore FTA.

In services, both countries are assured of non-discriminatory treatment and there is a mechanism to lock in future liberalisation of exempted measures to create certainty in the business climate. In the education sector, the ROK agreed to provide access to the ROK market in the areas of language education (certified language programs like TOEFL and

TOEIC), corporate training and service quality programs. In addition, contract manufacturers are free to provide services that support the manufacture of machinery (office, computing, and electrical), communications equipment, medical precision and optical instruments, rubber and plastics products. The ROK also agreed to provide access to its courier services sector. In financial services, the Korean Stock Exchange (KSE) and the Singapore Exchange (SGX) are to be encouraged to work towards a KSE-SGX linkage that can enhance the liquidity pool in both markets and range of products available to investors in the two countries.

The ROK and Singapore agreed to explore cooperation in research and training activities that will enhance the development of ICT, particularly e-commerce, in both countries. Both countries also reaffirmed and strengthened their commitment to ensure telecommunications companies operating or intending to operate in the other country are accorded non-discriminatory treatment, with specific obligations on the dominant suppliers in both countries.

ROK- EFTA FTA

In the ROK-EFTA FTA framework, the ROK agreed to remove tariffs on 99.1 per cent of products originating from EFTA over a maximum period of seven years. Some sensitive agricultural and fishery products will either be exempt or the tariffs on these items will be removed over a maximum period of ten years.

In investment, the ROK also agreed to strengthen foreign investor protection of EFTA investors. This is particularly significant as EFTA is a major source of foreign investment. The ROK and EFTA dramatically improved on the Bilateral Investment Treaty that was concluded between the ROK and Switzerland in 1971 by including clauses on investor protection and areas for liberalisation.

Liberalisation of the services sector was accelerated in the FTA. This was based on plans to open up services under the WTO negotiations. In addition, the ROK and EFTA agreed to include cooperative measures in broadcasting services in the FTA. By establishing a basis for the joint production of TV broadcasting programs, the ROK-EFTA FTA is expected to facilitate the penetration of ROK broadcasting programs into the EU.

ROK-US FTA

Under the terms of the Korea-US FTA (KORUS), about 94 per cent of bilateral trade in consumer and industrial products will become duty-free within three years of entry into force of the agreement. These include products such as industrial and consumer electronic machinery and parts, auto parts, power generation equipment, the majority of chemicals, medical and scientific equipment, motorcycles, and certain wood products. Most of the remaining tariffs will be eliminated within ten years.

The ROK agreed to allow trade in remanufactured goods under the Agreement. This will provide significant export and investment opportunities for US firms involved in remanufactured products such as medical equipment, machinery, and auto parts. The ROK also agreed to overhaul its auto-related tax scheme under which a special excise tax of 5 per cent is levied on automobiles.

More than half (or $1.6 billion) of current US agricultural exports to the ROK will become duty-free immediately on entry into force, including wheat, corn for animal feed, soybeans for crushing, hides and skins, and cotton, plus a broad range of high value agricultural products such as almonds, pistachios, bourbon whiskey, wine, raisins, grape juice, orange juice, fresh cherries, frozen French fries, frozen orange juice concentrate, and pet food. Those products with two-year tariff phase-outs include avocados, lemons, dried prunes, and sunflower seeds. In addition, the product category with five-year tariff phase-outs include food preparations, chocolate and chocolate confectionary, sweet corn, sauces and preparations, breads and pastry for example.

The ROK and U.S. agreed to exclude rice from tariff cuts and maintain current tariffs on some sensitive products such as oranges, beans, powdered milk and other imported agricultural products. The ROK will maintain safeguard measures and a tariff rate quota (TRQ) on such goods as pork, beef, and some other agricultural products.

All forms of investment are protected under the agreement.

In the FTA framework, the ROK vastly improved upon its WTO commitments in services, providing meaningful market access commitments that extend across virtually all major service sectors. Significant progress was made in express delivery services, where the ROK provided greater and more secure access and charted a course for future domestic reform. The ROK also provided access to foreign legal consulting services for the first time. Other areas of improved access being phased in include the following sectors: R&D, legal, accounting, maintenance and repair of equipment, environmental, telecommunications, audio-visual, and services incidental to mining.

The ROK did not liberalise public services such as education and medical care. Restrictions on foreign movies will be maintained; these require local theatres to run domestically produced movies for at least 73 days of the year.

In financial services, the FTA provides for a temporary safeguard measure which controls sudden and massive capital outflows in case of financial crisis. The ROK's state-run financial institutions such as Korea Development, the Industrial Bank of Korea and the Korea Housing Finance Corporation are not on the list of the financial sector's agreement.

In telecommunication services, the ROK will lift regulations that bar foreign investors from owning more than 49 per cent of the country's major telecommunications firms that provide core networks and services, no later than two years after the FTA enters into force.

2.1.3 Multilateral trends

2.1.3.1 Developments in the WTO Doha Round

The Doha Round of multilateral trade negotiations was launched in 2001 in Doha, Qatar. WTO members agreed to commence a new round of trade negotiations for liberalisation of agricultural goods, industrial products, intellectual property and services. The final package is not to be adopted until negotiated outcomes in all areas are agreed (termed the 'single undertaking').

Six years on, negotiations have progressed slowly. The Cairns Group of agricultural exporters and some developing countries, such as Brazil and India, have pressed developed countries such as the EU and US to go significantly further in cutting their tariffs on agricultural goods and reducing their domestic subsidies to farmers. The EU and the US have been reluctant to do this without offers for further liberalisation in industrial products and services from the developing countries. Australia, as Chair of the Cairns Group of agricultural exporters, has pushed strongly for agricultural reform in both developed and developing countries, and supported further liberalisation in both industrial products and services. The ROK, a member of the G-10 group of countries, has sought to maintain agricultural protection for its farmers in sensitive areas, while advocating wider liberalisation for manufactured goods and services.

By July 2004 WTO members had been able to agree on a broad framework for further liberalisation. However, this agreement did not address many of the outstanding and difficult issues still to be negotiated. (For example, how the formula for tariff reductions in agriculture or in industrial goods might apply to developing countries on the one hand and developed countries on the other.) The continued divergence in negotiating positions culminated in a temporary suspension of negotiations in July 2006. Although they officially resumed in January 2007, progress has been slow. WTO members have yet to reach agreement on the degree to which agriculture, industrial products and services will be liberalised.

While it is hoped the main elements of a Doha outcome can be agreed by early 2008, the prospects remain uncertain. Further liberalisation in the short term is more likely to occur as a result of unilateral, bilateral or plurilateral liberalisation.

Importantly, the slow pace of negotiations does not diminish the WTO's ability to administer existing commitments to liberalisation and enforce compliance with them. Commitments to liberalise already made by members are legally binding and are not affected by current negotiations.

2.1.3.2 Developments in APEC

Trade has been a core focus of the Asia Pacific Economic Cooperation (APEC) forum since its inception. Members have pledged to reach the Bogor Goals of free trade in the region by 2010 for developed member economies and 2020 for developing member economies. Recognising the positive flow-on effects of high-quality regional and bilateral trade liberalisation on the broader liberalisation agenda, in November 2005 APEC Leaders declared the promotion of high-quality regional trade agreements (RTAs) and FTAs as an element of the Busan Roadmap towards the Bogor Goals.

APEC has encouraged members to conclude comprehensive agreements which are consistent with WTO rules and disciplines by developing a set of best practice principles for the development of RTAs and FTAs — see Box 2.1 for a summary. They were adopted in 2004 to guide APEC members when negotiating such agreements. They are intended to encourage a coherent and consistent approach to the design and content of regional and bilateral agreements consistent with the Bogor Goals.

Box 2.1 APEC Best Practice Principles for RTAs and FTAs

Consistency with APEC Principles and Goals. RTAs and FTAs should be consistent with APEC goals/ This is to ensure they promote structural reform among the parties through the implementation of transparent, open and non-discriminatory regulatory frameworks and decision-making processes;

Consistency with the WTO. FTAs and RTAs should be fully consistent with the disciplines of the WTO.

Go beyond WTO commitments. FTAs and RTAs should build upon existing WTO **o**bligations. It should also explore commitments to liberalise trade and investment in areas that are not covered, or only partly covered, by the WTO. This helps to ensure that the economies in question are in a better position to provide leadership in any future WTO negotiations on these issues.

Comprehensiveness. FTAs and RTAs should be comprehensive in scope, and provide for liberalisation in all sectors. They should recognise phase-out periods and take into account the different levels of development among the parties. They should be seen as an opportunity to undertake liberalisation in all sectors as a first step towards multilateral liberalisation at a later stage.

Transparency. FTAs and RTAs should provide for public availability of information and notification and reporting of new and existing agreements in line with WTO obligations and procedures.

Mechanisms for consultation and dispute settlement. RTAs and FTAs should include proper mechanisms to prevent and resolve disagreements in an expeditious manner, such as through consultation, mediation or arbitration, avoiding duplication with the WTO dispute settlement mechanism where appropriate.

Cooperation. RTAs and FTAs should include commitments on economic and technical cooperation in the relevant areas.

Accession of Third Parties. Consistent with APEC´s philosophy of open regionalism and as a way to contribute to the momentum for liberalisation throughout the APEC region, RTAs and FTAs should be open to the possibility for accession of third parties on negotiated terms and conditions.

Provision for periodic review. RTAs and FTAs should allow for periodic review. This is to ensure that the terms of the agreement are fully implemented by each party. It also necessary to ensure the terms of the agreement evolve over time so that they continue to provide the maximum possible economic benefit to the parties in the face of changing economic circumstances and trade and investment flows.

The APEC principles set out the characteristics that a high quality FTA or RTA should possess, including consistency with APEC Principles and Goals and consistency with the WTO rules and disciplines. Such agreements should build upon multilateral liberalisation in the WTO and be comprehensive in their scope. FTAs should apply transparency, include mechanisms for consultations and disputes settlement, provide for cooperation and accession of third parties and be subject to periodic review in the face of changing economic circumstances.

Members have also committed to developing, by 2008, model measures for the promotion of High-Quality FTAs and RTAs that are consistent with the APEC principles. The model measures reflect the general APEC principle of voluntarism and are neither mandatory nor exhaustive. They are not in legal language that might be used in an agreement. The model measures are indicative examples to provide members with useful reference in negotiating RTA/FTA provisions. They are not intended to prejudice the positions of APEC members in any of their current or future trade negotiations.

To date model measures have been developed for trade in goods, technical barriers to trade, transparency, government procurement, cooperation, dispute settlement, trade facilitation, rules of origin and origin procedures, electronic commerce and sanitary and phyto-sanitary procedures.

Recently APEC Leaders, at their meeting in Sydney in September 2007, agreed to a work program which builds on these models measures as a means to support further regional integration through RTAs/FTAs. They affirmed their intent to complete model measures for FTAs and identify ways to facilitate their use as a guide for negotiating RTAs and FTAs. They committed to expand dialogue to examine ways to achieve greater consistency in key provisions of RTAs/FTAs in the region.

At the meeting in Sydney, Leaders agreed to consider the prospect of a possible FTA of the Asia Pacific (FTAAP). They endorsed a report on strengthening Regional Economic Integration (REI), which establishes a work program on the FTAAP and on RTAs/FTAs more generally.[77]

Recommendations for further exploring a FTAAP include compiling an inventory of issues relevant to an FTAAP to be addressed as part of a possible preparatory process and their possible implications; conducting an analytical study of existing bilateral and plurilateral free-trade agreements in the region with the aims of increasing knowledge of their similarities and differences; undertaking a review of existing analytical work relevant to a possible FTAAP and examining the feasibility of docking or merging existing free trade agreements.

2.2 Implications for the bilateral economic relationship

(a) The rise of bilateral and regional free trade agreements

Threat of third party preferential treatment

As Australia's and the ROK's FTAs with third countries have resulted in the extension of preferential market access to enterprises from those countries, they have introduced discrimination against Australian and ROK enterprises in one another's market vis-à-vis their competitors from those third countries.

The impacts will depend on a range of factors including the level of tariffs and other barriers to two-way trade, the scale of trade and investment flows, and the comparative advantages of the two economies. They will be greatest in areas where bilateral trade and investment is high and where either Australia or the ROK are globally competitive.

[77] The report '*Strengthening Regional Economic Integration A Report on regional economic integration including a possible Free Trade Area of the Asia Pacific as a long-term prospect*', can be accessed at www.apecsec.org.

Preferential access to the ROK market granted to US producers under KORUS has the potential to adversely impact on agricultural trade between Australia and the ROK, in particular. According to the National Farmers Federation (NFF), if KORUS is ratified, Australian exporters of beef, sheep and goat meat, dairy (cheese, butter, skim and whole-milk powders), roasting barley, molasses (and other sugars), cotton seed and some root crops (potatoes) will see their competitiveness in ROK markets begin to erode progressively within three to eight years as substantial tariff quotas at zero duty are created for US competitors.[78] A recent study estimated that its cost to the Australian food and agriculture sectors could be as high as A$800 million in output foregone to 2030.[79]

Australia's beef exports to the ROK will be affected. Australia is a low cost and globally competitive beef producer. Australian beef exports currently face very high tariff barriers in the ROK market, at 40 per cent, where they compete directly with US beef exports. Under KORUS, the tariffs on US beef will be progressively eliminated over 15 years but those on Australian beef will be unchanged. Other things being equal this will lead to a loss of market share by Australian producers and a parallel gain by US producers. A similar situation applies to offal. Tariffs on US offal will likewise be progressively reduced to zero over this period from the current levels of 18-27 per cent, which will continue to be applied to Australian offal.

Dairy exports to the ROK will also be affected. The ROK is an important market for Australian exports of cheese, and a growth market for exports of butter blend.[80] Dairy Australia notes that if ratified, KORUS moves significantly towards free trade in dairy products between ROK and the US, with all dairy products eventually achieving free trade within 15 years. Tariffs on whey and dairy spreads, frozen cream and yoghurt, milk and cream and some infant formula preparations are to be reduced progressively. Tariff rate quotas for products such as whey powder, butter, cheese and milk powered preparations will be set allowing for some growth until eventual elimination. In quota tariffs will be set at zero for TRQ trade.[81]

Similarly, competitive disadvantages suffered by ROK exporters of manufactures as a result of preferential treatment accorded to third parties under Australia's FTAs, could adversely impact on bilateral trade.

The ROK has a-comparative advantage in manufacturing transport equipment, machinery, chemical and rubber products and electrical machinery. It is a globally competitive, low cost supplier of automobile parts to Australia. In addition to Australia's long-term plan for tariff reductions in the automotive sector, those countries that have signed a free trade agreement with Australia will experience either the complete abolition of its automotive tariffs or, at least a further reduction in any ongoing tariff rates. For example, provisions under the Australia-US FTA (which came into effect in 2005) provide for tariffs on automobiles and automotive parts from the US to be phased-out over ten years with 2 per cent annual reductions annually until 2010. Third parties,

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[78] NFF, *NFF Submission to the Australia-Korea Non-Government Free Trade Agreement Study*, 2007, p. 1.
[79] Davis, Hanslow and Andrew Stoeckel (2007) *Impact pf KORUS on Australian Agriculture*, Centre for International Economics, Sydney and Canberra, Australia, August 2007
[80] Australian exports of cheese were over $130 million in 2005 and 2006. Butter blend were worth US$8.4 million in 2004 and 2005, up from $US 332,000 in 2001. [Source Dairy Australia, 2007].
[81] Information provided by Dairy Australia, 2007. Out of quota tariffs will be bound at the MFN rate or the applied MFN rates (which ever is lower).

including the ROK, will continue to face a 5 per cent tariff on automobiles and parts after 2010.

Tariff concessions accorded by Australia to imports of vehicles and automotive parts from Thailand under TAFTA also discriminate against imports from the ROK. In TAFTA, tariffs on Thai motor vehicles, and automotive parts and components were eliminated with varying phasing arrangements.

In the case of TCF under the Australia-US FTA, the annual 1 per cent reduction in tariffs will result in a zero per cent tariff rate in 10 years, bestowing upon the US a distinct export advantage compared to the other countries. As a result, the ROK will be in a weaker competitive position compared to the US, and to a lesser extent Thailand.

Bilateral trade in these and other areas where the ROK is internationally competitive, such as electrical equipment and steel, could also be further adversely affected by concessions accorded by Australia under subsequent FTAs to ROK competitors such as China and Japan.

The impact on Australia and the ROK of commitments by the other to liberalise services and investment with third parties are harder to measure. This is because the opening up of services and investment to one country under a bilateral agreement can either substitute for or complement merchandise trade flows.

There is a natural preference for Australia and the ROK to counteract any competitive disadvantages that each suffers from preferential agreements between the other country and a third party. They also wish to maintain or improve their competitive trading strengths. Both factors strengthen their mutual desire for a bilateral FTA which provides better or at least the same terms of access for either party.

From an economic perspective, preferential treatment compared to third parties is not a sound basis for an FTA. Economic benefits are derived by creating rather than diverting trade. This implies reducing restrictions across the board, rather than simply creating preferences for some (this is discussed in further detail in Chapter 4). In practice, preferential treatment does not always arise from immediate reductions in applied tariffs. In the case of Australia's FTA with Singapore, for example, for almost all products Singapore's tariff commitments simply bound tariffs at the applied MFN rate (which are zero). Furthermore, there is nothing to prevent a party from eliminating any preferential treatment (in the sense that the FTA tariff is lower than the applied MFN rate) by reducing the MFN rate applied to third parties to remove the difference.

More importantly, FTAs generally do not create preferences in services as government regulation tends to be non-discriminatory in most countries. As a rule, FTA commitments are generally about securing non-discriminatory treatment, rather than greater market access for service providers from the FTA partner.

Opportunities for deeper economic integration

FTAs between Australia or the ROK and third parties also offer potential opportunities for expanding bilateral trade between Australia and the ROK. They also deepen the extent of economic integration between them.

FTAs also help to remove domestic regulatory impediments to welfare enhancing economic integration. The removal of such impediments are an increasingly effective means of driving economic growth more generally as well as enhancing the economic basis of the bilateral relationship. In an environment where traditional trade barriers (such as tariffs) are low, removing regulatory barriers to services trade and investment 'beyond the border' (such as competition policy) has become increasingly important.

The benefits of a potential FTA in this regard are discussed further in Chapter 4.

(b) Progress in the WTO Doha Round

Opportunities for further liberalisation

Assuming the Doha Round of multilateral negotiations are successfully concluded, opportunities exist to expand the bilateral trade and investment relationship through further, non discriminatory liberalisation. The negotiations offer the prospect for improved market access for trade in goods and services.

If the agricultural negotiations conclude, the ROK's agriculture sector will be further liberalised, increasing market access opportunities for Australia, as well as other exporters on equal terms. The National Farmers Federation estimates that assuming that the Round concludes with duty reductions that follow the G-20 proposals of October 2005, then ROK duties on Australia's agricultural exports would be cut by between 25 and 30 per cent, depending on the initial level of protection.[82]

Further liberalisation of industrial products by Australia and the ROK would also be realised, albeit limited. WTO Secretariat simulations of cuts in industrial protection under the formula currently proposed, would see average applied tariffs in Australia fall from 4.2 precent to between 2.7 and 2.9 per cent. Applied tariffs on industrial products in the ROK would fall from 6.5 per cent to between 3.9 and 4.1 per cent.

Table 2.3: Prospects for Doha Round MFN tariff cuts on selected agricultural products of interest to Australia

Tariff range (per cent)	G-20 Proposed cut (per cent)	Product	Pre-Doha ROK MFN tariff (per cent)	Post Doha ROK MFN tariff (per cent)
<30	25	Sheep meat Sugar	22.5 3	16.88 2.25
30 - 80	30	Cheese Butter Bovine Meat	36 40 40	25.2 28 28

Source: WTO Secretariat, 2007.

Opportunities to deepen bilateral trade through multilateral liberalisation exist particularly in services, where both the ROK and Australia have supported further liberalisation.

82 NFF 2007, p. 23. This assumes that Korea did not claim "sensitive" or "special" protection and that Korea took advantage of developing country rates of reduction.

In their revised offers of 2005, the ROK has generally proposed making further commitments to liberalise in areas of business mobility, professional services, communications services, construction and distribution, private education, banking and financial services, entertainment and maritime transport.

Although already relatively open, Australia has proposed further liberalising business mobility, business services such as legal services, some construction services, environmental services, insurance and banking and some transport services

Both Australia and the ROK have also been party to plurilateral initiatives[83] for liberalisation across particular service sectors in the negotiations. Both countries have sought to advance market opening and reduce discriminatory treatment in the following areas - architectural, engineering and integrated engineering services, computer and related services, construction, energy, environmental services, financial services, maritime transport and telecommunications.

Should the Doha Round negotiations conclude, they represent opportunities to strengthen bilateral services trade through greater liberalisation of the services sectors in both economies. Multilateral liberalisation within the WTO remains a core priority for both parties. FTAs have a role to play in advancing this multilateral objective, provided that they are consistent with and build upon the parties' WTO commitments.

Supporting multilateral liberalisation

The adoption of the APEC principles for RTAs and FTAs is a useful way of ensuring that FTAs concluded remain consistent with and supportive of the WTO and serve to facilitate rather than undermine liberalisation at the multilateral level. To date FTAs concluded by Australia have been consistent with the APEC principles in applying a comprehensive coverage, consistency with WTO rules and extension of liberalisation commitments in key areas. There are complementarities with the approach taken by Korea in its FTAs, in particular the recent agreement with the US.

[83] Whereby small groups of countries interested in particular sectors request market openings of a number of other WTO Members.

3. Measures affecting bilateral trade and investment

3.1 Measures affecting merchandise trade

3.1.1 Measures affecting Australian exports to the ROK

3.1.1.1 General levels of protection

Tariffs are the ROK's main instrument of trade policy.[84] The average applied tariff level across all ROK merchandise imports is 13 per cent in 2006.[85] Its bound tariff rates are slightly higher, averaging 17 per cent. Both levels are high by the standards of other OECD countries.[86] They largely reflect the ROK's 'dualistic' approach to border protection, whereby relatively high tariffs are applied to agricultural products and relatively low tariffs to industrial ones.

The ROK's agricultural sector is protected by tariffs that are applied at an average rate of 48 per cent and bound at an average of 61 per cent. Industrial products, by contrast, have an average applied rate of 7 per cent, and an average bound rate of 10 per cent. Manufactured goods (averages of 7 per cent applied and 12 per cent bound) are subject to higher tariff rates than minerals and ores (averages of 3 per cent applied and 5 per cent bound) or metals (averages of 6 per cent applied and 9 per cent bound). 99 per cent of ROK applied tariffs are on an *ad valorem* basis, meaning they are expressed as a percentage of landed value of the product in question. In a few instances, bound tariffs are in specific rates.

Many tariff lines maintain a large 'binding overhang'. This is the gap between the applied tariff rate and the bound rate, the latter being the maximum tariff rate that a member of the World Trade Organisation (WTO) is allowed to levy under its treaty obligations. Large gaps between applied and bound tariffs allow the ROK to manage import flows by adjusting the tariff rates that it applies from time to time.[87]

The ROK uses autonomous tariff quotas to apply concessional tariffs, mainly to raw materials, inputs, semi processed goods, components, parts, and engines.[88] These quotas are issued annually and operate in much the same way as TRQs do, by providing lower 'in quota' tariff rates. 'In-quota' tariff rates ranged from zero to 30 per cent. These quotas are autonomous in the sense that the quota volume is determined by the Government without the constraint of any international trade commitments.[89] For some of these products, the ROK sets an unlimited quota volume, with the 'in quota' tariff rate set at zero. This effectively allows the products in question duty-free access to the ROK market without technically reducing applied tariff rates.[90]

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84 WTO 2004
85 The average tariff rates in this section were calculated on a weighted basis, with the relevant import volumes as the weights. Details of all tariff and quota rates in the ROK were sourced from WTO 2004.
86 Organisation for Economic Cooperation and Development [OECD], *Economic Survey of Korea: Economic Prospects and Macroeconomic Policies*, Paris, 2005.
87 NFF 2007, p. 6.
88 WTO 2004.
89 Asia Pacific Economic Cooperation (APEC), '*APEC Individual Action Plan Study Report – Korea 2007*', 2007, p.18.
90 WTO 2004.

Only one product –rice - is the subject to of a quantitative import quota. In 2007, the ROK's minimum market access quota for rice was 226,269 metric tonnes, which will rise in equal increments each year to 408,700 tonnes in 2014. The quota is allocated as country specific quotas (CSQ) for China, the United States, Thailand and Australia, as well as a global quota administered on a Most Favoured Nation basis.[91] As part of its Uruguay Round commitments, the ROK has progressively increased its annual rice quota to 205,228 tonnes (milled basis.

In addition to tariffs and quotas, Australian exporters face non tariff measures in the ROK market in the form of standards, labelling requirements, administrative practices and tax treatment for local products. For example, Australian business considers the ROK's labelling requirements for imported liquor, which require the inclusion of up to 18 pieces of information in Korean on labels, are excessive and expensive to comply with.[92]

The ROK is continuing a process of revising and harmonising its national industrial standards, regulations and other measures so as to bring its domestic policies into alignment with its international trade commitments. It is promoting, for example, the application of uniform standards in central government ministries to overcome inconsistencies and to improve efficiency.[93]

3.1.1.2 Measures in Key Product Areas

The following discussion is based on those products that are of most interest to Australia. These are defined by the products that currently constitute Australia's major exports overall.

(i) Agriculture and food

Korea applies tariff rate quotas (TRQs) for 63 product groups, including agricultural and food products. Products that are under TRQs are subject to the imposition of an 'in quota' tariff rate on a certain volume of imports (the 'quota') and when imports exceed the quota volume, a higher 'out of quota' tariff rate is applied to the excess. While not technically considered non-tariff barriers to trade under WTO rules, according to Australian business, their level and administration can effectively act as a barriers to trade by constraining imports.

The details of tariff and quota arrangements that apply to Australia's major agricultural exports are set out in Table 3.1. Rates are based on official sources available at the time of writing.

Since the abolition of the tariff quota in 2001, beef products have been subject to a single tariff rate. For fresh, chilled and frozen beef, the applied rate is 40 per cent, and for offal it is 18 per cent. Despite the removal of tariff quotas, the OECD estimates the overall

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[91] In 2006, Australia's CSQ was 9,030 tonnes.[91] The current drought in Australia has been so severe that Australia has not been able to fulfil its CSQ in 2006 and 2007.

[92] Australian Wine and Brandy Corporation, *Submission to DFAT Australia-Republic of Korea Free Trade Agreement Study*, 2007, p5.

[93] WTO 2004.

level of protection given to beef production in the ROK remains relatively high at 66 percent.[94] There is also a tariff of 22 per cent on sheep meat.

Forage products are subject to three different applied tariff rates.[95] Lucerne and alfalfa in bales are levied at 10 per cent and 18 per cent respectively. Both forage roots and other forage products are subject to TRQs. The first 32,133.3 tonnes of each product attracts a duty of five per cent but beyond that the tariff is 100.5 per cent. Wine tariffs apply at 15 per cent, and are bound at 30 per cent.

TRQs apply to concentrated milk and cream products.[96] The 'in quota' tariff rates range from 20 to 40 per cent, and the 'out of quota' rates from 89 to 176 per cent.[97] Cheese and curd products are not subject to quota but are subject to an applied tariff rate of 36 per cent.

Tariffs on wheat for milling and feeding are applied at the bound rate of 1.8 per cent.[98] Raw cane and beet sugar have applied tariff rates of 3 per cent. However, refined cane or beet sugar containing additives and other kinds of sugar have a 50 per cent applied tariff. In each case, the bound tariff is an *ad valorem* rate of 85.1 per cent or a specific rate of W 199.8 per kilogram, whichever is the greater.

Table 3.1: ROK quotas & tariff rates, major agricultural exports by Australia

Product	Bound tariff (range in per cent)	Applied tariff (range in per cent)	In quota tariff (range in per cent)	Out of quota tariff (range in per cent)	Quota volume (tonnes)
Fresh or chilled beef	40	40	n/a	n/a	n/a
Frozen beef	40	40	n/a	n/a	n/a
Beef offal	18	18	n/a	n/a	n/a
Lucerne	10	10	n/a	n/a	n/a
Alfalfa	18	18	n/a	n/a	n/a
Forage roots	105.5	105.5	5	105.5	32,133.3
Other forage products	105.5	105.5	5	105.5	32,133.3

94 The OECD has estimated that the Producer Subsidy Equivalent (PSE) for beef production in the ROK in 2003 was 66 per cent (see *OECD Agricultural Policies 2004: At a Glance*, AGR/CA/APM (2004)2/FINAL, 3 June 2004). The PSE is a measure of the overall degree of border protection that is given to an economic activity as a consequence of the domestic and trade policy measures of the country in question.

95 'Forage products' refers to HS code 1214: swedes, mangolds, fodder roots, hay, lucerne (alfalfa), clover, sainfoin, forage kale, lupins, vetches and similar forage products, whether or not in the form of pellets

96 This includes skim milk powder, evaporated milk and whole milk powder.

97 Three products are levied at 20 per cent on the first 573 tonnes, after which a duty of 176 per cent applies. Another three have duties of 40 per cent on the first 1,034 tonnes, and then a duty of 176 per cent applies. Four have duties of 40 per cent for the first 130 tonnes, after which a duty of 89 per cent applies.

98 According to WTO 2004, there is an autonomous tariff rate quota applying to wheat for feeding and wheat for milling with an in-quota rate of 1 per cent, an out of quota rate of 3 per cent and quantities of 1.55Mt and 2.6Mt respectively. This appears to be inconsistent with the bound rate (shown in Uruguay Round tariff schedule) and the applied rate (DFAT 2007 statistics) of 1.8 per cent.

Product	Bound tariff (range in per cent)	Applied tariff (range in per cent)	In quota tariff (range in per cent)	Out of quota tariff (range in per cent)	Quota volume (tonnes)
Concentrated milk or cream products – in solid form	89 to 176	89 to 176	20 to 40	89 to 176	573 (whole milk powder) 1034 (skim milk powder) 130 tonnes per product (evaporated milk)
Butter	89	89	40	89	420
Whey products	36 to 49.5	49.5	20	49.5	54,233 (per product)
Cheese and curd products	36	36	n/a	n/a	n/a
Wheat – for feeding[99]	1.8	1.8	n/a	n/a	n/a
Wheat –- for milling [100]	1.8	1.8	n/a	n/a	n/a
Rice	n/a	n/a	5	n/a	205,228
Raw cane sugar	3	3	n/a	n/a	n/a
Beet sugar	3	3	n/a	n/a	n/a
Refined cane sugar containing additives	85.1per cent or W 199.8 per kg, (whichever is greater)	50	n/a	n/a	n/a
Refined beet sugar containing additives	85.1per cent or W 199.8 per kg, (whichever is greater)	50	n/a	n/a	n/a
Wine	30	15	n/a	n/a	n/a

Source: WTO 2004

(ii) Minerals and ores

Tariffs on minerals and ores imported into the ROK are between 1 and 5 per cent (Table 3.2). The rates applied to imports of liquefied petroleum gas into the ROK were cut from 5 per cent to 3 per cent in August 2006. While no tariff is applied to imports of coal or iron, zinc, copper and lead ores, the ROK technically applies a duty of 1 per cent on imports of these products. Gold, copper, nickel and lead, are subject to applied tariffs of between zero and 8 per cent. Some aluminium products are subject to an 8 per cent tariff.

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[99] See footnote 96.
[100] See footnote 96.

In 2006 Australia accounted for 60 per cent of the ROK's iron ore imports, 29 per cent of ROK's coal imports, 19.3 per cent of ROK's aluminium imports, 25.7 per cent of ROK's copper, ores and concentrates, 42.1 per cent of ROK's nickel imports, 47.1 per cent of lead ores and concentrates imports, 31 per cent of ROK's zinc, ores and concentrates imports.

Table 3.2: ROK quotas & tariff rates, selected minerals & ores

Product	Bound tariff (per cent)	Applied tariff (per cent)	In quota tariff (per cent)	Out of quota tariff (per cent)	Quota volume (tonnes)
Liquefied natural gas	5	1	n/a	n/a	n/a
Liquefied petroleum gas	5	3	n/a	n/a	n/a
Crude oil	5	3	3	3	unlimited
Propanes & butanes	No	3	1.5	3	unlimited
Coal	1	1	0	1	
Iron, zinc, and lead ores	1	1	0	1	unlimited

Source: WTO 2004

Although tariffs are relatively low, other barriers exist. Access for bituminous coal imports into the ROK is limited by a tax exemption and a system of administered prices for domestically produced anthracite coal. The Government exempts anthracite coal, which is more expensive and of poorer quality than bituminous coal, from the 10 per cent value-added tax. It is recommended that the Korean Electric Power Corporation buy anthracite coal, which is domestically produced, at nearly twice the price of imported bituminous coal.

Korea adopts a management strategy for the supply of energy resource permits, given that it is the world's largest importer natural gas and imports 97 precent of its energy resources. Only the state-owned company, Korea Gas, is permitted to import gas, although other importers can import for self-consumption.

(iii) Metals

Most metals imported into the ROK, which are of interest to Australia, enter under the autonomous quota system, generally with unlimited volumes. Table 3.3 has the details.

The tariff rates that are applied to metals are relatively low. Gold, copper, nickel and lead, are subject to applied tariffs of between zero and 8 per cent, and bound rates between 5 and 11.8 per cent. Certain articles of nickel enjoy the lowest duties at zero to 2 per cent, whilst some aluminium products are subject to an 8 per cent tariff.

Autonomous quotas apply to alloyed unwrought aluminium and aluminium waste and scrap. The first 65 tonnes of alloyed unwrought aluminium is subject to a 3 per cent tariff; imports exceeding this amount are levied at 5 per cent. Aluminium waste and scrap is not subject to a 1 per cent tariff until 220 tonnes have been imported.

Table 3.3: ROK quotas & tariff rates, selected metals

Product	Bound tariff (per cent)	Applied tariff (per cent)	In quota tariff (per cent)	Out of quota tariff (per cent)	Quota volume (tonnes)
Zinc	3-13	1-8	n/a	n/a	n/a
Refined copper	10	5	n/a	n/a	n/a
Nickel	2	1-2	n/a	n/a	n/a
Unwrought lead	5-10	2-5	n/a	n/a	n/a
Aluminium – unwrought	5	5	3	5	65
Aluminium – waste and scrap	3	1	0	1	220

Source: WTO 2004

(iv) Manufactures

Imports of colours and dyes into the ROK have an applied tariff of 6.5 per cent, the same as its bound rate.[101]

Parts and accessories of motor vehicles and piston engines are both subject to a tariff of 8 per cent. The bound rates are both 13 per cent.

Iron and steel and cotton products are covered by autonomous quotas with unlimited quantities. The 'in quota' rates for these products are set at zero.

The ROK's textiles and garments industries receive modest tariff protection. Tariffs are applied to apparel at between 8 and 13 per cent and are bound at between 16 and 35 per cent.[102] Tariffs of 8 to 10 per cent are charged on textiles for industrial use, all bound at 13 per cent.[103]

There is no tariff protection on electronic circuits, and with an unlimited autonomous tariff rate quota applying, electrical parts used for transmission are also effectively tariff free. An 8 per cent tariff applies, however, to electronic bases.

An 8 per cent tariff applies to medicines. Medicine is included in the large majority of pharmaceuticals imports which do not appear to have bound tariffs. For the minority of pharmaceutical products which do have bound tariffs, the average rate is 0.4 per cent.

[101] HS code 3206.
[102] HS Chapters 61 and 62.
[103] HS Chapter 59.

Table 3.4: ROK quotas & tariff rates, selected manufacturing exports

Product	Bound tariff (per cent)	Applied tariff (per cent)	In quota tariff (per cent)	Out of quota tariff (per cent)	Quota volume (tonnes)
Beverages, spirits & vinegar	8 to 270	8 to 270	n/a	n/a	n/a
Chemicals	6.5	6.5	n/a	n/a	n/a
Motor vehicle parts & accessories	13	8	n/a	n/a	n/a
Piston engines	13	8	n/a	n/a	n/a
Iron & steel	0	0	0	n/a	unlimited
Wood chips		2	0	n/a	unlimited
Cotton	2 to 13	1	0	n/a	unlimited
Apparel	16 to 35	8 to 13	n/a	n/a	n/a
Textiles for industrial use	13	8 to 10	n/a	n/a	n/a
Medicines	n/a	8	n/a	n/a	n/a
Electronic circuits	0	0	n/a	n/a	n/a
Electronic parts used for transmission	10 to 13	0	8	n/a	unlimited
Electronic bases	n/a	8	n/a	n/a	n/a

Source: WTO 2004

3.1.2 Measures affecting ROK exports to Australia

3.1.2.1 General levels of protection

Australia maintains overall low tariff rates, with average applied tariff rates of 4.2 per cent and 4.6 per cent specifically on industrial products. However it retains a comparatively higher rate of tariff on automobile and TCF products.

However, the Australian Government has put in place a ten-year plan dedicated to the long-term reduction of tariffs for automobile and TCF products. Starting from January 1, 2005, the tariffs imposed on textiles and automobiles reduced from 15 per cent to 10 per cent, and by 2010 a further reduction of 5 per cent is expected – see table 3.5 below. For clothing products, there has been a 10 per cent reduction in tariffs since 2005.

Table 3.5: Automobiles and TCF tariff rates- Present rates and target rates

Products	1998	1999	2000	2005	2010
Vehicles	20	17.5	15	10	5
Garments	31	28	25	17.5	10
Textiles	19	17	15	10	5
Footwear	21	18	15	10	5

In addition to limited tariff protection, ROK exports face non tariff barriers in the Australian market. These relate principally to quarantine procedures and anti- dumping investigations applied to products from the ROK.

3.1.2.2 Measures in Key Product Areas

(i) Agriculture

Australia, like all WTO members (or like Korea), is party to the World Trade Organization Agreement on the Application of Sanitary and Phytosanitary Measures. The Agreement allows member to set their own level of quarantine and food safety protection. It also requires quarantine and food safety measures to be based on science and not industry protection. This ensures that Members cannot use unfair quarantine or food safety restrictions to block trade.

As a result of Australia's quarantine inspections, certain agricultural products exported from ROK can experience delays while passing through customs. The requirements can be cumbersome and effectively act as barriers to trade. Since June 1999, Australia has required import risk analyses (IRA) to be conducted for quarantine purposes, which involves an inspection and assessment of the risks from pests being transported into the country with agricultural products. The IRA process is rigorous and requires the submission of scientific documentation for analysis and completion of certain deliberative procedures. When delays are experienced as part of the IRA process it can act as an important barrier to trade. Notably an investigation on South Korean pear imports took ten years to complete.

(ii) Automobiles

In 2005, Australian tariffs on automobiles were set at 10 per cent. They are expected to be reduced to 5 per cent by 2010.[104]

Despite this, exports of automobiles from the ROK compete with Australian automobile manufacturers that benefit from the Australian Government's Automotive Competitiveness and Investment scheme (ACIS).

Until December 31, 2000, the Australian Government carried out an export facilitation scheme (EFS) in the automotive industry, based on administrative arrangements. The EFS was replaced from January 2001 with the Automotive Competitiveness and

[104] World Trade Organization, *Trade Policy Review: Australia: Report by the WTO Secretariat*, WT/TPR/S/178, 2007.

Investment Scheme (ACIS) under the 1999 ACIS Administrative Act. The aim of the Scheme was to induce investments and technological innovation so as to enhance the competitiveness of the automotive industry.

Participants in the Scheme receive duty credits which can be used to pay customs duty on certain eligible imports. Duty credits can also be sold and transferred to a third party. Participants in the scheme may be motor vehicle producers (MVPs), automotive component producers, automotive machine tools and tooling producers or automotive service providers. For MVPS, duty credits are earned on the basis of a percentage of eligible production and eligible investments in plant and equipment. For other participants, duty credits are earned on the basis of a percentage of eligible investments in plant and equipment and eligible investments in R&D. Accordingly, there is a perception among business that the credits can effectively act as a government subsidy. This amounted to approximately A$280 million from 2001 to 2005.

In December 2002, the Australian Government announced a 10 year extension of the ACIS from 2006 until 2015 worth A$4.2 billion. As part of the extended ACIS scheme, the Government introduced the $150 million MVP R&D Scheme which provides MVPs with R&D assistance projects.

Environment-based restrictions also apply in the automotive sector. On January 1, 2004 a new system for displaying fuel efficiency for automobiles was introduced. In addition to the initial system that required the gauge to display fuel efficiency (litre per 100 kilometres), automobiles are now also required to display their CO_2 emission rates (grams per kilometre). For new vehicles sold in Australia, the recent system is applicable for passenger cars, four wheel drives and regular cars under 3.5 tonnes.

Facing high oil prices, efforts to increase the usage of LPG were also made by the Government on August 14, 2006, including an eight year support plan of A$1,000 for new LPG vehicles and A$2,000 for existing ones.

(iii) Textile, clothing and footwear

As in many industrialised countries, Australia's TCF sector has historically been more highly protected than most other parts of the economy. From the mid-1980s, however, Australian governments have substantially reduced the level of tariffs and abolished quantitative restrictions. In 1989, the effective rate of protection of the sector was 85.5 per cent. In January 2005, Australia's average applied tariff on apparel and certain finished textile articles was set at 17.5 per cent, 10 per cent on cotton sheeting, woven fabrics, footwear and carpets, and 7.5 per cent on sleeping bags, table linen and footwear parts.[105] TCF tariffs are to be reduced to 5 per cent in 2010, except for apparel and certain finished textile goods, which will be reduced from 17.5 per cent to 10 per cent. From 2015, all TCF tariffs will be five per cent.[106]

In preparation of the gradual reduction of tariffs planned for the TCF industries, the Australian Government has put in place a $747 million TCF Post-2005 Assistance Package which includes a staged ten year program of tariff reduction from 2005 to 2015.

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[105] WTO 2007.
[106] WTO 2007.

The Package includes six programs, which are noted below:

- The $575 million TCF Post-2005 (SIP) Scheme—a ten-year grant scheme to foster the development of a sustainable and internationally competitive TCF design/manufacturing industry;
- The $25 million TCF Small Business Program—a ten-year competitive grant program to improve the business enterprise culture of TCF small businesses that do not qualify for assistance under the TCF Post-2005 (SIP) Scheme;
- The $50 million TCF Structural Adjustment Program—a ten-year program to support industry consolidation and labour market adjustment;
- The $50 million Product Diversification Scheme—a ten-year scheme to assist clothing and finished textile product manufacturers internationalise their sourcing arrangements and complement their existing product range by providing duty relief for certain finished clothing or finished textile articles;
- The $27 million Expanded Overseas Assembly Provisions (EOAP) Scheme—an outward processing scheme finishing in 2010 to facilitate the ongoing development of Australian TCF firms; and
- The $20 million TCF Supply Chain Program—from 2010 to 2015 the Government will implement a competitive grant program to support major capital investment that strengthens the local supply chain for the clothing and finished textile sectors of the TCF industry.

(v) Anti-dumping

The ROK exports of steel, chemicals and other goods have been subject to a number of anti-dumping measures adopted by Australia. In the period January 1995 -30 June 2007, Australia imposed 72 anti-dumping measures, 11 against dumped ROK imports. The ROK imposed 54 anti-dumping measures over the same period. There are currently six products on which measures are imposed[107].

South Korean companies have tended to be non-retaliatory and indifferent in the face of anti dumping investigations, principally due to the costs of retaliation in the form of filing a law suit. Often these outweigh the benefits accrued from the curtailing of imports. Furthermore, such legal actions can require companies to expose critical information on their cost schedules. There is a perception amongst Korean business that this indifference, combined with the growth of lower priced South Korean goods into Australia, has resulted in antidumping measures being filed by Australian firms against ROK imports. This applied particularly to the extension of antidumping measures on South Korean expandable polystyrene (EPS), which was under a 15 year antidumping restriction. This expired in November 2007. (See Table 3A.1 in Annex 3A for a description of Australian antidumping restrictions imposed on South Korean products).

Anti-dumping procedures also pose problems for ROK products exported to Australia. While the Australian Customs Service must conduct investigations within a finite period (155 days), the final decision on the imposition of measures based on the findings of the Customs Service is made by the Minister responsible for the Australian Customs Service,

[107] As of 31 January 2008 measures were in force on six commodities according to data published by Australian Customs: greyback cartonboard; hot rolled steel plate; high density polyethylene; linear low density polyethylene; PVC homopolymer resin washing machines. EPS measures expired in November 2007 and were not renewed.

who is in no way restricted by a deadline. As a result, final decisions, particularly those concerning the clearing of allegations, can be considerably delayed.[108]

3.2 Measures affecting trade in services

3.2.1 Measures affecting Australian services providers

3.2.1.1 General levels of protection

In 2003 the ROK was ranked by the OECD as the fifth most restrictive country in the services sector in terms of its product market regulation. In 2004, foreign entities accounted for only 8 per cent of the services sector turnover in the ROK, compared to the OECD average of 19 per cent.[109] In 2002 the share of the stock of inward FDI invested in the services sector in the ROK was one of the lowest in the OECD area.[110] This reflects the relatively high degree of restrictions on foreign ownership in the services sector in the ROK.

The Government has extensively restructured public policy in the ROK, following the country's accession to the OECD in 1996 and in the wake of the Asian financial crisis of 1997. In doing so, it has sought to liberalise trade barriers and encourage greater inflow of foreign investment into the ROK. As a consequence, out of 1,058 lines of business in the ROK, only two sectors — television and radio broadcasting — are wholly closed to foreign investment at present, as compared to 30 sectors in 1997. Furthermore, in 2006 the ROK Ministry of Finance and Economy adopted a comprehensive plan aimed at promoting the services industry thorough tax incentives, subsidies, and deregulation.[111]

3.2.1.2 ROK measures in key service sectors

The following discussion is based on those services sectors that are likely to be of most interest to service providers in Australia. These are taken to be those services sectors that currently supply the bulk of Australia's overall services exports to the ROK[112].

(i) Education

Australian education providers face certain barriers in entering the market in the ROK. Foreign for profit education institutes are not permitted to operate in the ROK, except for those operating in Free Economic Zones (FEZ).[113] Foreign education institutes therefore need to establish themselves as non-profit entities. Under ROK law,

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[108] Under WTO obligations, investigation shall be concluded within 18 months after initiation. Australia claims to meet these obligations.

[109] Organisation for Economic Cooperation and Development (OECD), *Korea: Progress in Implementing Regulatory Reform—OECD Reviews of Regulatory Reform*, 2007.

[110] *Ibid.*

[111] *Ibid.*

[112] The information provided in this section has been obtained from official sources. Notably, since time of writing there may be recent developments and changes in the regulatory framework which are not reflected in the following analysis.

[113] Foreign institutes in the free economic zones are excluded from the obligations under current ROK education law, including the Higher Education Act and the Private School Act (OECD 2007).

educational institutes operating as non-profit bodies are not permitted to repatriate any earnings from their operations in the ROK.[114]

In the higher education sector, foreign entities are allowed to set up institutes to provide adult education, including universities. Establishment of universities and vocational technical education (VTE) institutions by foreign organisations are permitted only in the FEZs, and must be operated by non-profit foreign bodies or those founded and governed by a foreign national or local government under foreign law. Registration of foreign higher education institution in the ROK involves establishment of a ROK office to serve as a representative of the foreign body. The foreign institute must then apply to the Ministry of Education and Human Resources Development for approval. The foreign corporate must also register with the ROK authorities as a non-profitable incorporated organisation. ROK nationals must constitute more than half the members of the board of each higher education institute. Foreigners can constitute up to two-thirds of the board if they contribute more than half of the institution's property.[115]

There are no restrictions on foreign universities engaging with ROK universities to provide joint curriculum programs, with the exception that they are required to abide by the basic higher education standards applicable in the ROK. However, in order to engage in joint curriculum programs, foreign institutions interested in participating must be accredited by their own governments or government approved bodies. Foreign teachers must take responsibility for part of the lecturing, but the teaching time and level of participation are decided to by the head of the institute.[116] No restrictions apply to foreign entities for establishing and operating private tutoring institutions that cater to ten or more students for 30 days or longer. Repatriation of profits from these institutions is permitted. However, repatriation of profits generated by tuition services provided in ROK schools, which form part of the national education system, is prohibited.[117]

The ROK Government has recently begun to encourage foreign education providers into the FEZs to provide primary and secondary education. Restriction imposed by the ROK Government limits the number of ROK nationals who can enrol in foreign schools to 10 per cent. However, foreign schools located in the FEZs can enrol up to 30 per cent students who are of ROK nationality.[118] Moreover, foreign primary and middle schools are required to include a minimum of two hours per week of Korean language and culture as part of their curriculum. Foreign schools classified as '*miscellaneous schools*' may be allowed to operate outside the FEZs. Academic records from miscellaneous schools are however not recognised in the ROK. These schools are not accredited and cannot accept ROK students.

In order to provide English language courses, institutes are not restricted to the FEZs.[119] Applicants interested in establishing English language institutes must pass a background character check performed by the police and must be over twenty years of age. A licence fee must be paid for setting up such an institute. Furthermore, the institutes must adhere

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114 Foreigners are also not allowed to establish or operate distance higher education or adult education institutions that offer degrees or provide degree-related-services. (OECD 2007).

115 APEC, *IAP Study Report- Korea*, 2006.

116 Department of Education, Science and Training, Australian Government, *Country Regulatory and Business Fact Sheet: Republic of Korea*, March 2007.

117 APEC, *IAP Study Report- Korea*, 2002.

118 Department of Education, Science and Training, Australian Government, March 2007.

119 *Ibid.*

to standards and regulations relating to physical and environmental conditions of the facility, and are subject to occasional spot checks by the relevant authorities.

Foreign natural persons are also prevented from teaching in national and public kindergartens, and in primary and secondary schools in the ROK, except for schools in designated areas[120]. Foreigners are, however, permitted to teach in ROK universities when they meet the requirements and qualifications stipulated in the relevant laws.[121]

(ii) Travel services

Australians are not required to have a visa for admission to the ROK for the purpose of travel or transit, unless they are considered to be undertaking employment for the period specified in the agreement. A business investor visa (D-8) may be granted to specialists[122] engaged in the business management, production or technological sector of an FDI company supported by the Foreign Investment Promotion Act (FIPA).[123] An individual foreign investor with an investment of more than W 50 million who manages the foreign-invested company may also apply for a D-8 investor visa.[124] Businesses are required to obtain a short-term business visa (C-2) for preparing the establishment of the foreign-invested company, and then change the status to a D-8 visa after completion of registration of the company.[125] In addition to visa requirements, mobility of persons travelling between ROK and Australia can be further restricted by the limited number of flights operating between the two countries.

There are no restrictions on foreigners providing hotel and restaurant services in ROK. All hotel service providers must comply with the registration standards prescribed under the ROK Tourism Promotion Act. Restaurant service providers are required to comply with the registration standards as prescribed by the ROK Food Sanitation Act.[126]

Foreign firms may operate as travel agencies and tour operators in the ROK, provided they comply with the standards as prescribed by the ROK Tourism Promotion Act.[127]

(iii) Transport services

Foreign companies seeking to provide marine transport services in the ROK must enter a joint venture with a local shipping company. There is a cap on foreign investment of 50 per cent in such joint ventures.[128] Companies wishing to establish a branch office in the ROK to conduct business in marine passenger or freight transportation must report to the Minister of Maritime Affairs and Fisheries.[129]

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120 Designated areas refer to those that are prescribed in the Free Economic Zone and its Operation Act and the Regionally Specified Development Act (Source: APEC IAP Study Report- Korea, 2006)
121 *Ibid.*
122 Specialists are executives, senior managers and specialists with highly professional and proprietary experience and essential knowledge for research, design, technology and management of the services
123 Invest Korea website, accessed at <http://www.investkorea.org/> on 22 August 2007
124 *Korea Foreign Direct Investment: Question & Answers*, April 2005.
125 *Ibid.*
126 APEC 2006 <http://www.apec-iap.org/>
127 *Ibid.*
128 WTO 2004.
129 APEC 2006.

Both foreign and domestic carriers must be incorporated in the ROK, have a minimum equity in excess of W 500 million and cargo capacity of at least 5,000 tonnes. Pilots must be ROK nationals.[130] Coastal sea freight and passenger transportation (including scheduled and non-scheduled[131] services) are limited to carriage between North and South Korea[132]. There are no restrictions on the use of ROK ports, with the exception of cabotage[133] which is reserved for ROK vessels only.[134] Both ROK and foreign vessels are treated similarly in the transport of bulk cargo.[135]

In air transport services, foreign ownership is limited to 50 per cent of total voting shares or equity of the relevant company.[136] A local residency requirement applies to the sale and marketing of aviation services in the ROK as well as for maintenance and repair of aircraft.[137]

(iv) Financial services

Banking

Prudential regulation in the ROK applies equally to domestic and foreign financial institutions and is conducted in accordance with internationally accepted standards.

Any foreign financial institution that intends to establish a branch, agent or office to conduct banking business in the ROK, or to close any branch or agent, must first obtain regulatory approval from the Financial Service Commission (FSC) in accordance with the Banking Act of ROK.[138] There are licensing requirements for branch establishment, including:

- a minimum capital of W 3 billion for each branch[139];
- approval from the home country regulatory authority;
- assurance that banking business in home country is appropriately supervised;
- demonstration of satisfactory financial and operational capabilities, reputation and creditability;
- demonstration of appropriate expertise in banking and service capabilities;
- proper risk management, internal controls, and credit approval processes;
- a viable business plan; and
- capacity to provide the regulator with the information required for its supervision.[140]

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130 WTO 2004.
131 Scheduled marine services involve the transport of domestic and foreign passengers and freights by sea. Non-scheduled services are non-regular services (such as charter of ship, etc).
132 ROK Ministry of Commerce, Industry and Energy, *Consolidated Public Notice for Foreign Investment*, March 2003.
133 Cabotage is the transport of goods or passengers between two points in the same country.
134 WTO 2004
135 *Ibid.*
136 *Ibid.*
137 APEC 2006.
138 The FSC is the ROK's first fully integrated financial supervisory body and was established in 1998 to restructure the country's financial and corporate sectors. The FSC and its executive body, the Financial Supervisory Services (FSS) are responsible for the overall regulation and supervision of the financial sector. The Securities and Futures Commission (SFC) supervises and regulates the securities and futures market.
139 WTO 2004.
140 Financial Supervisory Service, *Financial supervisory System in Korea*, December 2005.

Foreign bank branches are also required to keep a minimum of 8 per cent of operational funds against risk-weighted assets.[141] They are prohibited from using capital borrowed from their head office to meet regulatory requirements but they can include the net borrowing from their head offices as 'Class B capital'. [142] Foreign bank branches are required to credit at least 10 per cent of their net profit to a legal reserve until it accumulates to a level equal to its total paid-in capital.[143] Foreign bank branches using the Bank of Korea's discount window have to extend at least 35 per cent of the increase in their Won-denominated loans to ROK companies that are not part of the top four *chaebol* conglomerates, as well as to small- and medium-sized enterprises (SMEs).[144] Under the recently amended prompt disclosure rule, they have to make periodic disclosures on their performance to the regulator.[145]

There are restrictions on the assets a foreign bank branch may hold.[146] The ownership of non-business real-estate is prohibited and all assets must be physically located in the ROK. Furthermore, such branches must get approval for any new product or service to be offered in the ROK.[147]

The licensing requirements for foreign bank branches are less stringent than for foreign bank subsidiaries. There are, however, no restrictions on the number of banking licences that may be granted to a foreign interest wishing to establish subsidiary units in the ROK as long as prudential requirements for a licence are met.[148] A license must be obtained for each foreign branch, whereas a foreign subsidiary may operate a number of branches under the one licence.

Financial institutions are permitted to handle only transactions with residents of the ROK that are denominated and settled in won. Any transaction in a foreign currency or with a non-resident requires prior government approval.[149] Foreigners are also precluded from making investment in special banks, national agricultural cooperative federation, national federation of fisheries cooperatives and the livestock cooperative federation.[150]

Tax treatment for loans, although not a direct "trade barrier," also impacts on business operations of foreign banks. A branch tax of 25 per cent is imposed annually on the adjustable taxable income of the ROK branch of the foreign company. This tax is in addition to that which is paid under the ROK's corporate income tax (the general corporate tax rate is 16 per cent for the first W 100 million and 28 per cent for the balance of all taxable income).

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141 For a foreign bank branch, the ratio of operational funds to risk-weighted assets is regarded as its capital adequacy ratio for the purposes of compliance with the Basel II standard of the Bank for International Settlements (Financial Supervisory Service 2005).

142 Class B capital/shares are a classification of common stock that may or may not have more voting rights. National Trade Estimate Report on Foreign Trade Barriers, USTR, 2007.

143 Financial Supervisory Service 2005.

144 For those not utilizing the Bank of Korea's discount window, the minimum is 25 per cent.

145 Including disclosures relating to their financial soundness, profitability, productivity, sources and use of funds, etc (Financial Supervisory Service 2005).

146 WTO Services Database Online.

147 USTR 2007

148 However, no foreign bank subsidiaries were operating in the ROK as of 2004 (WTO 2004)

149 WTO Services Database Online.

150 Overview of FDI System: Promotion and Regulations, Invest Korea, at <http://www.investkorea.org/> .

A deemed capital tax adjustment is also imposed when a ROK branch's ratio of loans (assets) to equity (capital) exceeds the parent's ratio. A Thin Capital Rule imposes an additional tax if inter-company borrowings in a foreign bank's ROK branch exceed six times its capital. From 1 January 2008, this rule will be reduced from six to three times a branch's loan ratio.

Securities

A foreign company wanting to establish a foreign branch in the ROK to conduct securities business with ROK residents must obtain a licence from the FSC/FSS. Licences vary according to the type of securities business that is to be conducted.

The licensing requirements mandate minimum operating funds for different aspects of business[151]. Additional requirements apply for foreign securities firms, including:

- demonstrated ability to protect investors;
- sufficient manpower and other physical facilities;
- adequate experience in securities business in its home country; and
- a high international credit rating

Securities companies are required to appoint at least one compliance officer, who has to check whether internal control standards are being observed, to inspect any violation of the those standards, and to report the results to the auditor or the inspection committee.[152]

There are no equity restrictions on the establishment of a securities business in the ROK.[153]

Insurance

Foreign insurance firms, including branches of such firms, are required to obtain a licence and appropriate regulatory permissions from the FSC/FSS to enter the insurance market in the ROK.

The minimum paid-in capital requirement varies with the scope of the business.[154] There are no additional restrictions, compared to what ROK insurers face, on the establishment of commercial presence by foreign insurers to conduct the business of both life and non-life insurance in the ROK.[155] Foreign insurers are however precluded from forming joint ventures with ROK insurance companies.[156]

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151 Minimum operating funds requirement include: W 15 billion for dealing, brokerage and underwriting; W 10 billion for brokerage and dealing; and W 3 billion for brokerage business only (Financial Supervisory Service, *Financial supervisory System in Korea*, ,December 2005).

152 Financial supervisory System in Korea, Financial Supervisory Service, December 2005.

153 WTO Services Database Online.

154 For instance, a minimum paid-in capital of W 3 billion is required to do business with both South Koreans and foreigners, while W 500 million is required if working mainly with foreigners and W 100 million if working only with foreigners (WTO 2004).

155 WTO Services Database Online.

156 *Ibid.*

Additional requirements to deliver insurance services apply.[157] Qualification or requirements are needed in certain positions of insurance firms. Moreover, customers must be identified in person (in order to use online services.[158] The supply of insurance services by Korea Post (a government agency), the Agricultural Cooperative Federation (NACF) and the National Federation of Fisheries Cooperative (NFFC) are not regulated by the FSS/FSC[159], unlike those of private operators. As a consequence the insurance operations of these organisations are subjected to generally less stringent regulatory requirements. [160]

(v) Telecommunications

Traditionally relatively protected, in recent years telecommunications in the ROK have been gradually deregulated and opened to competition, including from foreign providers.

Only ROK entities can apply for a facility-based service provider (FBT) licence. Foreign providers must enter into commercial arrangements with ROK service providers. Share-holding by foreign entities is limited to 49 per cent of total voting shares or equity. This includes foreign ownership of KT Corporation[161], the dominant non-mobile carrier.[162] Any foreign entity acquiring more than 15 per cent of a ROK telecommunications company has to obtain the prior approval of the Ministry of Information & Communication (MIC).[163]

No foreign ownership limits apply to either special telecom service providers (ST) or value-added telecom service providers (VAT).[164] They enjoy fewer access rights to the telecommunication network, however, compared to facility-based service providers.[165] ST providers need to register with the MIC and meet certain criteria, such as a capital requirement of at least W 3 billion in the case of exchange-based ST providers. VAT providers must notify the MIC of their activities.

All licensed telecommunication service providers with revenues exceeding W 30 billion have to pay an annual charge of 0.5 per cent (0.75 per cent for KT, the dominant operator) of their previous year's revenue into the government operated Institute of Information Technology Promotion Fund, for their R&D expenditure.[166]

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157 These requirements include having adequate professional manpower and facilities, a sound business plan, and sound financial standing.
158 European Union Chamber of Commerce in Korea *Issues & Recommendations,* 2007, accessed at < http://trade.eucck.org/site/2007/en/trade12.htm>
159 For instance, Korea Post is not subject to product approval requirements, inspections, contribution to policyholder protection funds, reserve or solvency requirements, etc. unlike private insurance firms.
160 USTR 2007.
161 The KT Corporation (Korea Telecom) has been fully privatized since 2002.
162 The largest shareholder in KT is a foreign company with a 48.99 per cent share-holding as of December 2003 (WTO 2004).
163 As per the commitments of the US-Korea FTA, after two years of the Agreement being in force, US companies will be allowed to own up to 100 per cent equity in South Korean entities, which in turn can own up to 100 per cent of a facility-based licensee. See Report to the Industry Trade Advisory Committee for ICT, Services & Electronic commerce, April 2007, p. 9.
164 Value-added services are those provided via telecommunications network facilities leased from network service providers and which store, forward or process customer's information on a non-real time base.
165 WTO 2004.
166 OECD, '*Korea Progress in Implementing Regulatory Reform*', OECD Reviews of Regulatory Reform, OECD, 2007.

The above restrictions also apply to foreign mobile and cellular telephone service providers. Resale-based service providers (i.e. non-FBT providers) must enter into commercial arrangements with ROK operators to provide in-country telecommunications services but there are no restrictions on their degree of foreign ownership.

(vi) Audio visual services

Foreign firms are precluded from providing or investing in broadcast terrestrial television services in the ROK Foreigners are also precluded from investment in cable television relay service.[167] In the cable television broadcasting sector, foreigners are permitted to hold a maximum of 49 per cent of total voting shares or equity (increased from 33 per cent recently).[168]

Quotas apply to foreign content in programming on both broadcast and cable television services. Foreign programmes are restricted to 20 per cent of the total broadcast time per month. Annual quotas restrict the broadcasting of foreign movies to a maximum of 75 per cent of the total broadcasting time for movies.[169] In the case of cable television, quotas limit programmes with foreign content to a maximum of 50 per cent of transmission time per channel.[170] Foreign programming from any one country is limited to a maximum of 60 per cent of the cable television quota.[171] There is also an annual quota on the screening of foreign movies in domestic cinemas: cinemas in the ROK must show locally produced films for at least 73 days of the year (down from 146 days in July 2006).

Equity restrictions in satellite broadcasting limit foreign ownership to 33 per cent of total voting shares or equity. The Integrated Broadcast Law mandates contracts between companies re-broadcasting satellite transmissions of foreign programs and the foreign program provider. The number of foreign re-transmission satellite channels is restricted to 20 per cent of the total number of operating channels in the ROK. Additional restrictions include programming prohibitions on voice-over and dubbing in the Korean language, and on local ROK advertising on foreign re-transmission channels.

Foreign investment is prohibited in radio broadcasting in the ROK. Foreigners are also precluded from investment in businesses for specialized news program channels.

(vii) Other business services

Legal

Consultations with business indicate that deregulation in the legal sector has been slow. Foreign law firms face a number of difficulties operating in the ROK market.

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167 Invest Korea, *Overview of FDI System: Promotion and Regulations*, at <http://www.investkorea.org/> on 19 June 2007.
168 USTR 2007.
169 Annual quotas also apply for animation (55 per cent) and popular music (40 per cent) (Source: National Trade Estimate Report on Foreign Trade Barriers, USTR, April 2007).
170 This comprises annual quotas of 75 per cent applicable for movies, 65 per cent for animation, and 40 per cent for popular music. *Ibid.*
171 *Ibid.*

Foreign law firms cannot operate in the ROK, nor can foreign lawyers practice or provide advice on domestic law there. To qualify as an attorney-at-law in the ROK, a person must pass the local Judicial/Bar Examination and complete two years of professional education at the Judicial Research and Training Institute.[172] The person must then register with the Korean Bar Association to provide legal services within the jurisdiction of the ROK. Exceptions can be made by the Ministry of Justice (MOJ) where a foreigner has rendered meritorious services to the ROK or is deemed worthy.[173]

The proposed Foreign Legal Consultants Act will further liberalise the domestic legal sector. It proposes to allow persons who are licensed to practice law in a foreign jurisdiction and who have at least three years of relevant experience in that jurisdiction to apply for qualification as a foreign legal consultant in the ROK. Such a consultant will be required to stay in the ROK for a minimum of 180 days per year, and will not be allowed to hire local lawyers to establish or operate a law office with a local law firm or collaborate in any form of partnership, joint venture or share transfer.[174]

Accounting

Under the Certified Public Accountants (CPA) Act, only CPAs registered with the Ministry of Finance and Economy (MOFE) can provide accounting services in the ROK. Both local and foreign service providers are subject to the same set of qualifications and registration requirements.[175] To register, a person must pass the CPA examination administered by the MOFE, and complete a year of field experience.

Architectural

Foreign firms wishing to provide architectural services in the ROK must do so thorough a joint venture with a domestically certified architect and file a report with the Minister of Construction and Transportation. Foreign architects must hold a licence to practice in the ROK. This requires them to pass the local Architect Qualifying Examination, have five years of relevant practical experience and an architectural licence or qualification from their home country.

Health services

Only health care professionals who are licensed in the ROK are permitted to provide medical services there. To obtain a license an individual must apply to the ROK Ministry of Health and Welfare.[176] Foreign licences are not recognised in this sector.[177] Foreign companies are not allowed to run health care institutions in the ROK.[178]

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172 APEC 2006.
173 Applicable only where the foreigner's home country recognizes the qualifications of, and permits legal practice by, ROK nationals who qualify as attorneys-at-law in the ROK. A foreign attorney-at-law cannot, however, handle legal matters other than those related to foreigners or foreign Acts. (MOCIE [Korean Ministry of Commerce, Industry and Energy], *Consolidated Public Notice for Foreign Investmen*t, March 2003)
174 European Union Chamber of Commerce in Korea 2007.
175 APEC 2006.
176 APEC, *IAP Study Report- Korea*, 2007.
177 APEC 2006.
178 APEC 2002.

Advertising

The advertising market in the ROK is relatively open to foreign participation. There are, however, some restrictions. Any advertiser and its agency must register with the state-sponsored Korea Broadcast Advertising Corporation (KOBACO) to advertise on broadcast television, as broadcast advertising time is sold exclusively through KOBACO. As of 2006, approximately 256 foreign and ROK agencies were registered with KOBACO.

The broadcasting of advertising for alcoholic beverages with over 17 per cent of alcohol content is not permitted, while alcoholic beverages containing less than 17 per cent alcohol are prohibited from being advertised during specified hours.

3.2.2 Measures affecting ROK services providers

3.2.2.1 General levels of protection

Barriers to ROK services exports to Australia (which amounted to A$419 million in 2006) are limited, principally due to the fact that Australia's services sector is relatively open. Regulations in the core areas of ROK exports, namely transportation and travel services, though not overly restrictive, are currently commercially important. As the ROK is known as having a comparative advantage in the telecommunications and IT services industry, the impact of rules and regulations in these sectors on ROK exports are of increasing interest. Australia, along with a number of other countries, does maintain foreign equity restrictions in certain sectors, namely real estate, civil aviation (Qantas Airways, international carriers, as well as airports), telecommunications (Telstra) and shipping.

3.2.2.2 Australian measures in key service sectors

(i) Education

ROK students who wish to undertake full-time study in registered courses in Australia[179] are required to obtain a student visa from the Department of Immigration and Citizenship (DIaC) under the Australian Government's Student Visa Program.[180]

Documentation requirements for processing visa applications can be extensive. Depending on the type of education the incumbent intends to avail in Australia, a number of documents need to be submitted along with the visa application. These include medical examinations and evidence of sufficient funds to cover tuition, living costs, etc. for the first twelve months of their proposed stay in Australia.[181] Whether and the extent to which visa requirement operate as buyers to service to trade will depend on the particular situation on the incumbent seeking entry.[182]

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[179] Technically Australian visa requirements for ROK students or tourists to visit or study in Australia would be considered barriers to Australian service providers, rather than barriers to ROK service providers.
[180] Student guardian visa to accompany a student visa holder coming to Australia, who is under 18 years or has physical or cultural need for an adult companion, may also be granted (DIMIA website, accessed at < http://www.immi.gov.au/students/student_guardians/index.htm> on 1 June 2007)
[181] DIaC website, < http://www.immi.gov.au/students/checklists/index.htm>, accessed on 01/06/07
[182] The study did not examine the extent to which these requirements operate in practice as obstacles to trade.

Students from some foreign education institutes also face problems in having their qualifications recognized for the purpose of further study in Australia. Some institutes require foreign students to take an International English Language System (IELST) exam prior to lodging their visa applications.

(ii)Travel services

Tourists and business visitors from the ROK are eligible for Electronic Travel Authority (ETA), which can be issued by travel agents or obtained online and involve a fairly simplified process. There is no Government Visa Application Charge on the tourist or short validity business ETAs. Both ETAs are valid for one year and allow for three month stay periods and multiple entry. ROK passport holders were granted 229,718 tourist ETAs and 4,399 business ETAs during 2006-07. Should a visitor from the ROK wish to stay in Australia for a period longer than three months, they can apply for a Subclass 676 tourist visa.

FTA negotiations between Australia and the ROK could be expected to address issues such as business mobility, recognition of qualifications and education services.

(iii) Media and Audiovisual

In the case of investments in TV and radio broadcasting, foreign investment proposals to acquire more than 5 per cent of the broadcasting company's shares must be notified to the Government for approval. In April 2007, Australia removed foreign media ownership restrictions that previously applied to broadcasting and newspapers under the Broadcasting Services Act 1996.

Quotas apply to television advertising and radio broadcasting. A minimum of 80 per cent of total commercial television advertising between 6:00am and midnight must be Australian produced. For radio broadcasting during that same period, at least 25 per cent of all music should be Australian in origin or performance.

(iv) Aviation industry

As long as it does not affect the national interest, domestic flights may be fully owned (100 per cent) by a foreign firm or individual irrespective of whether it is newly established or not. Until May 2000, foreign ownership in international flights was restricted to a maximum of 25 per cent (35 per cent of total airlines). Recent reform of the aviation law now permits up to 49 per cent shareholding by foreign investors. In the case of Qantas Airways, in which 49 per cent foreign shareholding is permitted, individual holdings are limited to 25 per cent and aggregate ownership by foreign airlines is limited to 35 per cent.

In the case of airports, foreign shareholding is limited to 49 per cent while individual airlines are permitted to buy up to a 5 per cent stake. The Sydney-Melbourne airports and the Brisbane-Perth airports may not be owned in pairs by the same investor.

(v) Telecommunications

New foreign investment in the telecommunications sector, irrespective of whether it is in an existing or newly established company, must undergo prior authorization. With the exception of Telstra, the national communications company, there are no specific limits on foreign investment in new carriers in the communications industry in Australia.

Telstra, which was formerly owned by the Australian Federal Government, has been privatised, with the Government selling a third of its shares in the company. On September 13, 2005, the Government received authorization from the parliament which enabled total denationalization of Telstra. By late 2006, the process of selling off government shares was well underway.

With the selling of its stake in Telstra, the Government's ownership share was reduced from 51 per cent to 17 per cent. This has eased the Government's conflicting roles as both a regulator and owner of the dominant telecom operator. Ownership of Telstra by foreign groups however, is still capped at 35 per cent of the company's listed capital, while maximum shareholding by individual foreign entities is limited to 5 per cent. Australian firms and individuals will continue to maintain their share even after the denationalization process. Such regulation is expected to last for several years.

(vi) Financial services

Foreign ownership restrictions apply in the Australian financial services sector. For a foreigner (other than from the United States) to hold more than 15 per cent of shares in the financial industry, the investor must obtain prior authorization from the Treasurer.

Tax treatment in the financial services industry can impact on business operations. For fiscal year 1997-98, the ratio of loans and stock was reduced from 3:1 to 2:1 in the case of non-financial entities. Loans also include payment guarantees issued by the foreign head offices, i.e. offshore borrowing. If a local subsidiary in Australia receives a loan from the head office that exceeds the local subsidiary's capital stock by more than double the amount, then the interest on the loan in excess of this amount is not recognized as business expenses for tax treatment purposes.

Foreign banks face an analogous situation whereby the loans received from the main/head office are limited to six times the capital stock the foreign banks hold, and any sum in excess of this limit is not considered as business expense for tax purposes. As a result, ROK businesses and banks that rely heavily on loans or payment guarantees from their main office have an increased financial burden. Banks which have no option but to rely on the loans from their main office can face severe restrictions in financing and thus experience great difficulty expanding their operations in Australia.

3.3 Measures affecting investment

3.3.1 Measures affecting Australian investment in the ROK

Since the Asian financial crisis of 1997, the ROK has embarked on a wide ranging program of economic reform. This has included reforms to encourage foreign investment.

The Foreign Investment Promotion Act (FIPA) adopted in 1998 has liberalised the ROK's investment regime, and has opened up most business sectors to FDI. The Commission on Foreign Direct Investment is responsible for formulating all major policies related to FDI.[183]

The ROK's investment regime is applied on an MFN basis, and foreign investors are assured of national treatment, except in cases otherwise stipulated in the law.[184] All forms of FDI are allowed, including establishment of new business, stock acquisitions in existing businesses, mergers and acquisitions (including hostile takeovers) and long-term loans. No restrictions to FDI are permissible, except for those listed in the services sector or relate to issues of national security, public order, public health, environmental preservation or social morals.[185] Three sectors are completely closed to foreign investment[186] and another 26 are partially restricted allowing less than 50 per cent foreign ownership[187]. No prior approval of the Government is required for FDI, except for investment in 90 defence-related companies[188] which require approval by the Ministry Knowledge Economy (MKE).

To be considered as FDI, the minimum investment is W 50 million per investor and the investor generally must acquire a minimum of 10 per cent of the stock of the local business, although a lesser amount is acceptable in certain cases.[189]

(i) Portfolio investment

Under the Foreign Exchange Transactions Act international capital transactions must be approved by the Minister of Finance and Economy.[190] These include loan contracts or guarantees between residents and non-residents, derivative financial transactions or securities issuing/offering, acquisition of securities or rights to securities by residents from non-residents, and other similar transactions.

(ii) Controls on FDI remittances

Overseas remittance is completely guaranteed in the case of dividends and capital from the sale of shares and equity owned by foreign investors in the ROK.

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183 WTO 2004

184 *Ibid.*

185 *Ibid.*

186 In the cereals sector, rice and barley growing are closed to foreign investment. Foreign investment prohibited in television and radio broadcasting services

187 Partially opened sectors include: Cultivation of grain and/or other food crops; Beef cattle raising; Near-sea fishing; Coastal fishing; Newspaper publishing; Magazines and periodicals publishing; Nuclear fuel processing; Electric power generation; Power transmission; Power distribution and sales; Meat wholesaling; Coastal passenger transportation; Coastal cargo transportation; Regular air transportation; Charter air transportation; Lease of power or communication circuit facilities; telephone and other communication services; Mobile phone services; Pagers and other mobile communication services; Other telecommunication services; Domestic banks; Broadcasting channel use; Integrated cable and other cable broadcasting; Satellite broadcasting; News provision; Nuclear waste collection; transport and processing

188 The list of companies covers a number of ROK companies that also produce non-defence products

189 Less than 10 per cent is acceptable in the following cases: an agreement which allows for the dispatch or appointment of executives; an agreement for supply or purchase of raw material or goods for at least one year; or an agreement for introduction or provision of technology or R&D (Invest Korea 2005).

190 MOCIE March 2003.

Although the ROK has largely deregulated its foreign exchange and capital account transactions, a few restrictions remain. Controls on FDI capital remittance require that FDI capital that is remitted to domestic foreign exchange banks be converted into ROK Won to pay for acquisition of the outstanding stocks. FDI capital carried through customs must be reported to the custom authorities and converted into ROK Won. Alternatively, FDI capital can be transferred as foreign currency directly into the stock transferor's account.[191]

(iii) Land acquisition

Under the new Foreigner's Land Acquisition Act, foreigners can purchase land subject to the same restrictions as ROK nationals, regardless of their residence status.[192]

This excludes land, which is of military, cultural or environmental significance, and farmland designated for growing rice and barley.[193] Foreign land purchases must be reported to the relevant authorities within 60 days.[194] There is, nevertheless, an extensive regulatory framework governing land use. This includes 112 different laws administered by different ministries. A lack of transparency can be a problem as there is no comprehensive database on these regulations.[195]

(iv) Privatisation of state-owned enterprises

Foreigners can participate in the privatisation of state-owned enterprises but foreign equity limits often apply. Foreign equity limits include maximum aggregate foreign equity cap for the Korean Telecom Corporation (KT) of 49 per cent, while foreign equity limits for the Korea Tobacco and Ginseng Corporation (KT&G) have been removed.[196] Since privatization of POSCO (Pohang Iron and Steel Company) in 2000, foreign ownership limits (both aggregate and individual shareholding) on POSCO have been abolished.[197]

(v) FDI incentives

The ROK offers a range of incentives to attract FDI. Under the Special Tax Treatment Control Act, a range of tax reductions and/or exemptions may be granted to foreign corporations that invest in certain high technology or industry-supporting service businesses given that they meet the specified criteria.[198]

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[191] *Ibid.*

[192] Ownership of land in the ROK may be denied to nationals of those countries that do not allow South Koreans to purchase land in their home country but this provision has yet to be used (WTO 2004).

[193] To acquire other farmland, foreigners, like South Koreans, must be directly involved in farming there (WTO 2004).

[194] *Ibid.*

[195] OECD 2005.

[196] WTO 2004

[197] *Ibid.*

[198] In general these tax incentives consist of a full exemption from corporate income tax for five years and a 50 per cent reduction for a further two. There are similar concessions in respect of various local taxes (acquisition, property, registration, and land taxes), as well as full exemptions from customs duties (customs, special excise, and value-added taxes) on imported capital goods for up to three years (WTO 2004).

The ROK operates an elaborate system of zones[199] that provide tax and other financial incentives (such as rent subsidies on state land) to FDI within the zone.[200] Cash grants[201] are paid on investments of over US$10 million for construction or expansion of factory facilities in high technology, parts and materials, and over US$5 million in construction or expansion of facilities to carry out R&D activities.[202] To be eligible the business must employ at least 10 full-time research employees.[203]

(vi) General impediments

Environmental laws related to the establishment of new factories require that an evaluation concerning environmental impacts be conducted for a factory site which is larger than 150,000m^2. For a site covering less than 150,000m^2, an environmental evaluation consultation is necessary when the area is to be used for other purposes.[204] Labour laws can also affect FDI, with limitations on a firm's ability to lay-off workers,[205] and a complex wage structure[206] and retirement system.

3.3.2 Barriers to ROK investment in Australia

It is widely recognised that Australia encourages foreign investment. It has an open and transparent foreign investment regime. A screening procedure is maintained to ensure that foreign investment is not contrary to national interests. This operates under the presumption that foreign investment proposals are in-line with national interests. The Foreign Investment Review Board (FIRB) screens and provides advice on investment proposals. However, where the Treasurer considers a proposal contrary to national interests, he or she may reject it under the Foreign Acquisition and Takeover Act 1975 (FATA). Australia also provides national treatment with respect to the post-establishment of operations in investments.

The recent Australia-United States Free Trade Agreement (AUSFTA) substantially liberalized Australia's foreign investment screening regime with respect to US investors. Relevant measures include a large increase in the notification threshold for investments by US investors in non-sensitive sectors which are subject to screening, from A$100 million to A$871 million. Also all US "greenfield" investments have been exempted from notification and screening.

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199 There are four major zones: individual-type foreign investment zones, complex-type foreign-investment zones, free trade zones, and free economic zones. The division is largely to do with the amount of investment and the industries/technologies involved in the investment. The free trade zones, for instance, attract manufacturing companies, logistics, trade and supporting service companies.
200 WTO 2004.
201 It is not possible to receive both a cash grant and other financial support.
202 Invest Korea 2005.
203 Invest Korea 2005.
204 Invest Korea, *Korea Foreign Direct Investment: Question & Answers*, at <http://www.investkorea.org/> accessed September 2007.
205 According to Article 43 of the Trade Union and Labour Relations Adjustment Act of Korea, it is prohibited to replace or recruit new workers during industrial action. An employer shall not hire or substitute any person not related to the relevant business during a period of industrial action in order to continue work which has been interrupted by the industrial action.
206 This is due to the various allowances or welfare benefits included in the wage structure.

According to an APEC IAP review, while the liberalisation measures contained in the AUSFTA have not been extended to other APEC countries, Australia has indicated that it is open to extending further investment liberalisation on similar terms to other economies with which it is negotiating trade agreements. In addition, all APEC member economies will benefit from a recent decision by the Australian Government to raise general screening thresholds from A$50 million to A$100 million and to exempt from screening offshore takeovers of businesses valued at up to A$200 million (where Australian assets count for less than half of the total).

With respect to the rule of law and compensation principles regarding expropriation, there are no laws or regulations that prevent foreign investors from removing legitimately earned income and financial assets from the country. Australia also has a healthy and independent judicial system and a sophisticated financial system that facilitates adherence to the principles outlined above.

(i) Restricted sectors

With the exception of real estate (especially conurbations), finance, aviation, shipping and communications, foreign investors are permitted to invest in most sectors in Australia without much restriction. However, the following forms of investment must be notified to the FIRB for approval:

- Acquisition of an Australian company whose assets are worth more than A$100 million (when acquiring a 15 per cent or more stake in the company);
- Acquisition of developed non-residential commercial real estate, where it is not subject to heritage listing, worth A$50 million or more (same for farms);
- Establishment of a new business requiring total investment of more than A$10 million;
- Acquisition of residential real estate in urban areas;
- Investments in media (except for portfolio investment of less than 5 per cent);
- Direct investments by foreign governments, or companies with greater than a 15 percent direct or indirect holding by a foreign government.

The FIRB bases its decision to grant approval by rigorously investigating whether such investment is contrary to the national interest. On certain occasions, the FIRB will condition approval on certain criteria, notably the real estate development enterprise which is made subject to the condition of realizing development in a year, and large scale major industries which is subject to the condition of tackling of environmental problems.

(ii) Real estate

Foreign investors wishing to acquire residential real estate (housing and land) with the prospect of developing a collective housing community on land which was previously vacant are usually given authorization under the condition that they commence the development within one year.

Foreign buyers are permitted to purchase up to 50 per cent of all houses and apartment blocks that are newly developed or re-developed without authorization and may also purchase a house within a collective housing area designated as an “integrated tourism resort”. Furthermore, foreigners who are staying in Australia temporarily but for a period longer than one year may purchase developed residential real estate for use as their principal residence on the condition that on the date of visa expiry the property will be sold. Long-stay retirees from foreign countries also fall under this category.

The purchase of housing is permitted by foreign corporations with an established substantial business in Australia where they are buying for named senior executives who are resident in Australia for more than 12 months. Unless there are special circumstances, no more than two houses can be purchased. The corporation must also abide by the condition that the housing must be sold when the period of business ends.

3.4 "Beyond border" measures

3.4.1 Measures in the ROK market

(i) Government procurement

The ROK is a member of the WTO Government Procurement Agreement (GPA). The ROK carries out international tendering and other government procurement procedures in line with these commitments. It maintains an international tendering system is based upon open competitive tendering. No special pre-qualification requirements or restrictions are imposed on foreign suppliers.[207]

The GPA, however, applies only to the government entities that the ROK has listed in the Agreement and only for contracts above a certain monetary threshold. The threshold for procurement of goods and services is equivalent to 130,000 Special Drawing Rights (SDR)[208] for the relevant central government agencies; 200,000 SDR for sub-central government; and 450,000 SDR for all others entities bounded by this agreement.[209]

The ROK has excluded from the GPA products and services procured for resale or onward use in the production of goods or services for sale. The Agreement also does not apply to single tendering procurement and set-asides for small- and medium-sized enterprises under the Act Relating to Contracts to which the State is a Party and its Presidential Decree, as well as to agricultural, fishery and livestock products.[210]

Concerns have been raised about the implementation of these procurement procedures due to a perception of discrimination against foreign competitors.[211] Concerns have been noted that the Government's e-procurement system (KONEPS) is underutilised, accounting for only about 56 per cent of the total procurement volume in the ROK in 2004.[212]

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207 WTO 2004

208 The Special Drawing Right is an international reserve asset created by the International Monetary Fund (IMF) that also serves as the unit of account for the IMF and other international organizations. Its value is based on a basket of the key international currencies. As at 14 November 2007, one Australian dollar was worth 0.57 SDR, and one South Korean Won was worth 0.0007 SDR.

209 The threshold for procurement of construction services is 5 million SDR for central government agencies, 15 million SDR for local government and 15 million for other entities (WTO, *Government Procurement Appendices and Annexes to the GPA*).

210 WTO, Government Procurement Appendices and Annexes to the GPA.

211 OECD 2007.

212 APEC 2007.

(ii) Competition policy

The Monopoly Regulation and Fair Trade Act (MRFTA) was enacted in 1980 and amended in 2005. It regulates trade practices and anti-competitive behaviour in the ROK, including, cartels,[213] collusion, monopoly, abuse of dominant market position and anti-competitive mergers.[214]

The Korea Fair Trade Commission (KFTC) is responsible for enforcing the MRFTA.[215] It also regulates the *chaebols and* their subsidiaries. *Chaebol* subsidiaries with assets exceeding W 5 trillion cannot invest more than 25 per cent of their assets in other companies.[216] *Chaebol* subsidiaries with more than W 2 trillion in assets are banned from having cross-shareholdings in or providing cross-debt guarantees to affiliated companies.[217]

Although the KFTC actively enforces ROK competition law[218], concerns linger about the transparency of its procedural rules for hearings, and its inability to negotiate settlement agreements with parties under investigation. There are also concerns that the existing laws do not afford sufficient opportunity to respond to the allegations brought by the KFTC.

(iii) Intellectual property

ROK has a relatively comprehensive IP regime with legislation providing protection for patents, trade marks, industrial designs, copyright and related rights, utility models, computer programs and layout designs of integrated circuits.

In recent years, ROK has strengthened its intellectual property laws in a number of areas including improved protection for sound recordings and films and enhanced enforcement. Further positive changes are anticipated as a result of the KORUS FTA which was concluded in April 2007.

Despite recent reforms by the ROK to its IP laws, Australian industry has raised some concerns related to fair reimbursement for drug makers. Currently further reforms are underway prospectively to meet the KORUS FTA, which are expected to enhance overall IP protection standards in the ROK.

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213 'Hard core' cartels are illegal *per se* (WTO 2004)
214 *Ibid.*
215 Sectors such as electricity, gas, water, public health and SMEs are regulated under separate regulations as they are thought to have certain public good characteristics (Source: Korean Competition Laws, Korea Law website).
216 Certain exemptions apply, such as for subsidiaries in which there is at least 10 per cent foreign investment or where foreign investors have a say in the management (WTO 2004).
217 *Ibid.*
218 Under the three-year Market Reform Roadmap, the KFTC has pursued tasks in areas of ownership reform, transparency in corporate management and market competition. In 2005, KFTC took upon eliminating or reforming 51 government regulations that were anti-competitive.

3.4.2 Measures in the Australian market

(i) Government procurement

Australia is one of 4 OECD members (including New Zealand) which has not signed the WTO Government Procurement Agreement (GPA). The Government uses a range of schemes and policies which according to Korean business, can restrict the participation of foreign firms concerning government procurement. However, since the FTA with the US came into effect in January 1, 2005, government procurement policies at the Australian Federal Government level have undergone drastic adjustments. Australia has extended the benefits of the AUSFTA to all other countries. Non-discriminatory rules have been introduced, resulting in the abolition of barriers to access to the Federal Government procurement market.

At the state level, some domestic preferences persist. If states purchase domestic goods (i.e. Australian made), they can be granted a 10 to 20 per cent preferential margin compared to the purchase of imported goods. The preferential margin for domestic businesses varies among the states and territories: 10 percent applies for Western Australia, and 20 percent for New South Wales, Northern Territory and South Australia. Although there is no official preferential margin for domestic businesses in the case of Victoria and Queensland, state government entities are strongly encouraged to consider regional employment inducing effects in their government procurement decisions, implying that in reality polices to maintain preferential treatment for Australian businesses continue to exist.

Australia has not yet established a single institution dedicated to overseeing government procurement. According to Korean business, bid results can be unannounced and the bidding process can be non-transparent. For example, unless requested, firms which withdraw from the bidding process can face difficulty obtaining information on the status of their bid.

There is also a perception among Korean business that when bidding for government procurement, firms can experience difficulty in securing a price margin. Current practices can make it very difficult for a foreign firm to be successful in a bid. Procurement requirements can differ from international standards in cases where such standards do not apply, which can further disadvantage foreign firms. For these reasons bidding for Australian Government procurement by South Korean firms and businesses has generally been avoided in past years, with the result that participation has been minimal.[219]

[219] MOFAT, Trade Environment and Sectoral Analysis. (2006)

4. Economic impacts of liberalisation of bilateral trade and investment

4.1 Overview of the net benefits of liberalisation

The net benefits of liberalising international trade and investment are based on the principle that liberalisation increases the mutual gains from exchange. Such gains exist regardless of whether the exchanges take place within or across national boundaries. Both parties to any voluntary exchange must obtain a net benefit for it to proceed.

A free trade agreement between Australia and the ROK offers potential economic benefits to both parties in terms of improved allocative efficiency, improved productivity growth and enhanced investment flows deriving from further liberalisation of both trade and investment. It also offers significant opportunities to strengthen and build on the bilateral relationship to reap mutually beneficial outcomes via the closer economic integration that an FTA can be expected to deliver.

4.1.1 Improved allocative efficiency

Liberalisation of trade and investment allows increased specialisation. Countries have incentive to produce those things in which they have a comparative advantage. Through increased specialisation the countries in question increase the total value of the output that they can produce from a given quantity of productive resources— specifically their endowments of land, labour and capital.

In technical parlance, liberalisation improves the allocative efficiency of the economy.[220] It does so by encouraging resources to move away from producing those goods and services that are less valued by the community and into producing those goods and services that are more highly valued.

The gains in static allocative efficiency that flow from reducing barriers to trade and investment are relatively easy to quantify using econometric models.[221] The quantitative gains from reducing barriers to trade and investment that are estimated by econometric

220 Static allocative efficiency looks at the productivity of an economy over the long term, given fixed quantities of labour, capital and land. In doing so it ignores the time that is taken in adjusting to economic changes. Dynamic allocative efficiency is concerned with the productivity when the quantities of labour, capital and land are able to very over time in response to changes in the wage rate, the rate of return on capital and the rent received for land.

221 Computable general equilibrium (CGE) models, such as the Global Trade and Assistance Project (GTAP) and Monash Multi-Country (MMC) models used in this report have been specifically developed for this purpose. They include a number of parameters — the elasticities of substitution between the imported and domestically produced versions of products, for example — which are difficult to estimate precisely. Broadly speaking there are two analytical approaches to estimating the economic costs and benefits of liberalisation — econometric estimation or general equilibrium simulation. Econometric analysis is generally highly selective about the explanatory variables that it considers and is, therefore, relatively parsimonious in the data it requires. Unfortunately it can only be performed after the event and its results can be statistically inconclusive. CGE analysis, on the other hand, can be undertaken before the event and is comprehensive in its scope — CGE models have a mathematical representation, albeit highly idealised, of every sector in an economy and their relationships with each other. As a result, however, CGE models require relatively large quantities of data if they are to generate results that are sufficiently detailed to be useful for policy development.

modelling techniques do not, however, generally capture the full extent of all the efficiency gains that are derived from liberalisation.

For example, they can have difficulty accounting for the consumer benefits from the increased choice of goods and services that can flow from a reduction in trade and investment barriers. This can be most pronounced in the case of non-tariff barriers, particularly where they completely insulate a particular domestic market from any foreign competition.

Liberalisation of tariff barriers to merchandise trade

Qualitatively, it can be assumed that an Australia-ROK FTA which reduced tariffs in areas of international comparative advantage for each country would be likely to result in gains in static allocative efficiency for both parties. These gains are not expected to be large, given that generally tariffs barriers between the two economies are generally already low. The most significant exceptions to this are the tariffs and tariff rate quotas applied to agricultural imports into the ROK, and those on textile, clothing and footwear (TCF) imports into Australia.

For Australia the most obvious gains in static allocative efficiency from an FTA with Korea would arise from reductions in ROK agricultural trade barriers, where Australia is a globally competitive exporter. The Australian agricultural sector has a strong interest in expanding market access to the ROK market in meat, dairy, grains, and sugar. Gains could also be expected to arise from tariff reductions in areas where ROK tariffs are modest, but the bilateral trade is growing and important, such as medicines, chemicals and wine.

For their part ROK exporters could be expected to gain from reductions in Australia's tariff on textiles and garments, as well as automobiles and automotive parts. In each of these sectors the barriers are relatively high compared with overall levels of tariff protection in the rest of the economy and ROK exports are globally competitive. The ROK could also be expected to gain from reducing its own levels of tariff protection against imports from Australia that serve as important inputs for local production. This also offers obvious benefits for ROK consumers. Likewise, reductions in Australia's tariffs would not only aid ROK exporters, but also benefit Australian consumers in terms of greater variety and lower prices.

Liberalisation of non-tariff barriers to merchandise trade

Typically the static allocative efficiency gains arising from tariff reductions, particularly in a low tariff environment, are relatively modest compared to the gains that flow from reducing non-tariff barriers. These are generally much more damaging to economic efficiency than tariffs. Consumer benefits from the increased choice that can flow from a reduction in such barriers can be large, particularly as they can prevent products from even entering the domestic market.

The removal or reduction of the non-tariff barriers affecting bilateral trade in goods could offer significant allocative efficiency gains for both parties. These would mainly be derived from improving the transparency and administration of regulatory procedures affecting trade in goods.

For ROK exporters, efficiency gains could be derived from improved transparency in quarantine and anti-dumping procedures in Australia.

Likewise, Australian exporters would benefit from improved coordination and harmonisation of labelling requirements and inspection standards in Korea, particularly for agricultural and food and beverage products, as well as improved transparency in customs procedures and regulatory responsibility. Greater transparency and improved administration of the tariff quotas, which are applicable to some agricultural imports into the ROK, could also be important commercially.

Addressing many of these barriers often requires more than simply removing trade barriers and implies some form of regulatory reform in each country or harmonisation of regulations between them. FTAs can assist this process to some extent by setting up regulatory frameworks in which these issues can be addressed, although harmonisation — or some progress towards it — is generally limited to specific areas of mutual interest to the countries in question as a long term objective.

The Closer Economic Relations Trade Agreement between Australia and New Zealand demonstrates the very considerable benefits that can be achieved from such approaches. In the Australia-US FTA, for example, several committees and working groups were established under the auspices of the FTA to address issues of particular concern, such as on quarantine and other SPS matters, and to facilitate further regulatory cooperation between the two countries, such as in financial services. Similarly the Korea-US FTA (KORUS) will establish committees to deal with bilateral quarantine issues that arise in that bilateral relationship.

Minimising trade diversion

A key to securing the gains from reductions in tariff protection from a bilateral trade agreement is in ensuring that, on balance; trade with the rest of the world is created rather than diverted. Where liberalisation is undertaken bilaterally, the barriers to trade between the two partners are reduced but any barriers they each have against the rest of the world are not affected. There is therefore a clear possibility that bilateral liberalisation could divert merchandise trade with the rest of the world, rather than create new trade in aggregate.

When merchandise trade is diverted from a lower cost supplier in the rest of the world to a higher cost supplier in a free trade area, both the importing country and the lower cost supplier are made worse off by the switch. On the other hand the lowering of trade barriers on a bilateral basis will tend to increase the total merchandise trade in which the two countries are involved, both the trade with each other as well as that each conducts with the rest of the world. Such trade creation enhances the economic welfare of each. Assessing the trade-off between the economic benefits of trade creation and the economic costs of trade diversion is a therefore critical issue for the assessment of all prospective FTAs.

The empirical literature makes it clear that assessments of bilateral liberalisation have to be done on a case-by-case basis.[222] There are no robust 'rules of thumb' to guide policy

[222] For a recent survey of the economic literature on preferential trading areas, both the theoretical and empirical literature, see Richard Adams, Phillipa Dee, Jyothi Gali, and Greg McGuire, *The Trade and*

makers. The assessment will depend on the nature and the extent of the liberalisation sector-by-sector — particularly the exemptions from and exceptions to liberalisation — as well as on the detailed rules that accompany them — such as rules of origin, safeguard arrangements, and provisions for the settlement of disputes.

For Australia and the ROK, it can generally be assumed that trade diversion should be minimal, with a significant increase in net trade creation where bilateral barriers are reduced comprehensively.[223] This is likely to favour trade by each country in its areas of comparative advantage. An FTA which lowered trade barriers in the ROK in areas where Australia is globally competitive — particularly agriculture and minerals – and lowered them in Australia where the ROK is globally competitive — namely electronics and automobiles — would achieve this end.

A further and increasingly important consideration in assessing the benefits of bilateral liberalisation is the need to minimise the scope for trade diversion, including the trade diversion that arises from FTAs with third parties where they adversely impact on the competitiveness of both Australian and ROK exporters. A strong case can be made for an Australia–ROK FTA which grants at least equivalent terms of market access, or treatment, to either party in each country to that granted to third countries in other FTAs.

As noted in greater detail in Chapter 2, the KORUS FTA presents a significant threat to Australia's agricultural trade with the ROK. For its part, Australia's FTA with Thailand has disadvantaged ROK automobile manufacturers in terms of their access to the Australian market.

Some companies in the mining industry and the precious metals industry have cited other agreements ROK has with third countries which have disadvantaged them commercially. They have raised the need to secure equal (or better) treatment as a key benefit to be derived from an FTA. This is particularly important since China is a competing market for Australia. In addition, the ROK-Switzerland FTA removes a 3 per cent tax on gold imported into ROK from Switzerland. While seemingly not large when expressed in terms of the value of output, the tax advantage is much more significant in terms of the share of value-added in the product.

Prospective ROK FTAs with trading partners such as China and Japan, further strengthen the need to ensure that our bilateral trade relationship is not disadvantaged by discriminatory treatment accorded to third party competitors.

Investment Effects of Preferential Trading Arrangements – Old and New Evidence, Staff Working Paper, Australian Productivity Commission, Canberra, Australia, May 2003. One of the most comprehensive surveys of the theory is to be found in Jagdish Bhagwati, Pravin Krishna and Arvind Panagariya (eds.), *Trading Blocs: Alternative Approaches to Analyzing Preferential Trading Agreements*, The MIT Press, Cambridge and London, UK, 1999. Surveys of the empirical literature are in Dean A De Rosa, 'Regional Integration Arrangements: Static Economic Theory, Quantitative Findings, and Policy Guidelines', *Mimeo,* The World Bank, Washington, DC, 17 August, 1998 [accessed at http://www.worldbank.org/html/dec/Publications/Workpapers/wps2000series/wps2007/wps2007.pdf] and Sherman Robinson and Karen Thierfelder, 'Trade liberalisation and regional integration: the search for large numbers', *Australian Journal of Agricultural and Resource Economics*, 46(4), pp. 585-604, December, 2002. One of the few surveys that canvass the literature on the non-trade aspects of preferential arrangements is Richard Pomfret, *The Economics of Regional Trading Arrangements*, Clarendon Press, Oxford, UK, 1997.

[223] See results of modelling conducted in Chapter 4.2.

Notably, an FTA that leads to each partner eliminating all of its tariffs on imports from *all* countries is clearly the simplest and most desirable way to remove the scope for trade diversion arising from FTAs with and among third parties.[224] This consideration underscores the importance of each FTA partner achieving the comprehensive elimination of all its tariffs if it is to derive maximum economic gains from FTAs. If, however, such comprehensive elimination is impractical, the only alternative is to assess the extent of trade diversion from the partial removal of tariffs between the FTA partners on a case-by-case basis as outlined earlier.

Liberalisation of services trade

While improvements in static allocative efficiency are expected in both goods and services, an Australia-ROK FTA offers the potential for much greater gains in the services sector.

This is becoming increasingly important as the extent and importance of services expands rapidly in both economies. This is true even in the manufacturing sector, where the effects of services on backward and forward linkages, value-added, and job creation become more significant.

Notably the true extent of trade in services tends to be underestimated by statistics, which make quantitative estimates of actual gains deriving from them difficult. This is particularly the case when it comes to services provided outside the nation state.

4.1.2 Improved productivity growth

A further benefit from the liberalisation of international trade and investment is faster productivity growth, which with population growth is the fundamental determinant of the growth in national living standards.[225] Liberalisation fosters productivity growth in two ways. Lowering barriers to trade and investment facilitates access to technologies that are not available from the domestic market and increases competition in the domestic market.

The combination of the two increases the incentives for domestic firms to develop new products and services, new markets for existing products and services, and less costly ways of producing or distributing existing products and services. Successful innovation, in turn, generates increased investment in the domestic economy. This attracts foreigners who are likely to bring with them other new technologies and know-how as part of their investment, thereby creating a 'virtuous circle'.

These are known as the gains in dynamic efficiency from liberalisation. They are more difficult to quantify than the gains in static allocative efficiency but they are generally considered to be potentially much larger.[226] Business innovation is much broader in

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[224] This approach is often termed 'open regionalism' in the literature and it forms the foundation of the Bogor Declaration of the Asia-Pacific Economic Co-operation on the liberalisation of trade and investment in the region.

[225] Nasar, Sylvia, 'Productivity', in David R Henderson (ed.), *The Concise Encyclopedia of Economics*, Liberty Fund, Indianapolis, IN, 2007 [accessed at http://www.econlib.org/library/Enc/Productivity.html]

[226] Most of the empirical approaches to the quantification of the dynamic efficiency gains form liberalisation to date have been somewhat *ad hoc* and arbitrary. They have tended to concentrate on the implications of liberalisation for the extent of the factor endowments — land, labour and capital — that

scope and more varied in its application than R&D. Accordingly, its benefits and costs are inherently difficult to isolate and quantify with any precision.[227] Despite these difficulties, the available evidence suggests that the spur to productivity growth is by far the largest single benefit of the liberalisation of trade and investment. As Baumol, Blackman and Wolff have concluded:

> 'It can be said without exaggeration that in the long-run probably nothing is as important for economic welfare as the rate of productivity growth.' [228]

The ROK needs a significant expansion of its services industry if it wishes to develop its economy fully by eliminating the gap with leading OECD economies. Over the past 40 years, the ROK has implemented an export-led economic development policy, focusing primarily on the manufacturing sector. The development of the service industry has been relatively slow.

As indicated in Table 4.1 below, the labour productivity in most ROK service industries lags well behind that in the developed countries, including Australia. This has affected the capacity of the ROK to realise the economic benefits from developing globally competitive services industries.

Table 4.1: Index of Labor Productivity in Services, PPP basis, selected countries, ROK = 100

Services Sector	2000	2001	2002	2003	Average [229]
Australia	175.1	177.4	171.8	172.7	172.0
Canada	159.6	161.8	157.3	155.7	157.7
France	202.2	200.3	192.9	192.0	198.3
Japan	188.4	190.1	186.5	185.1	189.1
USA	246.1	248.0	240.9	241.1	245.7

Source: International Productivity Comparison, Korean Productivity Center, 2006

An Australia-ROK FTA will increase the competitive pressure on the ROK services sector to develop more advanced structures and strategies. It would assist with the development of an advanced service industry; increase competitiveness of manufacturing and other industries and result in higher productivity and efficiency in the whole economy, with resulting gains in welfare and growth. By reducing the margin between the prices of Australian and domestic services, the ROK could increase national welfare, in a way comparable to the liberalisation of goods trade. Because many services are

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are able to be productively deployed in the domestic economy. The Dynamic GTAP and Monash models, which have been used by KIEP and CoPS respectively for the present study, both incorporate explicit capital accumulation features. As with virtually all approaches to GE modelling, however, their treatment of the capital accumulation process is essentially mechanical and ignores how capital accumulation is the outcome of an earlier process of entrepreneurial discovery and innovation.

[227] For this reason, their quantification has generally been handled by the use of relatively crude proxies, such as arbitrary assumptions about the impact on sectoral costs of production in GE models.

[228] William J Baumol, Sue Anne Batey Blackman, and Edward N, Wolff, *Productivity and American Leadership – The Long View*. The MIT Press, Cambridge, MA, 1989.

[229] The aaverage reported here is the numerical mean for the period 1995-2003 for Australia; 1995-2004 for Canada; 1999-2004 for France; 1996-2004 for Japan; and 2000-2004 for USA

intermediate inputs in the production of goods and other services as mentioned above, this can be compared to a reduction of a tax on downstream sectors.

The labour productivity of individual services industries in the ROK lags the outcomes observed in Australia across all service industries (see Table 4.2). Greater competition from Australian service providers could therefore serve as a basic platform to help assist the development and advancement of ROK service industries.

Table 4.2: Index of Labour Productivity, by Service Industry, PPP basis, Australia, ROK = 100.0

Services Sector	2000	2001	2002	2003	Average [230]
Wholesale & Retail trading	212.3	211.4	205.2	215.6	217.4
Restaurants/hotels	251.4	239.9	246.1	249.5	257.4
Transportation/warehouse/ telecommunications	167.8	163.6	166.3	153.2	183.0
Finance Insurance	150.4	167.5	157.8	163.0	149.6
Real estate/Business service	145.1	175.5	180.8	184.2	149.1
Other services	128.5	130.1	129.9	131.0	120.1
All Services	175.1	177.4	171.8	172.7	172.0

Source: International Productivity Comparison, Korean Productivity Center, 2006

Kim and Kim[231] have found some evidence of this phenomenon occurring in the ROK.[232] They examined the changes in productivity of the ROK services and manufacturing sectors from 1970 to 1997. They found that the services sub-sectors of distribution, transport, and communications, which were liberalized in the 1990s, showed improvement in productivity in the late 1990s, whereas finance, which had been nearly closed until the late 1990s, showed negative total factor productivity (TFP) growth rates throughout the period studied.[233]

The experience of the distribution services of the ROK provides some additional evidence of enhanced competition and productivity due to liberalisation. Price margins of department stores and supermarkets have fallen significantly since the government allowed the establishment of hyper-markets by foreign retailers.

Australian service exporters should also benefit from greater liberalisation of the ROK services sector through the removal of specific barriers and improved functioning of the economy more generally as a consequence of an FTA that achieved liberalisation of services exports of interest to Australia. Although deregulation and reform of the

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[230] The average reported here is the numerical mean for the period 1995-2003

[231] June-Dong Kim and Jong-Il Kim, *Korea's Liberalisation of Trade in Services and Implications for Australia*, August 2001

[232] To what extent an FTA between the ROK and Australia might contribute to a more competitive services sector is beyond the scope of this report.

[233] Notably though, due to the short time period of the liberalisation process, it is difficult to conclusively prove that liberalisation of trade in services has caused an increase in productivity in Korea.

services sectors has continued since the Asian currency crisis, business continues to face restrictive regulations in some service areas, such as financial services, legal and accounting.

Australian suppliers of software applications in the banking and financial services sector have the capacity to assist with the development of the ROK's service industries. The ROK's reform and modernization 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.

A more efficient banking sector would support the functioning of both foreign and domestic businesses. A strengthened education sector would improve the quality of training and the available workforce for domestic and foreign enterprises in the ROK.

The benefits could extend beyond services trade. An FTA would offer Australian companies an advantage in participating in ROK growth and the wider opportunities it offers. For Australian companies in the electrical and electronics sector for example, an FTA will provide increased access to global supply chains that operate through the ROK. The ROK is one of two key economies in the Greater China/North Asian region identified by the Australian Electronics Industry Action Agenda as being critical to the success of Australian industry in accessing global supply chains.[234] Australian industry has already forged a series of important strategic alliances with ROK industry groups (including those representing electrical manufacturing and information security), so as to maximise the opportunities for global integration, which could be further strengthened through an FTA.[235]

4.1.3 Enhanced investment flows

Liberalisation of investment

Bilateral investment flows are growing and can be expected to continue to increase. As noted in Chapter 1, for example, Macquarie Bank has a strong and growing presence in the ROK and Oceanis Australia is to expand its operations in the next few years. Korea has an interest on Australia's mineral and energy resources which are essential for Korean industry. Given the complementarities between the two economies, there is significant potential for liberalisation of investment to enhance bilateral investment flows, in particular, greater ROK investment in Australia. A liberalised investment environment also offers potential growth opportunities for mutually beneficial bilateral commercial relationships.

Opportunities exist to enhance FDI in the mining sector. Australia has contributed to the ROK's sustained economic development over the past decades by steadily supplying energy and mineral resources. The ROK has made substantial investments in Australia's

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[234] See Australian Electrical and Electronic Manufacturers Association (AEEMA) Media Release; *Australian industry integrates globally through Korea*, 25 October, 2007.
[235] AEEMA, *Submission- Australia's relationship with the ROK and developments on the Korean Peninsula*, May 2005. Also see AEEMA, *Strategic Alliances- the Australian Electrical and Electronic Manufacturers Association*, 18 April 2005, accessed at http://www.aeema.asn.au/ArticleDocuments/27/Strategic%20Alliances.pdf

natural resources and it is also seeking to establish more opportunities for partnership with Australian companies in order to secure reliable supplies.

Australia has low cost mineral resources, strong and stable institutions and well-developed infrastructure (unlike many other resource-rich countries). [236] These factors make it an attractive source of mineral commodities for the ROK.

ROK has growing energy and security concerns and is looking to secure a stable supply of natural resources. Australia represents for the ROK a strategically important country in terms of natural resources (such as coal, iron ore, nickel and uranium). It is one of the ROK's major suppliers of mineral resources. In a globalised economy in which countries must think about how to secure inputs before deciding on what to produce, imports of Australian minerals and energy resources are important to the ROK economy. The ROK's future steel, aluminium and mineral consumption will continue to increase in both aggregate and per capita terms on account of its micro and macroeconomic reform agenda, and strong expected future growth forecasts.[237]

An FTA provides a means to strengthen institutional arrangements in each country and provide a strong base for building flexible commercial relationships supportive of further investment. The Australian mining industry has pointed out for example, that less restrictive controls on investment in Australia and the consolidation of laws that promote flexible commercial relationships (such as mergers and acquisitions and joint ventures) have the capacity to encourage greater foreign direct investment (FDI) for mining related purposes.[238] For Australia, an FTA offers the possibility of guarantees of market access for commercial ventures in a growing and indispensable export market and reassurance of consistency of supply.

For the ROK, an FTA would allay concerns that other countries, such as Japan and China, which are negotiating FTAs with Australia, might gain preferential access to its energy resources. Coal is a critical requirement for ROK industry and LNG is perceived as the next strategic fuel for the ROK's economic growth. In energy resources, Australia is a major world player and has the capacity and experience to be a reliable supplier to meet ROK energy needs. The ROK's six most important mineral resources — bituminous coal, iron ore, uranium, copper, zinc and rare earths — are already imported from Australia.

The ROK's *National Energy Plan* sets out the country's energy policies and requirements until 2011. It projects a 4.8 per cent annual increase in the demand for LNG. Australia is in a good position to meet the ROK's energy demands well into the future. In addition, the ROK's development plan for strategic minerals aims to secure mineral resources for industrial raw materials.

The potential to enhance the investment relationship extends beyond the resources sector. The Australian market offers many potential investment opportunities from the ROK's perspective. It 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 ROK companies, particularly in terms of telecommunications

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236 Minerals Council of Australia, *Submission to the Australian Government*, August 2007.
237 *Ibid.*
238 *Ibid.*

equipment, passenger motor vehicles, television and computers. Greater investment opportunities could be expected to flow through to growth areas such as financial services, IT, automotive and leisure.

Minimising trade diversion

The inclusion of provisions to liberalise investment in a bilateral FTA does not reduce the importance of the issue of trade diversion. Bilateral removal of relatively small barriers to merchandise trade can have significant impacts on investment flows. For example their removal can attract investment into one of the partners to service a market in the other and thereby enlarge the extent of the trade diversion.

At the same time the removal of barriers to inward investment can have a significant effect on investment flows. In this case there is the risk of the investment in question being diverted from a lower cost source to a higher cost one, which would be economically costly to the destination country for the investment. The empirical evidence suggests that the risk of investment diversion is low under FTAs that liberalise investment.[239]

Provided that investment liberalisation reduces the transaction costs associated with investing in the respective countries, liberalisation does not have to increase the inflow of investment to be economically beneficial to the country in question. On the other hand if liberalisation simply means that the cost of capital on international capital markets is less than the risk-adjusted return in the domestic capital market, the greater the international mobility of capital the greater the economic cost to the countries in question.

The empirical evidence suggests that the risks of diversion occurring from both liberalisation of merchandise trade and also inward investment are relatively low.[240] This is likely to be the case with the proposed Australia-ROK FTA.

4.1.4 Closer economic integration

External benefits are expected to be generated by the liberalisation of international trade in services and investment through closer economic integration. These benefits arise from the impacts on third parties from a commercial transaction, which neither side of the transaction takes into account when they agree on its terms.[241] The external benefits that can flow from liberalisation include the introduction of new standards or models of commercial behaviour by foreign investors or service providers[242].

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[239] Adams et al 2003.
[240] Adams et al 2003.
[241] The textbook example of an external cost or negative 'spill over' is pollution from a production process where the costs that the pollution imposes on third parties are not reflected in either the price of the good being produced or the returns to the owners of the labour and capital that produce it.
[242] Such phenomena are also called 'externalities' or 'spill overs' in the economics literature. A notable example is the impact of McDonald's fast food franchises on the commercial conduct in transition and Asian economies. The introduction of McDonald's franchises in these countries has been associated with the acceptance of consumers of informal queuing arrangements and consumers demands for higher hygiene standards in food outlets more generally. Douglas A Irwin, *Free Trade Under Fire*, Princeton University Press, Princeton, NJ, 2002.

Although these benefits are difficult to assess, and more so than the other types of gains,[243] there is potential for strengthening the Australia-ROK economic partnership, especially in the areas of IT, communication, education, tourism and financial services. Since the ROK government is committed to the growth of these sectors and Australian firms can provide advanced know-how and experience, more bilateral cooperation in an FTA regime will bring a win-win situation for both Australian firms and the ROK economy.

There is also scope for benefits to be derived from cooperation in areas traditionally considered to be 'beyond the border' which are related to trade in services. This includes addressing matters such as differential tax treatment, mobility of business personnel and recognition of regulatory standards. Consultations with industry suggest there is scope for benefit from an FTA in all these areas in the financial services industry in particular.

Greater levels of FDI can also drive further benefits arising from stronger commercial relationships. An FTA can provide a platform for Australian and ROK firms to build stronger, mutually beneficial partnerships, such as those for the development and application of technology across industries.

A strengthened bilateral investment relationship will also foster greater cooperation in areas such as financial services, IT, automotive and leisure. Through the operation of the Korea-Australia Technology Cooperation Pilot Fund, for example, two companies from the ROK and Australia in 2003 succeeded in establishing a joint project in nano-power technology. Both sides are also committed to exploring further opportunities for cooperation between Australia's digital content and software sectors and the ROK IT industry. Both ROK and Australian industries will benefit from a synergy effect created by competitive ventures involving cutting-edge technologies.

In addition, over the long term the automotive sector may present many mutually beneficial business opportunities. Despite the ROK's considerable automotive manufacturing capacity, its components sector is relatively weak from a technological perspective. The development of an independent automotive technological capacity remains a high priority. ROK firms are increasingly seeking strategic technological alliances with Australian companies.

4.2 Economic feasibility of liberalisation of trade and investment

4.2.1 Overview

This section provides a quantitative assessment of the economy-wide and sectoral impacts of bilateral liberalisation between Australia and the ROK.

For this purpose, parallel analyses of the impacts of liberalisation were undertaken by the Monash Centre of Policy Studies (CoPS) and the Korean Institute of International Economic Policy (KIEP). CoPS and KIEP have both used Computable General

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[243] The empirical work that has been undertaken so far has been highly suggestive but somewhat inconclusive, at least as to the extent of this type of gain.

Equilibrium (CGE) models of the world economy that break down global economic activity between Australia, the ROK and the rest of the world.[244]

In each case the modelling analyses have relied on data from the 2001 version of the Global Trade Analysis Project (GTAP) database.[245] The database recognises up to 87 regional economies and 57 industry sectors that produce up to 57 goods and services. For each economy the database includes details of domestic assistance and border protection, as well as trade and investment flows on a bilateral basis.

i. Models used & key assumptions

CoPS used the Monash Multi-Country (MMC) model, a dynamic Computable General Equilibrium (CGE) model of the world economy, to estimate the effects of bilateral liberalisation between Australia and the ROK. Its dynamic features mean that MMC can estimate the impacts of changes in the stock of capital and the size of the labour force over time, as the producers and consumers in each economy respond to changes in prices and incomes. A non-technical description of the MMC model is presented in Annex 4A to this Report and a more technical one may be found in Mai (2004).

KIEP used three CGE models for its analysis of bilateral liberalisation. For its basic analysis KIEP used the Static GTAP model developed thorough Purdue University.[246] As static CGE models assume that the quantities of capital, labour and land in each economy are fixed, the time paths of the resource adjustments to any change cannot be addressed by such a model. To fill these gaps, KIEP supplemented the Static GTAP model with two other CGE models:

- Dynamic Capital Accumulation model. This CGE model allows the capital stock to accumulate over the medium term.[247] KIEP used it to capture the effects of liberalisation of trade on savings and investment, and in turn on output.
- Total Factor Productivity (TFP) model. KIEP used this CGE model to account for the impacts of trade liberalisation on productivity. [248]

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[244] GTAP is a global network of researchers and policy makers who conduct quantitative analyses of international policy issues. The Project is co-ordinated by the Department of Agricultural Economics at Purdue University in the US and involves the collection of data, as well as the development of models and utilities, for use in multi-regional, applied general equilibrium analyses of global economic issues.

[245] The base data in the GTAP database is from the year 2001. The model database is updated yearly to 2006 using historical data and updated yearly to 2020 using forecast data. In the tariff simulation, CoPS assumes that the level of bilateral tariffs in 2006 is reduced to zero from the year 2007.

[246] The 'kernels' of the Monash and GTAP modelling frameworks share a common ancestry and a number of the key research personnel have worked on the development of both. Not surprisingly, the two frameworks are based on very similar mathematical structures and microeconomic principles, such as constant rates of substitution between productive factors, constant returns to scale in production and constant rates of substitution in consumptions.

[247] In contrast the MMC model used by CoPS is a dynamic CGE model that captures changes to both capital and labour induced by liberalisation, and evaluates its net impact over the long term.

[248] For technical description of TFP model, see: Lee, Hongshik et al, *Regional Trade Agreements and Productivity Improvement*, Policy Analyses 06-17, Korea Institute for International Economic Policy (KIEP), 2006.

Differences between CoPS and KIEP modelling approaches

It is important to recognise that the modelling approach adopted by CoPS and KIEP differed significantly. For example, while CoPS analysed the bilateral liberalisation of services and investment as well as merchandise trade, KIEP only addressed the bilateral liberalisation of merchandise trade in its three modelling analyses. As a consequence KIEP estimates of the impacts of liberalisation on capital accumulation and productivity did not allow for the effects of the liberalisation of services or investment and therefore understate the full extent of those impacts.

Although all three models simulated by KIEP used the GTAP database, a number of modifications have been made to some of the parameters in the database.

The parameters in question were of the substitution elasticities for individual products between the ROK and imported sources of supply, and between different import sources of supply. They measured the proportionate change in the quantity of imports consumed for a one percent point change in price. KIEP considered that the values in the GTAP database for a wide range of products overestimated the responsiveness of the ROK domestic market. KIEP therefore substituted a series of 'Korean parameters' in their place. Such replacements may have reduced the size of the measured changes due to liberalisation but not their direction. The values of the Korean parameters used in the KIEP analysis are summarized in Table 4B.1 of Annex 4B.

In each case modelling was used to estimate the evolution of the Australian, the ROK and the Rest of the World economies for up to two decades into the future. This baseline scenario included a series of 'business as usual' assumptions. They included no change to existing trade or investment barriers, and informed the model of how the economies evolved during 2001 to 2006 based on historical data and how the economies were forecasted to evolve from 2006 to 2020 under 'business-as-usual' conditions with no policy changes.

The baseline scenario was used to measure the impacts of each liberalisation or policy scenario, as a series of annual variations from baseline measures. The measures used include gross domestic product (GDP), gross national product (GNP), consumption, investment, value of output by each industry sector, exports and imports.

For the policy scenarios, each model was used to estimate the evolution of the three economies when bilateral barriers were reduced. Given the nature of these models all such barriers have to be expressed as price equivalents. In the case of barriers to merchandise trade, all barriers have to be expressed as a single tariff equivalent. This meant that quantitative restrictions, such as import quotas, can only be roughly approximated for the purpose of the analysis. A similar problem existed in the case of analysing barriers to investment and services. Such barriers are often approximated by varying the rates of return on capital. As an FTA aims to eliminate or reduce tariff as well as non-tariff barriers, the modelling analyses in this report, therefore, cannot analyse the full impact envisaged under a proposed FTA.

For their evaluation, CoPS estimated the results for three policy scenarios:

- the removal of bilateral border protection on merchandise, with tariffs and tariff equivalents of all quotas reduced to zero in 2007;

- the removal of bilateral barriers to investment in 2007; and
- the removal of bilateral barriers to trade in services in 2007.

For its investment liberalisation scenario, CoPS assumed that the removal of investment barriers would reduce the required rate of return on Australian investment in the ROK by 0.19 percentage points, and that on ROK investment in Australia would be reduced by 0.20 percentage points. It also assumes across-the-board improvement in primary factor productivity in the ROK of 0.039 per cent and in Australia of 0.04 per cent.

In the case of its services liberalisation scenario, CoPS assumed that the removal of services barriers would reduce the required rate of return on Australian investment in the ROK services sector by 0.42 percentage points, and that on ROK investment in the Australian services sector would be reduced by 0.35 percentage points. Although the assumptions related to the required rates of return were based on a review of the relevant empirical literature, they were somewhat arbitrary. [249]

For their policy scenario, KIEP used all three CGE models to estimate the effects of the elimination of all tariffs and tariff-equivalents on all merchandise trade, except for rice, in 2007. For its analysis using the TFP model, KIEP assumed that total factor productivity in the ROK manufacturing sector would increase by 0.01 per cent as a result of bilateral trade and investment liberalisation.[250]

KIEP did not analyse the impact of any bilateral liberalisation of trade in services or of investment.

The results obtained with the Static and Dynamic Capital Accumulation models used by KIEP are summarised in Annex 4C.

ii. Key conclusions & results

The modelling results by CoPS and KIEP demonstrate that bilateral liberalisation of trade and investment will generate increased output and trade, and will be welfare enhancing for both Australia and the ROK.

To illustrate the extent of these gains, compared to the baseline, CoPS has estimated that comprehensive bilateral liberalisation (liberalisation of merchandise and services trade, and investment) will boost the present value of real GDP and real GNP between 2007 and 2020 as follows:

- Australia's real GDP by US$22.7 billion;
- ROK's real GDP by US$29.6 billion;
- Australia's real Gross National Product (GNP) by US$30.2 billion; and
- The ROK's real GNP by US$29.5 billion for the ROK. .

[249] The magnitude of the reductions in the required rate of returns and the productivity improvements are calculated by CoPS based on the following information: empirical estimation using Chinese data (Mai et. al. 2003; and Chuang and Lin 1999); bilateral investment volumes; and the relative restrictiveness to foreign investment in different countries as estimated in Golub 2003 and Hardin and Holmes 1997

[250] The joint research team for the ROK-Australia FTA estimated that total factor productivity in the manufacturing sector in ROK will increase by 0.01 percent due to the proposed FTA.

For its policy scenario under the assumption of total factor productivity gains, KIEP projected that bilateral merchandise trade liberalisations will:

- result in a 0.05 per cent increase in ROK's GDP and a 0.02 per cent increase in ROK's welfare; and
- for Australia, GDP and welfare will rise by 0.18 per cent and 0.24 per cent respectively relative to the baseline levels.

Due to differences in their CGE models, baseline assumptions and definition of the liberalisation scenarios, the analytical approaches that were used by CoPS and KIEP are not strictly comparable. Nevertheless, their results tell essentially the same story – the comprehensive liberalisation of merchandise trade between the ROK and Australia would enhance economic output and welfare in both countries. Their similarities can only increase the confidence that may be placed upon them.

Of the several modelling analyses that were undertaken by KIEP, its scenario of 100 per cent tariff liberalisation with its Dynamic Capital Accumulation and TFP Models are most comparable to the CoPS full trade liberalisation scenario under the Monash Multi-Country Model. In these cases, the proportionate changes in the key macroeconomic indicators— namely GDP, GNP, exports and imports — that were estimated for the ROK and for Australia by KIEP and by CoPS were consistent with each other.

The real GDP increase in both countries was due to increased capital accumulation, improved productivity and a better utilisation of resources. A key factor underlying the increase in real GNP for the two countries was improved terms of trade. Liberalisation will enhance the economic partnership between Australia and the ROK by increasing bilateral trade and investment flows between them. On balance, it was also trade creating for the world as a whole, with the volume of world imports increasing from its baseline level as a result of bilateral liberalisation between the two countries.

The Australian industries that were estimated to benefit most in terms of an increase in the value of their output were meat, dairy products, sugar, minerals, motor vehicles and parts, and non-ferrous metals. The ROK industries that are estimated to benefit most are textiles, iron and steel, fabricated metal products, machinery and equipment, motor vehicles and parts, and non-ferrous metals. The services sectors in both countries also benefit from liberalisation.

The removal of border protection on merchandise imports was also likely to lead to a reduction in tariff revenues in each country, and thereby affect the government's fiscal position – See Annex 4E for details.

CoPS undertook sensitivity tests with a series of policy simulations of gradual liberalisation of the relevant barriers between 2007 and 2011. The results revealed that the net present value of the gains in real GDP and real GNP were smaller with slower liberalisation, while faster implementation leads to earlier delivery of the gains for both countries.

An important contribution of the multi-country multi-sector CGE model was that it identified the sectors that will expand or contract as a result of bilateral trade liberalisation. Given the assumption that total employment was maintained over the long-run, there will be industries that will expand and contract. The total output of the manufacturing sector in the ROK was estimated to increase. The effect was found to be the most significant in automobile and parts industries, followed by the machinery industry, and the textile and clothing industry Agricultural output in the ROK, on the other hand, was estimated to fall, as labour and capital shifted towards the manufacturing sector.

4.2.2 Economy-wide impacts

4.2.2.1 Removing border protection on merchandise trade

CoPS simulated the removal of border protection on merchandise imports on a bilateral basis. The modelling assumes that starting from 2007 all bilateral tariff and tariff-equivalent barriers were reduced to zero from their levels in 2006. The level of bilateral tariffs in 2006 is presented in Table 4A.2 in Annex 1A.

KIEP simulates 100 per cent tariff reduction on all agricultural and manufacturing products, excluding rice.[251]

i. GDP

Simulation results from the CoPS and KIEP modelling showed that removing border protection on merchandise trade increases real GDP for both Australia and the ROK.

The CoPS modelling results show that compared to the baseline in 2020, the level of real GDP was estimated to be 0.04 per cent higher for Australia and by 0.05 per cent higher for the ROK. In other words, Australia's real GDP was forecasted to be about US$450 million higher and ROK's real GDP to be US$670 million higher in 2020 with bilateral liberalisation than without – See Table 4.3 and Tables 4F.1 in the annex.

The deviation in real GDP from its baseline level in each year to 2020 can be seen as additional income stream derived from bilateral liberalisation. (See Figure 4F.1 in Annex 4F). Discounted at a rate of 5 per cent per year, the additional income stream derived each year up to 2020 produced a Net Present Value (NPV) of US$7.7 billion for Australia and US$9.1 billion for the ROK.

As explained earlier the major sources of the gain in GDP over the long-run were:

- increased capital;
- improved allocation of resources; and
- trade-induced productivity improvements.

Increased capital inflow as a source of GDP gain is more important to Australia than to the ROK. This is because Australia imports more capital goods from the ROK than vice-versa. A reduction in tariffs on capital goods will tend to reduce the cost of investment. In the short-run this leads to a higher rate of return on the capital invested and, in the longer run, to increased capital accumulation and a larger capital stock. Improved productivity induced by greater trade liberalisation is a more important source of GDP gain for the ROK than it is for Australia. This is because ROK has a

[251] Modelling results are available in the Annexes 4C and 4D.

comparatively higher level of border protection, as a result of which trade liberalisation leads to a proportionately greater reduction in prices of imports thus giving ROK industries more incentives to improve efficiency and productivity. Finally, the third source of the gain in real GDP comes from a reallocation of resources across industries (see Annex 4G for more details).

Table 4.3: Effect of Removing Border Protection on Real GDP and Real GNP, Deviation from baseline in 2020

	Real GDP		**Real GNP**	
	US$ million, 2005 prices	**Per cent**	**US$ million, 2005 prices**	**Per cent**
Australia	451	0.04	1555	0.14
The ROK	668.8	0.05	897	0.07

Source: CoPS simulation with MMC model

The TFP modelling by KIEP shows that with a 0.01 per cent increase in ROK's productivity in the manufacturing sector, the ROK's GDP is expected to increase by 0.05 per cent while that of Australia is projected to increase by 0.18 per cent relative to the business-as-usual scenario. See Table 4.4 below.

Table 4.4: Impact of ROK-Australia FTA on GDP and Welfare – TFP model

	GDP (per cent)	**Welfare (per cent)**	**Welfare (US$ million)**
The ROK	0.05	0.02	67.9
Australia	0.18	0.24	752.6

Source: KIEP simulation with TFP model

ii. Trade

On bilateral trade, the removal of border protection on merchandise imports will boost trade volumes between Australia and the ROK.

According to the CoPS results, Australian imports from the ROK in 2020 are expected to be 14 per cent or US$4.3 billion higher relative to baseline values, while ROK imports from Australia are expected to increase by 31 per cent or US$7.5 billion (see Table 4F.2 in the annex).

According to KIEP's TFP model, exports from the ROK to Australia would increase by US$424 million and imports to the ROK from Australia would increase by US$878 million. KIEP does not report the percentage changes in bilateral trade between the ROK and Australia, but they are clearly likely to be much less than those estimated by CoPS, reflecting the fact that KIEP's model is static rather than dynamic.

iii. Real wages & employment

The CoPS modelling assumes that real wages are sticky in the short-run. Adjustment in the labour market in response to the removal of border protection on merchandise imports leads to an increase in the level of aggregate employment in both Australia and the ROK. The increase in aggregate employment, however, results in an increase in real wage, which in turn, bring the aggregate employment back to its baseline level (See Figures 4F.2 and 4F.3 in Annex 4F).

In the long-run national employment in each country is determined by demographic forces, such as labour-force participation rates and population growth, which are unlikely to be affected by bilateral liberalisation. Therefore, the long-run effect of removing bilateral border protection on labour market is an increase in real wage for both countries. The real wage rate in Australia in 2020 is expected to be 0.28 per cent above its baseline value, while in the ROK the real wage rate is expected to be 0.33 per cent higher relative to that in the baseline. See Figures 4F.2 and 4F.3 in Annex 4F.

Although in CoPS' simulations liberalisation does not affect employment in the long-run, it does affect the sectoral composition of employment. It is assumed that labour moves between industries so as to maintain inter-industry wage differentials at their baseline levels. Accordingly in the long-run, in each country industries that are favourably affected by liberalisation will experience increased employment at the expense of industries that are less favourably affected.

iv. Welfare

Results of both the CoPS and KIEP models indicate trade liberalisation under an Australia-ROK FTA to be welfare enhancing for the two economies. CoPS uses real GNP as its measure of economic welfare[252], and KIEP uses Equivalent Variation (EV).[253]

In the CoPS analysis, the removal of border protection on merchandise imports is estimated to increase real GNP in Australia by 0.14 per cent or approximately US$1,550 million relative to its baseline level in 2020. Real GNP in the ROK is projected to rise by 0.07 per cent or US$900 million compared to baseline without the policy change (see Table 4.3). The additional income stream as a result of the increase in real GNP over the period to 2020 is expected to produce a Net Present Value (NPV) of US$16 billion for Australia and US$10 billion for the ROK.[254] (See Figure 4F.4 in Annex 4F).

Another commonly used measure of welfare is real consumption (private plus public).[255]

Under KIEP's TFP model, the ROK's welfare is expected to increase by 0.02 per cent as a result of the ROK-Australia FTA, and Australia's welfare is to improve by 0.24 per cent. This translates to a welfare effect of US$68 million for the ROK and US$753 million for Australia (see Table 4.4).

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252 For the measurement of economic welfare, GNP is generally preferred over GDP. GDP measures the total value of the output produced in a country but part of the income produced in doing so accrues to any foreigner owners of land and capital that is used in the production process. GNP subtracts from GDP the value of the net income that is paid to foreigners.

253 Equivalent Variation represents the money metric equivalent to the utility (or welfare) change brought about by the price change, evaluated at pre-simulation prices.

254 The Net Present Values were estimated using a real discount rate of 5 per cent per year.

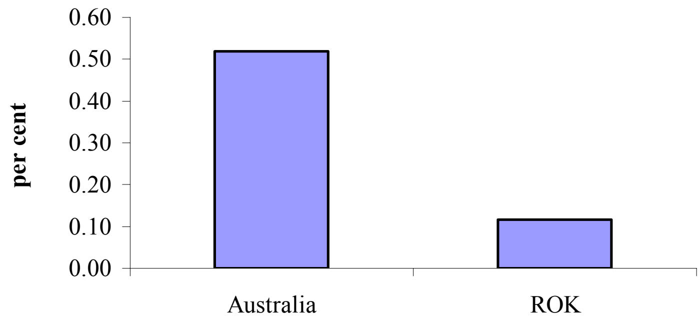
255 See Figure 4F.5 in Annex F for the effects of trade liberalisation on real consumption in the long-run as estimated by CoPS.

v. Terms of trade

According to the CoPS modelling, the terms of trade are projected to improve for both Australia (by 0.52 per cent relative to the baseline) and the ROK (by 0.12 per cent) – see Figure 4.1. The improvement in the terms of trade for Australia is comparatively larger than that of ROK's principally because the ROK has a much higher level of border protection compared to Australia. ROK's average applied tariff rates across all merchandise imports is 13 per cent[256], while Australia's overall average applied MFN tariff rate is about 3.8 per cent[257]. As a result, the absolute reduction in ROK tariffs is larger than that in Australian tariffs. See Table 4A.2 in Annex 4A for the level of tariff-equivalent border protection on bilateral merchandise trade in selected categories between Australia and ROK.

Simulations by KIEP with the TFP model project a negative impact on the terms of trade of ROK. The terms of trade of Australia is expected to increase by 0.36 per cent relative to the level in the baseline — see Table 4F(a).1 in Annex 4F(a) for the results.

Figure 4.1: Removing border protection on merchandise imports - Terms of trade effects Deviation from baseline in 2020, per cent



Source: Simulation results using the MMC model by CoPS

4.2.2.2 Investment facilitation

In recent years, investment facilitation measures have been given increased emphasis in bilateral trade negotiations. In order to estimate the potential benefits of investment facilitation under an Australia-ROK FTA, CoPS assumed that the resulting FTA would:

- enhance the understanding of ROK investment rules and regulations by Australian investors and vice versa;
- lead to simplified foreign investment screening procedures in both economies; and
- provide for better protection of bilateral investments in both countries.

KIEP did not undertake modelling on investment liberalisation. As such, the results reported in this section reflect those undertaken by CoPS only.

[256] WTO 2004.
[257] WTO 2007.

The assumed reductions in the required rates of return on investment in the two countries are expected to lead to increased bilateral investment flows between Australia and the ROK. The volume of Australian investment in the ROK is expected to increase by about 2.4 per cent, or by about US$1.7 billion. While the volume of ROK investment in Australia is projected to rise by about 4 per cent, which is about US$0.3 billion in dollar terms, above the baseline level by 2020. The results on the effects of investment facilitation on macroeconomic indicators are detailed in Annex 4H.

Increased bilateral investment flows between Australia and the ROK are estimated to lead to productivity improvements in both the countries, which in turn will induce investment from the rest of the world. This induced flow of investment from the Rest of the World to Australia is estimated to be about 0.04 per cent or US$1 billion above its baseline value, while for the ROK it is projected to amount to about 0.04 per cent or US$0.3 billion above its baseline value.[258]

Higher investment leads to increased capital and improved productivity. As a result both Australia and the ROK gain from bilateral investment liberalisation in the form of increased real GDP. Australia's real GDP in 2020 is expected to be about 0.05 per cent higher or approximately US$570 million more, relative to its business-as-usual value. The ROK's real GDP is forecasted to increase by 0.06 per cent, or US$763 million, compared to the baseline scenario — see Table 4.5 and Table 4H.1 in Annex 4H.[259]

Table 4.5: Investment facilitation - Effects on real GDP and real GNP
Deviation from baseline, 2020

	Real GDP		**Real GNP**	
	US$ million, 2005 prices	**Per cent**	**US$ million, 2005 prices**	**Per cent**
Australia	572	0.05	521	0.05
The ROK	763	0.06	680	0.05

Source: Simulation results using the MMC model by CoPS

Investment liberalisation is welfare enhancing for both economies. Australia's real GNP in 2020 is estimated to be 0.05 per cent higher, which translates into US$520 million more, compared to the baseline. Similarly, real GNP of the ROK is expected to be 0.05 per cent, or US$680 million, higher than the baseline (see Table 4.5 and Table 4H.1 in Annex 4H).

Investment liberalisation from an Australia-ROK FTA will also lead to increased bilateral trade in goods between the two economies. The volume of Australian imports from ROK in 2020 is projected to be about 0.1 per cent (or about US$26 million) above the baseline level; while the volume of ROK imports from Australia is expected to increase by about 0.1 per cent (i.e. about US$21 million) – refer to Table 4H.2 in Annex 4H.

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[258] The percentage deviation in investment flows from Rest of the World (RoW) into both Australia and ROK is estimated to be 0.04 per cent. The difference in the volume terms are due to the difference in baseline values: Australia hosts a larger inflow of investment from RoW than ROK does.

[259] Both Australia and the ROK derive gains from investment facilitation simulated in the CoPS modelling exercise. The difference in percentage deviation in real GDP (0.05 per cent for Australia versus 0.06 per cent for the ROK) is due to rounding. The difference in volume terms (US$570 million for Australia versus US$760 million for the ROK) is due to the difference in the size of GDP of the two countries.

4.2.2.3 Services liberalisation

KIEP did not undertake modelling on services trade liberalisation. As such, the results reported in this section reflect those undertaken by CoPS only.

CoPS focuses on the third mode of services trade, commercial presence, when quantifying the effects of services trade liberalisation[260]. In simulating bilateral liberalisation in services, CoPS assumes that liberalisation will enhance mutual understanding of investment rules and simplify the review procedures of foreign investment in services. This, in turn, will lead to an increased number of proposals and approvals for bilateral foreign investment in the services sectors of each country.

Services trade liberalisation is assumed to be implemented fully in 2007. The effects of increased approvals for bilateral investments in the services sector are modelled by reducing the required rates of return for Australian investment in the ROK services sectors by 0.42 percentage points, and by reducing the required rates of return for ROK investment in the Australian services sectors by 0.35 percentage points.[261]

The reduction in the required rates of return is expected to lead to increased bilateral investment. Increased foreign ownership leads to improved productivity as firms that invest overseas most often tend to be at the top of the efficiency scale.[262] Such improved productivity, in turn, attracts more foreign investment bilaterally, as well as from the rest of the world. The induced investment flow from the rest of the world into Australia and the ROK contributes to further productivity improvements in the two countries, estimated at 0.075 per cent for Australian services and 0.09 per cent for ROK services.

Services trade liberalisation is estimated to lead to an increase in real GDP in both countries, principally via improved productivity and increased capital. Australia's real GDP would be 0.1 per cent which is about US$1.2 billion higher by 2020 with the services trade liberalisation than without; while ROK real GDP would be 0.13 per cent, or US$1.8 billion higher (see Table 4.6 and Annex 4I).

Services trade liberalisation is also shown to be welfare enhancing, with both countries' real GNP forecasted to be higher than their baseline values. In 2020, real GNP of Australia is estimated to be 0.09 per cent higher while that of the ROK is expected to be 0.13 per cent higher than their baseline values. This amounts to real GNP gains of about US$1 billion for Australia and US$1.7 billion for the ROK (see Table 4.6).

The total volumes of exports from both Australia and ROK increase as a result of the services trade liberalisation. Export volumes in Australia are expected to rise by 0.07 per cent, while in the ROK it is projected to increase by 0.09 per cent (see Table 4I.1).

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260 KIEP did not undertake modelling on services or investment liberalisation. As such, the results reported in this section reflect those undertaken by COPS only.

261 The magnitude of the reductions in required rates of return, though still conservative, is larger than that simulated for the investment liberalisation. This is because, under the investment liberalisation scenario, it is assumed that general facilitation measures are implemented; while in this simulation, it is assumed that significant liberalisation in terms of increased number of approvals of bilateral foreign investment proposals in services sectors are carried out.

262 Helpman et al 2004.

Table 4.6: Services trade liberalisation - Effects on real GDP and real GNP Deviation from baseline, 2020

	Real GDP		Real GNP	
	US$ million, 2005 prices	Per cent	US$ million, 2005 prices	Per cent
Australia	1159	0.10	1039	0.09
The ROK	1766	0.12	1719	0.13

Source: Simulation results using the MMC model by CoPS

4.2.3 Sector specific impacts

4.2.3.1 Removing border protection on merchandise trade

i. Industry output

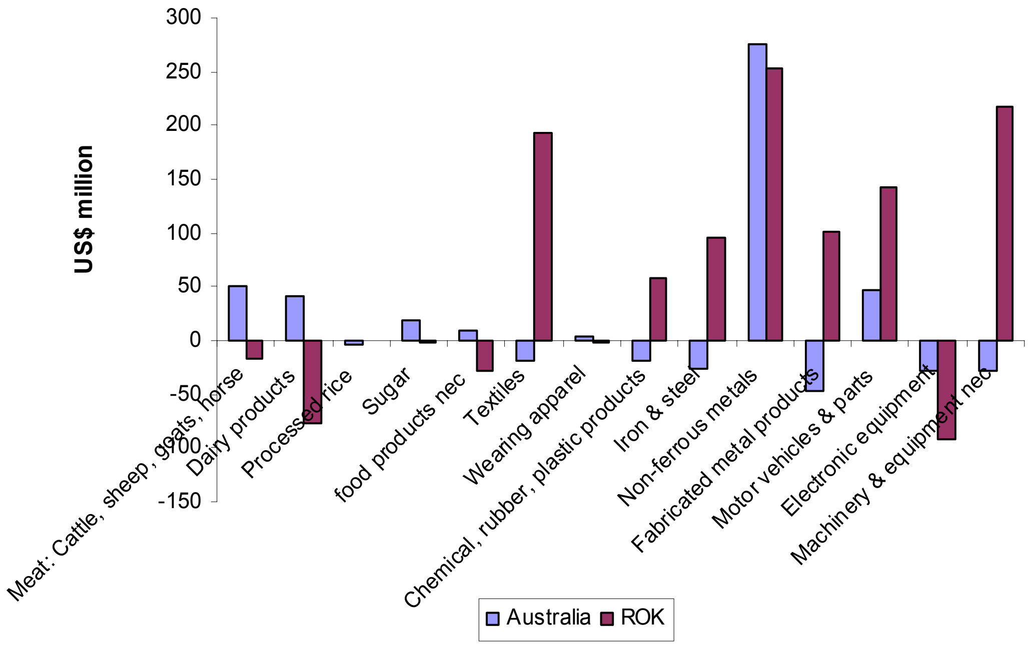
On sector specific impacts, the modelling by CoPS and KIEP shows that the removal of border protection on merchandise trade between Australia and the ROK will lead to changes in sectoral output, employment and bilateral trade. Resources will be reallocated based on the comparative advantage and competitiveness of the industries in the respective countries. As a result some industries will contract, while others will expand.

Simulation results from CoPS show the effects of removing border protection on the output of aggregated sectors of the two economies (see Figure 4J.1 and Tables 4J.1 and 4J.2 in Annex 4J). The CoPS model estimates in the agriculture sector include rice, wheat, plant-based fibres and wool industries; while meat, dairy, processed rice and sugar are included under the estimates of the manufacturing sector.

As shown by the CoPS modelling, the output of Australia's agricultural, mining and manufacturing sectors expands under bilateral trade liberalisation. In the case of the ROK, liberalisation results in an increase in the manufacturing sector output, while the output of the agricultural and mining sectors are expected to contract relative to their baseline values in 2020. Since the agricultural and the mining sectors in the ROK show reasonably strong growth in the baseline, the reduction in outputs in these sectors relative to their baseline should be taken to indicate slower output growth rather than an absolute decline.

The increase in Australia's manufacturing output is due mainly to a large increase in external demand arising from the significant reduction in ROK manufacturing tariffs. The industries that are expected to contribute most to the increase in output in Australia are non-ferrous metals, meat, sugar and dairy products. Increases in the manufacturing output of the ROK are mainly accounted for by the textiles, non-ferrous metals, motor vehicles and parts, and the machinery and equipment industries – See Figure 4.2.

Figure 4.2: Removing border protection on merchandise imports - Effects on the output of specific industries, Deviation from baseline, 2020 (in 2005 US$ million)



Source: Simulation results using the MMC model by CoPS

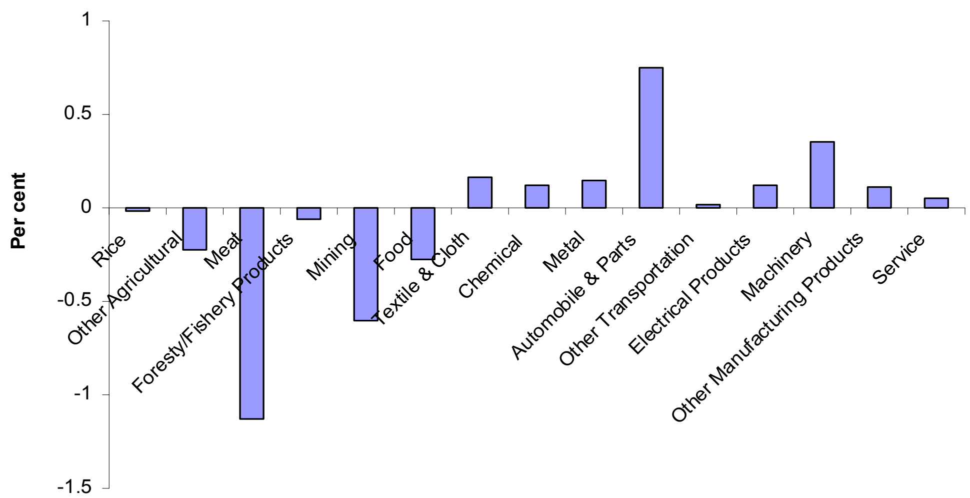
KIEP modelling also addresses the impact of liberalisation on ROK sectoral output – see Figure 4.3 and Table 4J.3 in Annex 4J – although the sectoral classification differs from that reported by CoPS.[263]

TFP modelling shows an increase in the output of the ROK manufacturing sector. The most significant effect occurs in the automobile and parts industry, with output rising by 0.75 per cent relative to the baseline, followed by the machinery (0.35 per cent), textiles (0.16 per cent) and metal products industry (0.15 per cent). The output of the ROK services sector is also expected to go up by 0.05 per cent relative to the baseline.

ROK agricultural output is expected to decrease as a result of liberalisation. The meat industry output, in particular, would reduce by 1.13 per cent. This may be explained by the fact that as a result of bilateral trade liberalisation, each country specialises more in the production of goods and services in which it has a comparative advantage. This is agriculture, processed food, mining and base metals for Australia, and manufacturing products for the ROK. Such increased specialisation in goods and services in which each country has a comparative advantage, will lead to more efficient allocation of resources in the two economies.

263 CoPS classify processed agricultural products as part for the manufacturing sector, while KIEP classifies all products with HS codes 1 – 24 as part of the agriculture sector.

Figure 4.3: Impact of ROK-Australia FTA on the output of specific industries in the ROK, per cent – TFP model results



Source: Simulation results by KIEP

ii. Industry employment

As explained above (section 4.2.2.1.iii), CoPS modelling shows that the Australia-ROK FTA is projected to have no long-run impact on employment as aggregate employment is determined by demographic factors, such as labour force participation and population growth, in the long-run. However, the FTA is expected to affect the industrial composition of employment. It is assumed in the model that labour moves between industries so as to maintain inter-industry wage differentials at their baseline levels. Accordingly in the long-run in each country, industries that are favourably affected by the FTA will experience increased employment at the expense of industries that are less favourably affected.

In Australia, the expansion in the mining sector is expected to attract labour from the agricultural and services sectors. While in ROK the expansion in the manufacturing sector will attract labour from the rest of the economy – See Figure 4J.2 in Annex 4J.

Within the manufacturing sector in Australia, labour is found to be attracted into the meat, dairy products, sugar, non-ferrous metals, and motor vehicles and parts industries. The largest employment adjustment is expected to occur in the textiles industry, with employment in the Australian textiles industry projected to fall by about 3.5 per cent below baseline level in 2020. Employment will rise by 1.6 per cent and 1.5 per cent in the non-ferrous metals and meat industries, and by 1.1 per cent in the dairy industry – see Table 4J.1 in Annex 4J.

In the case of the ROK, labour is attracted to the textiles and non-ferrous metals industries within the manufacturing sector. The meat and dairy products industries experience the largest employment adjustment. Modelling results by CoPS show that, as a result of the reductions in protection, employment in the non-ferrous metals industries will rise by 2.1 per cent and in the textiles industries by 0.4 per cent, while employment in the meat and dairy products industries of the ROK will fall by about 9 and 7 per cent respectively below baseline levels. See Table 4J.2.

iii. Bilateral trade

With the elimination of tariffs, bilateral trade between the two countries will expand relative to their baseline values. As a result of the removal of border protection on merchandise imports, Australian imports of manufactured goods from the ROK are forecasted to increase by 15.7 per cent relative to their baseline levels in 2020. Similarly, imports of agricultural and mining sector products from the ROK are expected to go up by 3.5 and 2.4 per cent respectively. Meanwhile, imports from Australia by the ROK will increase by 51 per cent in the manufacturing sector, by 24 per cent in the agricultural sector and by 10 per cent in the mining sector (See Figure 4J.3 and Tables 4J.1 and 4J.2 in Annex 4J).

Within the manufacturing sector in the ROK, the apparels industry is expected to be a major beneficiary of liberalisation in terms of increased exports. Currently Australia's average MFN applied tariff on apparel and certain finished textile articles is 17.5 per cent.[264] Tariff elimination would lead clothing imports from the ROK to increase by over 240 per cent. Similarly, in the textiles and fabricated metal products in which Australia imposes relatively high tariff rates of about 10 per cent and 4.2 per cent respectively, trade liberalisation will result in significant growth in Australian imports of these products from the ROK.

In terms of the impact of liberalisation on the agriculture industry, there is likely to be an increase in agricultural products imported from Australia. The ROK is expected to experience almost a three-fold increase in imports of dairy products and imports of meat from Australia will increase by 109 per cent.

In value terms, the largest increase in imports from the ROK by Australia is expected to be in textiles, with imports projected to be US$797 million higher. For the ROK, imports of non-ferrous metals from Australia are forecasted to be US$3.2 billion more than the business-as-usual scenario in 2020. In the case of chemical, rubber and plastic products, fabricated metals, motor vehicles and parts, and machinery and equipments industries, Australia and the ROK have established fairly strong two-way trade flows, which liberalisation would be expected to strengthen further (see Figure 4.4).

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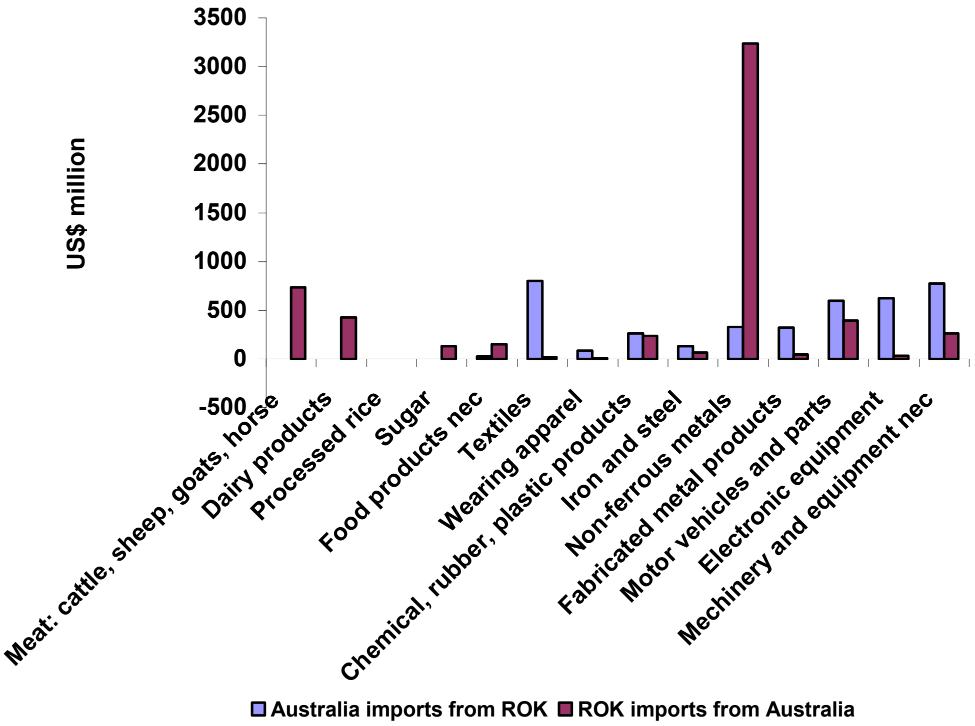
[264] WTO 2007.

Figure 4.4: Removing border protection on merchandise imports - Effects on bilateral trade by specific industries, Deviation from baseline, 2020 (in 2005 US$ million)



Source: Simulation results using the MMC model by CoPS

4.2.3.2 Investment facilitation

Investment facilitation is projected to lead to increased investment and improved productivity, which in turn is expected to result in increased output in both countries (See Tables 4K.1 and 4K.2). All industries, especially consumption-oriented industries, benefit from the induced income effects arising from higher incomes and hence greater consumption expenditure. In both Australia and the ROK, manufacturing and services sectors experience larger increases in output than agriculture and mining sectors. This is triggered by the fact that a relatively larger share of foreign capital flows into the manufacturing and services sectors in Australia and the ROK than in the agriculture and mining sectors.

Bilateral trade will also expand as a result of investment facilitation. Imports from the ROK by Australia increase in all sectors, with manufacturing imports expected to rise the most - by 0.09 per cent over the baseline value, followed by mining imports (0.08 per cent) and services imports (0.06 per cent). Similarly, ROK imports from Australia are forecasted to go up in all sectors, with the largest increases, amounting to 0.10 per cent, expected in the imports of manufactures and services from Australia – see Tables 4K.1 and 4K.2 in Annex 4K for the results.

4.2.3.3 Services trade liberalisation

Liberalisation of services trade will stimulate output in both countries – See Tables 4L.1 and 4L.2 in Annex 4L. The largest increase in output will be experienced in the services sector, with outputs expanding by 0.12 per cent in Australia and 0.15 per cent in the

ROK relative to the business-as-usual scenario in 2020. This is due in part to the improved productivity as well as the induced income effects arising from services trade liberalisation. In the long-run improved productivity increases the real wage rate. An increased real wage, in turn, denotes higher real income and hence increased real consumption in the economy.

Industries belonging to sectors, other than the services sector, also gain from services trade liberalisation. This is because productivity improvements in the services sectors lower the cost of services inputs for businesses in all areas. Manufacturing output increases by 0.08 per cent in Australia, and by 0.09 per cent in the ROK. While mining and agricultural output are projected to rise by 0.06 per cent and 0.02 per cent in Australia, and by 0.09 per cent and 0.04 per cent in the ROK, when compared with the values in the baseline scenarios in 2020.

Productivity improvements and subsequent reduction in costs of services inputs resulting from liberalisation are also particularly beneficial for trade-exposed industries.[265] The reduction in costs enhances the competitiveness of these industries enabling them to expand exports (or to replace imports on local markets), and hence to increase production.

Bilateral trade is enhanced as a result of services liberalisation, with Australian imports from the ROK and ROK imports from Australia increasing in all sectors (Tables 4L.1 and 4L.2).

4.2.4 Aggregate effects of a potential comprehensive Australia-ROK FTA

i. Economy-wide impacts

Comprehensive liberalisation, including removal of trade barriers, investment facilitation and liberalisation of services trade[266], is found to be beneficial for both Australia and the ROK. Each of the three aspects of potential policy change simulated by CoPS results in increased real GDP and GNP in the partner economies.

If implemented fully in 2007, the three policy changes will collectively lead to an increase in real GDP of Australia by 0.2 per cent and of the ROK by 0.2 per cent, relative to the baseline scenario in 2020. This amounts to gains in real GDP of US$2.2 billion for Australia and US$ 3.1 billion for the ROK – See Table 4.7. The impacts on macroeconomic indicators are detailed in Table 4M.1 in the Annex.

The present value[267] of the stream of deviations in Australia's real GDP from its baseline brought about by full liberalisation is around US$23 billion over the period 2007 to 2020. While for the ROK, it yields a gain of about US$30 billion. See Table 4M.2.

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265 Trade-exposed industries tend to face relatively flat demand schedules, such that the demand for the industries' products is relatively elastic (i.e. when the quantity demanded changes more than proportionately to a change in price).

266 KIEP did not undertake modelling on services or investment liberalisation. As such, the results reported in this section reflect those undertaken by COPS only.

267 Present value refers to the total value of the future stream of annual changes in, say, real GDP between 2007 and 2020 in terms of their value in 2005. A discount rate of 5 per cent is used for this purpose.

Comprehensive liberalisation is also projected to be welfare-enhancing, with an increase in real GNP of 0.3 per cent for Australia and 0.2 per cent for the ROK relative to their baseline levels in 2020 (see Table 4.7 and Table 4M.1 in annex 4M). These translate into welfare gains of US$3.1 billion for Australia and US$3.3 billion for the ROK.

Bilateral trade between Australia and the ROK will also expand as a result of comprehensive liberalisation, with Australian imports from the ROK increasing by 15 per cent and ROK imports from Australia rising by 31 per cent relative to the baseline in 2020 (see Table 4M.3 in Annex 4M).

Table 4.7: Comprehensive Australia-ROK FTA - Effects on real GDP and real GNP, Deviation from baseline, 2020

	Real GDP		Real GNP	
	US$ million, 2005 prices	Per cent	US$ million, 2005 prices	Per cent
Australia	2182	0.2	3114	0.3
The ROK	3141	0.2	3295	0.2

Source: Simulation results using the MMC model by CoPS

ii. Industry impacts

Liberalisation of all three aspects, as described above, will increase output in Australia, with manufacturing[268] output forecasted to be 0.4 per cent higher than the baseline in 2020, followed by mining (0.3 per cent), services (0.2 per cent) and agriculture (0.1 per cent).

For the ROK, comprehensive liberalisation increases the output of all sectors except agriculture. The output of manufacturing sector in the ROK is expected to be 0.4 per cent higher relative to its baseline, while output of the services and mining sectors are foreseen to be 0.2 per cent and 0.1 per cent higher respectively compared to the baseline levels in 2020 (see Table 4.8).

Within the manufacturing sector in Australia, the industries which contribute most to the increase in the sectoral output include non-ferrous metals, meat, sugar and dairy products. In the ROK manufacturing sector, the non-ferrous metals, fabricated metal parts, textiles, and motor vehicles and parts industries are expected to experience the largest increases in output relative to their baseline values in 2020 (see Figure 4.5 and Tables 4M.4 and 4M.5 in Annex 4M).

Bilateral trade is projected to expand in most sectors as a result of comprehensive liberalisation. Imports from the ROK by Australia are expected to go up relative to their baselines in 2020 in all the aggregated sectors, with manufacturing imports from ROK predicted to register the highest increase of about 16 per cent. While ROK imports from Australia in all sectors, except for the services sector, are expected to be higher than their

[268] As noted above, estimates in the agriculture sector include rice, wheat, plant-based fibres and wool industries; while meat, dairy, processed rice and sugar are included under the estimates of the manufacturing sector.

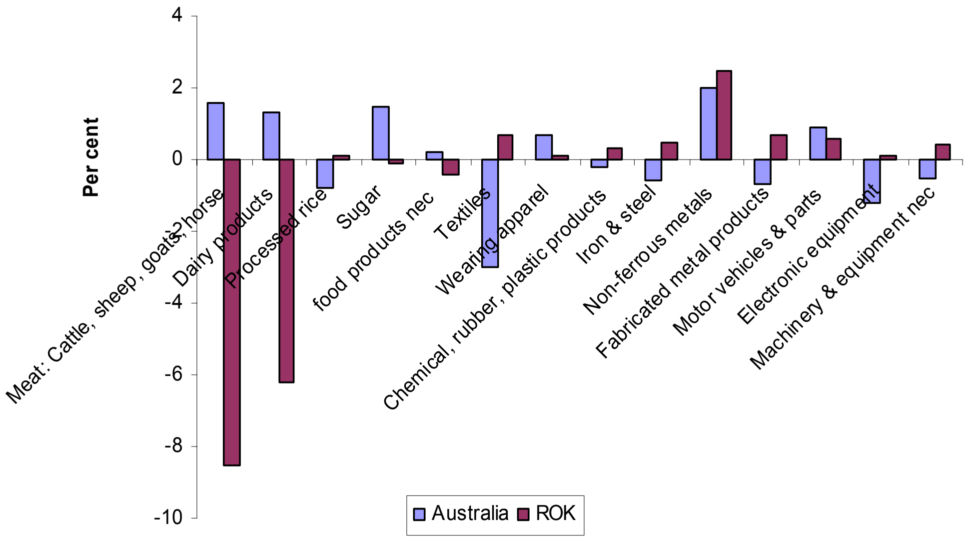
baseline levels in 2020, with the increase in manufactured[269] imports from Australia estimated at about 51 per cent, followed by agriculture imports (24 per cent) and mining imports (10.5 per cent) (see Tables 4M.4 and 4M.5 in annex 4M).

Table 4.8: Comprehensive Australia-ROK FTA - Effects on the output of aggregate sectors, Deviation from baseline in 2020, per cent

	Agriculture	Mining	Manufacturing	Services
Australia	0.1	0.3	0.4	0.2
The ROK	-0.4	0.1	0.4	0.2

Source: Simulation results using the MMC model by CoPS

Figure 4.5: All three aspects of an Australia-ROK FTA- Effects on the output of specific industries, Deviation from baseline in 2020, per cent



Simulation results using the MMC model by CoPS

4.2.5 Faster versus slower liberalisation

The above sections discussed the effects of the three aspects of an Australia-ROK FTA on the assumption that all barriers are removed immediately in 2007. In reality, however, trade liberalisation is often implemented over a number of years. To compare the effects of faster liberalisation as opposed to slower liberalisation, CoPS simulated the three policy dimensions with the barriers removed gradually between 2007 and 2011, as opposed to immediate liberalisation in 2007 (see Table 4.9 for the results).

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269 As noted above, estimates in the agriculture sector include rice, wheat, plant-based fibres and wool industries; while meat, dairy, processed rice and sugar are included under the estimates of the manufacturing sector

According to the CoPS' analyses, faster implementation leads to earlier delivery of the gains from an FTA for both Australia and the ROK. Table 4N.1 in the annex details the results on the effect on macroeconomic indicators of phased-in liberalisation.

The total present value of the income gains during 2007 to 2020 is higher for both countries and for all three types of policy changes simulated by CoPS when the policy change is implemented faster rather than gradually. With comprehensive liberalisation, real GDP gains in Australia in present value terms amounts to US$22.7 billion with immediate liberalisation, while it is US$19.4 under slower liberalisation. In the case of ROK, faster liberalisation leads to GDP gains of US$30 billion (in present value terms) compared to US$25 billion achieved under phased-in liberalisation. Hence, faster implementation of all three aspects of trade liberalisation leads to extra gains of US$3.3 billion for Australia and US$4.7 billion for the ROK in terms of present value of real GDP (see Table 4.9, and Figures 4N.1 and 4N.2 in Annex 4N).

In terms of the impact on industry output and employment of gradual liberalisation between 2007 and 2001, Australia will experience an increase in output in all aggregate sectors, with the largest increase registered in the manufacturing sector; while employment will increase in the mining and manufacturing sectors. For ROK, there will be an expansion in output of all aggregate sectors, with the exception of agriculture. The largest increase in output will be experienced in the ROK manufacturing sector, and employment will also expand in this sector. The results can be seen in Table 4N.2.

In terms of long-run impact, CoPS' model shows similar percentage changes under both faster and slower liberalisation. Therefore, all the long-run effects, including effects on macroeconomic indicators, trade and industries, from immediate liberalisation also apply in the case of gradual liberalisation.

Table 4.9: Full liberalisation in 2007 versus phase-in between 2007 and 2011 - Present value of gains from 2007-2020 (US$ million)

	Australia real GDP	Australia real GNP	ROK real GDP	ROK real GNP
Removing border protection on merchandise imports				
Full liberalisation in 2007	7,677	16,270	9,119	9,701
Phase-in between 2007-2011	6,962	14,937	7,685	8,547
Investment facilitation				
Full liberalisation in 2007	5,173	4,817	6,296	5,780
Phase-in between 2007-2011	4,294	3,990	5,358	4,877
Services trade liberalisation				
Full liberalisation in 2007	9,827	9,083	14,143	14,044
Phase-in between 2007-2011	8,111	7,481	11,838	11,842
All three aspects of an FTA				
Full liberalisation in 2007	22,677	30,169	29,558	29,525
Phase-in between 2007-2011	19,367	26,408	24,881	25,266

Source: Simulation results using the MMC model by CoPS

4.2.6 Impact on the rest of the world

In terms of real GDP and real GNP, the impact of bilateral liberalisation on the rest of the world is insignificant according to the modelling results of CoPS (see Table 4M.6 in Annex 4M). Although liberalisation shifts capital away from the rest of the world into the ROK and Australia, the amount that is shifted to these two countries is a negligible proportion of the total capital held by the rest of the world.

The CoPS results also show that an Australia-ROK FTA is trade creating for the world as a whole. While there is evidence of trade diversion, it is minor and the total volume of world imports increases from its baseline level as a result of the Australia-ROK FTA.

The analyses by KIEP show that both countries' exports and imports to and from the world would increase in all three models simulated. Estimates projected by the TFP model show that exports from the ROK to the world would increase by around 0.26 per cent and imports to the ROK from the world would increase by around 0.37 per cent due to conclusion of an Australia ROK FTA. Similarly, Australian exports to the world and imports from the world are expected to be 0.62 per cent and 0.68 per cent higher respectively relative to their baseline values in 2020.

Simulations using assumptions of static and capital accumulation models produce similar findings (see Table 4C.2 in Annex 4C).

4.2.7 Conclusion

Econometric analysis shows that bilateral liberalisation of trade and investment between Australia and the ROK has positive effects for both economies. Results support the conclusion that a bilateral FTA has the potential to deliver gains for both countries, further strengthening the bilateral economic relationship.

Comprehensive bilateral liberalisation increases real GDP and is welfare enhancing for both Australia and the ROK. The increases in GDP arise from the combined impacts of increased capital accumulation, improved productivity and efficiency gains from better utilisation of resources. Another factor behind the GNP gains is improved terms of trade for both countries.

Overall bilateral liberalisation of trade and investment between Australia and the ROK would significantly increase GDP and economic welfare in each country.
Bilateral liberalisation will also increase trade and investment flows between the two countries. Bilateral investment is expected to increase by up to US$4.2 billion. Trade and investment liberalisation will also increase the total volume of both ROK and Australian trade with the Rest of the World.

Both Australia and the ROK are expected to gain from trade liberalisation as resources are reallocated to those sectors in which each country has a comparative advantage. As a result some industries will contract, while others will expand.

At the sectoral level, the Australian industries which contribute most to increases in Australian output are meat, dairy products, sugar and non-ferrous metals. For ROK the manufacturing industries contributing most to the overall expansion in production include in particular, textiles, metal products, machinery, and motor vehicles and parts industries. The services sector in both countries is found to gain from liberalisation.

In summary, an Australia-ROK FTA would support an already significant, highly-complementary and growing, trade and investment relationship. While the bilateral trade and investment relationship is strong, barriers remain in some areas, and there is considerable potential for even greater growth. An FTA which is comprehensive in scope and coverage provides an opportunity to address these barriers, capitalize on this potential and further expand the Australia-ROK trade relationship – to the mutual commercial benefit of both countries.

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