

Australia and Korea: changing patterns of trade and investment

Since the 1960s, the bilateral economic relationship between Australia and the Republic of Korea (hereafter, Korea) has been based largely on Australia exporting commodities to, and importing finished products from, Korea. However, in recent years, Korea has become a significant market for Australia's manufactures and services. Two-way trade has grown strongly. Unprocessed and primary products, as well as manufactures and services, have made a substantial contribution to the growth in Australian exports.

Bilateral investment flows between Australia and Korea have grown strongly in recent years. This has been assisted by the liberalisation of the Korean services sector since the Asian financial crisis in 1997/98.

Australia and Korea agreed in December 2006 to conduct a joint private sector study on a possible free trade agreement (FTA). A comprehensive FTA has the potential to strengthen and further deepen the bilateral economic relationship.

The broadening bilateral trade relationship

The economic relationship between Australia and Korea has developed strongly over the past 40 years. From 1999-00 to 2006-07¹, two-way trade increased at an average annual rate of 8 per cent, with Australia's exports to Korea substantially exceeding its imports (**Chart 1**). In 2006-07, Australian trade in goods and services with Korea reached \$21.4 billion, with Korea becoming Australia's fourth largest market for exports and Australia's sixth largest trading partner overall.

Australia's **merchandise exports** to Korea increased by 49 per cent between 2000 and 2007 (**Chart 2**). Fuels made the largest contribution to Australian exports over this period, accounting for 30 per cent of the total on average, and growing by an average 10 per cent per annum. Coal and crude petroleum

were the top two export items in fuels, contributing 50 per cent and 49 per cent respectively on average. In 2007, the value of crude petroleum exports rose 60 per cent to \$2.4 billion to become the largest fuel export. The value of coal exports, however, decreased 15 per cent to \$1.7 billion in 2007, which partly reflects increasing price competition in the Korean market.

Australia's exports of minerals grew at an average annual rate of 19 per cent from 2000 to 2007. Iron ore was the largest contributor, making up 57 per cent of the total on average over this period, and growing at an annual rate of 17 per cent. Australia's exports of *Simply Transformed Manufactures* (STM) expanded at an average annual rate of 9 per cent. Aluminium was most significant, contributing 62 per cent on average to the total.

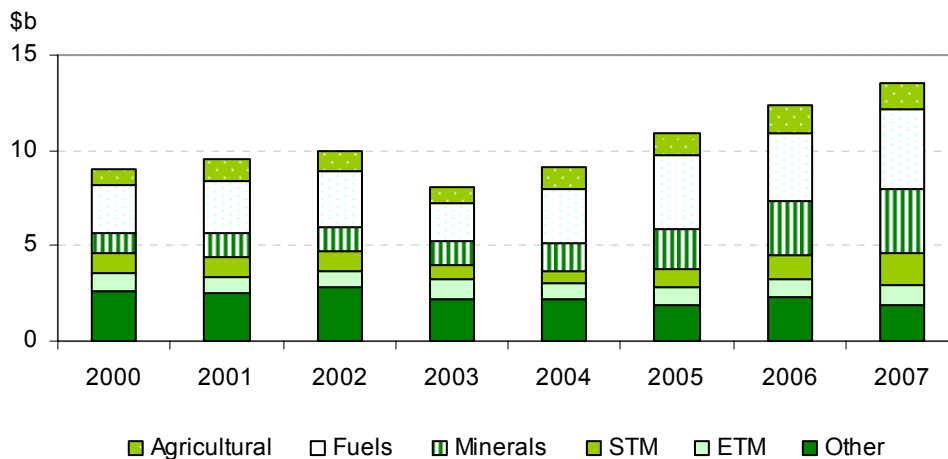
¹ Australia's services data for 2007 are not yet available.

Chart 1: Australia's trade in goods and services with Korea



Source: ABS trade data on DFAT STARS database and ABS Regional Services series.

Chart 2: Composition of Australia's merchandise exports to Korea



Note: See Explanatory notes for definitions of sectors.

Source: ABS trade data on DFAT STARS database.

Australia's agricultural exports to Korea have also expanded markedly, averaging an annual rate of 8 per cent from 2000 to 2007. Beef dominated this expansion, contributing an average 41 per cent of total agricultural exports. The value of beef exports grew at an average annual rate of 22 per cent to reach \$803 million in 2007, compared with 4 per cent for beef exports to all destinations over the same period. The remarkable growth of Australia's beef exports to Korea is due largely to the limited beef exports from the US after the discovery of BSE (bovine spongiform encephalopathy or 'mad cow disease') in the US.

Australia's merchandise imports from Korea grew at an average annual rate of 4 per cent from 2000 to 2007, to reach \$6 billion. Passenger motor vehicles, which accounted for 23 per cent of total imports in 2007 or \$1.4 billion, were responsible for a substantial part of this growth. From 2000, the annual rate of growth for passenger motor vehicle imports averaged 11 per cent. Other major imports included telecommunications equipment, refined petroleum, and televisions.

Historically, the expansion of two-way merchandise trade between Australia and Korea has been based largely on complementarity, with Korea importing raw materials for manufacturing² and Australia importing finished products. In 2007, Australian exports contributed 95 per cent of the two-way trade in primary products, while Korean exports accounted for 65 per cent of the total two-way trade in manufactures (**Chart 3**).

² One major contributor is POSCO (Korea's principal steel manufacturer). POSCO initiated the iron ore trade with Australia when it agreed to a 130,000 ton purchase in the 1970s. According to data from Invest Australia, in 2006, POSCO was the largest Korean investor in Australia, with total revenue of approximately \$86 million from its Australian operations.

While this complementarity has driven the trade relationship, Korea has become a more significant market for Australia's *Elaborately Transformed Manufactures* (ETM) exports. Australia's ETM exports were \$1.1 billion in 2007. Motor vehicle parts are an important element of this trade, totalling some \$390 million in 2007. The sale of motor vehicle engines alone totalled \$294 million in 2007 (**Table 1**) and accounted for 27 per cent of Australia's total exports of ETM to Korea in 2007.

A noteworthy feature of Australia's trade with Korea in recent years is the strong performance of Australia's **services exports**. From 1999-00, these grew at an average annual rate of 15 per cent, to reach \$1.6 billion in 2006-07 (**Chart 4**).

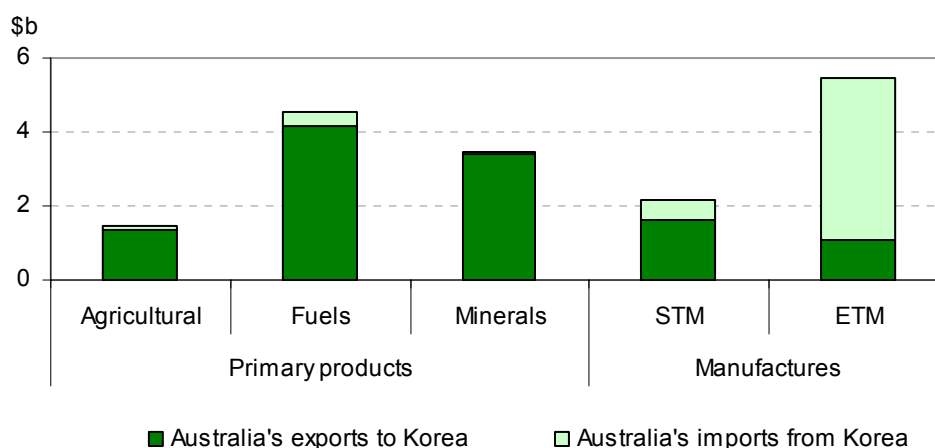
Travel services made up 90 per cent of total services exports in 2006-07 (**Chart 5**). Education-related services³ and personal travel services accounted for the bulk of travel services, reflecting the popularity of Australia not only as a destination for overseas education among Korean students, but also as one for Korean tourists.⁴ The share of business travel in total travel services exports was low at 4 per cent. Transportation services were important, reflecting the increasing number of people-to-people exchanges and related supporting services.⁵

³ According to data from the Department of Education, Employment and Workplace Relations (DEWR), Korea accounted for almost 21 per cent of foreign students flows to Australia studying English Language Intensive Courses for Overseas Students (ELICOS) in 2006, making Korea, the largest source.

⁴ Travel covers all goods and services acquired for personal use in an economy by travellers, students and foreign workers. Apart from education-related services, travel is broken down into two components, business travel and personal travel.

⁵ Transportation services cover services provided by residents of one economy to those of another economy which involve the carriage of passengers, the movement of goods, and related supporting auxiliary services.

Chart 3: Complementarity in two-way merchandise trade, 2007



Note: Definitions of sectors are as in the note to Chart 2. "Other" trade, including miscellaneous and confidential items, are excluded from the data in Chart 3.

Source: ABS trade data on DFAT STARS database.

Table 1: Australia's top 10 merchandise exports and imports with Korea, 2007

| Rank | | \$m | % share |
|----------------|------------------------------------|---------------|---------|
| Exports | | | |
| 1 | Crude petroleum | 2,403 | 17.8 |
| 2 | Iron ore | 1,762 | 13.1 |
| 3 | Coal | 1,650 | 12.2 |
| 4 | Other ores | 838 | 6.2 |
| 5 | Bovine meat f.c.f. | 803 | 6.0 |
| 6 | Aluminium | 794 | 5.9 |
| 7 | Copper ores | 458 | 3.4 |
| 8 | Copper | 308 | 2.3 |
| 9 | Internal combustion piston engines | 294 | 2.2 |
| 10 | Nickel ores | 230 | 1.7 |
| | Total merchandise exports | 13,486 | |
| Imports | | | |
| 1 | Passenger motor vehicles | 1,358 | 22.8 |
| 2 | Telecommunications equipment | 831 | 13.9 |
| 3 | Refined petroleum | 361 | 6.1 |
| 4 | Televisions | 302 | 5.1 |
| 5 | Paper & paperboard | 169 | 2.8 |
| 6 | Non-monetary gold | 163 | 2.7 |
| 7 | Rubber tyres | 145 | 2.4 |
| 8 | Household type equipment | 132 | 2.2 |
| 9 | Other electrical machinery | 107 | 1.8 |
| 10 | Civil engineering equipment | 102 | 1.7 |
| | Total merchandise imports | 5,958 | |

Note: f.c.f. = fresh, chilled or frozen.

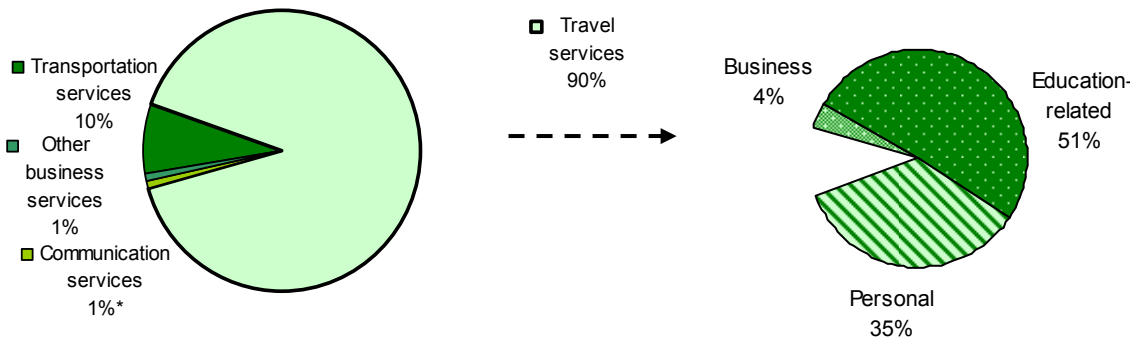
Source: DFAT STARS database.

Chart 4: Australia's services trade with Korea



Source: ABS catalogue 5368.0 International Trade in Goods and Services.

Chart 5: Australia's services exports to Korea, 2006-07



Note: *, figure of 2006.

Source: DFAT Trade in Services Australia.

Australia's services imports from Korea are modest, totalling under \$468 million in 2006-07. Transportation services made up approximately two-thirds of these imports.

Growing investment links

In recent years, the contribution of two-way investment to the bilateral economic relationship has increased markedly. In 2006, Korea ranked 16th in terms of the stock of total foreign investment in Australia.⁶ Korea's stock of investment reached \$4,980 million at the end of 2006 (**Chart 6**), more than ten times its value in 2001. At the same time, the stock of outward investment by Australia in Korea

reached \$6,897 million, with Korea ranking 12th as a destination for Australian investment abroad.⁷

Korea's investment in Australia

According to data from the Korea Export-Import Bank,⁸ the composition of Korea's direct investment in Australia from 2001 to 2006 has been largely driven by the wholesale and retail sectors, and mining industries, accounting for 55 and 21 per cent respectively (**Chart 7**).

⁷ ABS data do not indicate how much of the stock of inward or outward investment for Korea at the end of 2006 were direct investment. For the previous year, 71 per cent of the stock of Korean investment in Australia was direct investment, while 17 per cent of the stock of Australian investment in Korea was direct.

⁸ All outward foreign direct investment from Korea must be approved by the Ministry of Finance and Economy and reported to the Korea Export-Import Bank.

⁶ ABS, International Investment Position, Australia, Supplementary Statistics, Cat. No. 5352.0, July 2007.

Data on approved investment cases casts some additional light on two-way direct investment flows. In 1999, 17 cases were approved for Korean companies to invest in Australia (**Chart 8**), totalling US\$54 million in value. This number increased to 49 in 2006, valued at US\$188 million, with an average amount of US\$3.8 million per case. *Chaebol* (large conglomerates) contributed 81 per cent of total Korean investment in Australia in 2006 while constituting only 21 per cent of the number of investment cases.⁹ Small and medium-sized enterprises (SMEs)¹⁰ made up 30 per cent of the

number of investment cases, but accounted for only 13 per cent of Korea's total investment in Australia.

Australia's investment in Korea

The number of approved investments by Australian companies in Korea increased noticeably from 12 in 1999 to 30 in 2000.¹¹ However, while the stock of Australia's total investment in Korea has grown strongly at an average annual rate of 20 per cent from 2001 to 2006, the number of approvals each year of investments by Australian companies in Korea has been broadly steady since 2000¹² (**Chart 8**).

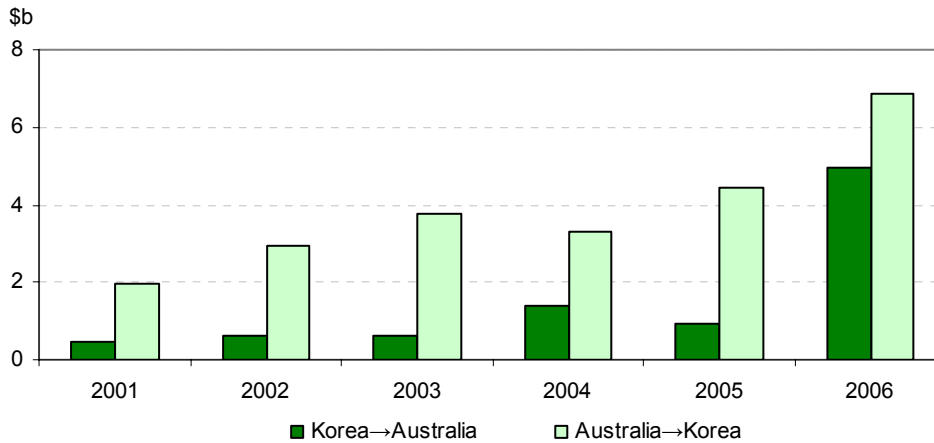
⁹ Others (not defined) accounted for 49 per cent of investment cases, but only 6 per cent of the value of investment.

¹⁰ In Korea, a small-medium enterprise (SME) is defined by its number of permanent workers, assets, sales, and by the specifications of its industry. For example, a manufacturing company with less than 300 permanent workers or less than KRW8 billion in assets is categorised as an SME.

¹¹ The growth of Korean investment in Australia from 2005 to 2006 was mainly due to new capital inflows in conjunction with market value changes.

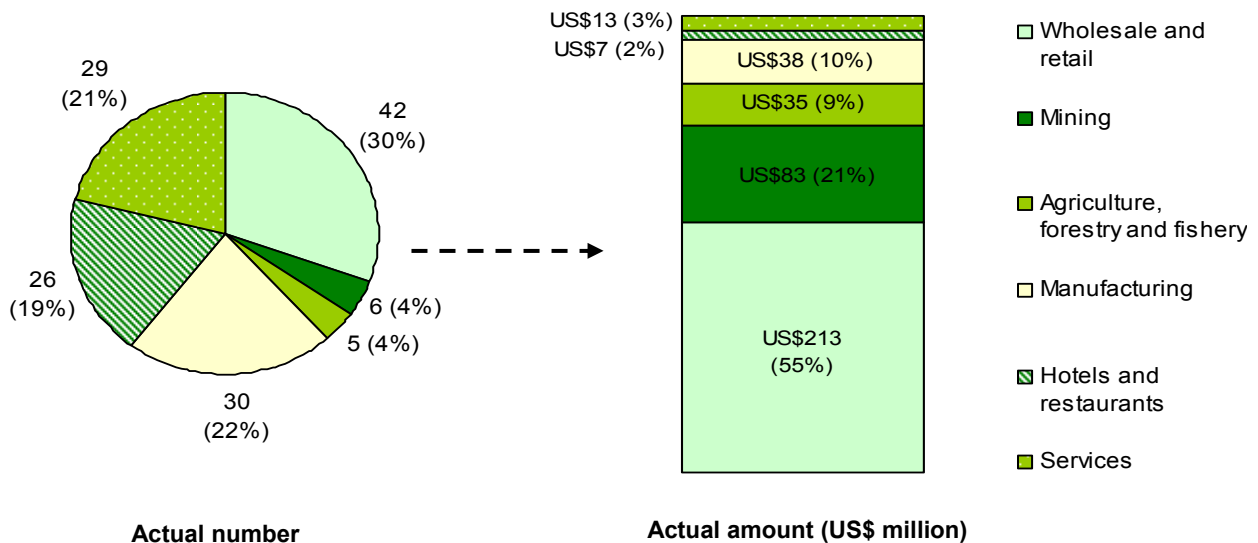
¹² All inward direct foreign investment in Korea must be approved by the Ministry of Commerce, Industry and Energy.

Chart 6: Stock of total investment Australia and Korea



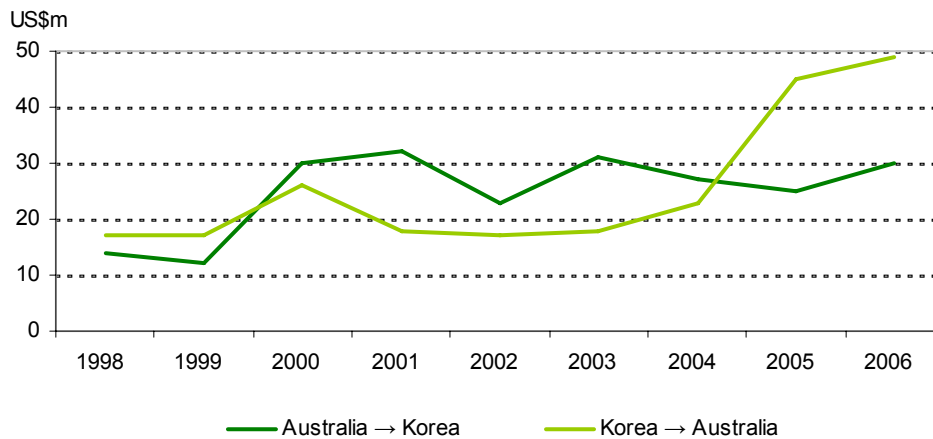
Source: ABS, International Investment Position, catalogue 5352.0, July 2007.

Chart 7: Korea's direct investment in Australia from 2001 to 2006 (actual number and amount)



Source: Korea Export-Import Bank.

Chart 8: Bilateral investment between Australia and Korea approved investments



Source: Korea Export-Import Bank, Ministry of Commerce, Industry and Energy.

The changing investment climate in Korea

Until the mid 1990s, Korea imposed heavy restrictions on foreign investment, especially in services sector. The Uruguay Round of GATT multilateral trade negotiations (completed in 1994) and Korea's OECD accession in 1996 led to the relaxation of some aspects of the Korean foreign investment regime in services sectors. Even so, investment in more than 40 services sectors was still restricted, either partially or completely, at the end of 1996.¹³

Services sector opening up

Korea has opened up further to foreign investment since the Asian financial crisis in 1997/98. The financial services sector underwent sweeping liberalisation in the aftermath of the crisis in Korea. In contrast to the pre-crisis period, foreign investors have been allowed to establish subsidiaries of banks and securities firms. Foreign investment now plays a pivotal role in the Korean economy, and official Korean Government policy is positive toward inward foreign direct investment.

The electricity, financial, and distribution services sectors were the areas where the domestic market was most significantly liberalised between 1998-2000 and 2005. All services sectors, except the telecommunications, electricity and transport sectors, are now more open to inward foreign investment than the average for OECD countries. By the end of 2005, the Korean Government had also concluded 80 bilateral investment treaties, making Korea the 11th most active country in such agreements.

Australian investors in the Korean services sector

This liberalised investment climate has created opportunities for Australian firms. For example, Macquarie Bank, Australia's largest investment bank, has set up a number of business operations in Korea and has become the largest foreign investment company operating in Korea (**Box 1**).

Investment liberalisation was also very marked in the distribution services sector in Korea, especially in retailing. In particular, the size of the online retailing sector has grown substantially in Korea, accounting for 45 per cent of the whole Asia-Pacific online market in 2005. In 2006, the total amount of E-Commerce transactions reached approximately US\$400 billion,¹⁴ a 9 per cent increase from 2005. This unique online market environment in Korea presents new opportunities for foreign investors. One of the successful stories from Australian companies in this sector, which is also boosting Australian exports, includes the recent development of an online shopping mall, OzMall (**Box 2**).

¹³ Ministry of Finance and Economy and Ministry of Commerce, Industry and Energy.

¹⁴ The US Department of Commerce.

Box 1: Macquarie Group in Korea

Macquarie first entered Korea as a co-advisor to a Korean client on cross-border leasing transactions. Its growth since then has been such that its Seoul office is now one of Macquarie's fastest-growing offices globally.

Macquarie now employs more than 300 people in Korea and had US\$17 billion in assets under management as of March 2007. Its staff presence on the ground makes it the largest foreign investment company operating in Korea.

In 2001, Macquarie established Shinhan Macquarie Financial Advisory (SMFA), which is a joint venture between Shinhan Financial Group and Macquarie Bank. SMFA provides advisory services including project finance advisory, infrastructure management, structured finance, cross-border leasing, M&A and specialised funds management in Korea.

In December 2002, Macquarie Shinhan Infrastructure Management (MSIM) was established as the Asset Management Company for Korean Road Infrastructure Fund (KRIF), Korea's first private infrastructure fund. KRIF raised approximately KRW1.3 trillion from a range of Korean institutional investors. In March 2006, it listed on the Korea Exchange and London Stock Exchange as the Macquarie Korea Infrastructure Fund, in the first ever listing of an infrastructure fund in Korea. This transaction opened a way for retail investors in Korea and international investors to invest in Korea's infrastructure sector.

On 2 August 2004, Macquarie acquired ING's Asian equities business, which has been renamed Macquarie Securities. Macquarie Securities has one of the largest research and sales teams in Korea, covering nearly 100 listed stocks in a variety of sectors.

Macquarie Securities Korea Ltd launched its equity-linked warrants after receiving an Over-the-Counter derivatives license from the Financial Supervisory Commission. As a result, Macquarie Securities became the first internationally experienced issuer in the Korean Equity-Linked Warrants (ELW) market, and Korea is already the world's fourth-largest ELW market by turnover.

Source: Macquarie Group.

Box 2: OzMall

A new on-line shopping mall called OzMall, developed in partnership between Austrade, Australia Post and Korea Post is proving a success, helping Australian small businesses export their goods to Korea cheaply and efficiently.

OzMall allows Koreans to purchase products online, after which Australia Post utilises its express courier international service to deliver them quickly, efficiently and relatively cheaply. OzMall is the first successful on-line partnership, and will be looking to grow and expand this model in other Asian markets.

Getting the project off the ground in Korea first was based on the fact that 92 per cent of Korean households are internet users. In 2006, internet retailing in Korea was worth over \$12.4 billion. The success of Korea's online shopping malls are being driven by connectivity to the internet, availability of quality products with competitive pricing, an extremely secure internet environment and a low incidence of credit card fraud, plus time savings.

www.ozmall.or.kr is linked to the Korea Post website and is being operated and promoted in cooperation with Korea Post's online shopping division, Kovix. Online shopping sales from Kovix reached over \$56 million in 2006. OzMall shares the same look and feel as Kovix, which raises the credibility of the site for Korean consumers.

Source: Austrade.

Conclusion

The value of Australian exports to Korea has grown appreciably in recent years. Australian exports of unprocessed and primary products have made an important contribution to this growth, as have manufactures. Services exports are growing rapidly, but are narrowly focussed.

Until recently, Australian investment in Korea was modest, largely because of investment restrictions in Korea's services sector. However, liberalisation of the Korean financial and distribution services sectors after the 1997/98 Asian financial crisis has opened up opportunities for Australian companies. Australian investment in Korea has risen substantially in recent years.

In December 2006, Australia and Korea agreed to conduct a joint study on a possible free trade agreement (FTA) through private research institutions in both countries. The study will provide a basis for both governments to consider moving to formal FTA negotiations. A comprehensive FTA has the potential to strengthen and deepen the bilateral economic relationship in both trade and investment, building on the growth that has occurred in recent years. The results of the study are expected to be considered by the Governments after the new Lee administration takes office, early in 2008.

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