

SOUTH AUSTRALIAN GOVERNMENT AND INDUSTRY COMMENTS ON THE AUSTRALIA-REPUBLIC OF KOREA FREE TRADE AGREEMENT FEASIBILITY STUDY

South Australia's Trade and Economic Relations with the Republic of Korea

Merchandise trade

As South Australia's 12th biggest export destination and 6th largest source of imported products in 2007-08, Korea is an important trading partner for the State. South Australian-Korean trade is also mutually complementary; that is, South Australia's exports to Korea heavily comprise raw materials (lead, malt, copper) which are used for additional processing while Korea's exports to the State comprise inputs used for further value creation (motor vehicle components and confidential items such as defence products). This suggests that as both economies grow, bilateral trade will not only grow, but grow at a faster pace.

Though both the Australian and Korean economies have been affected by the financial crisis, which is likely to slow the growth in trade in the short term, trade in both countries should pick up when global economic growth recovers in 2010, as predicted by the IMF. By then, a bilateral Australia-Korea FTA could be near completion, adding additional impetus to the growth in trade.

In 2007-08, total trade between South Australia and Korea was valued at \$600 million, reflecting an increase of 13 per cent over the previous year (\$72 million in value). South Australia's total exports to Korea in 2007-08 were worth \$264 million, an increase of 30 per cent over the previous year (or \$61 million). Over the same period, South Australia imported \$336 million worth of goods from Korea, an increase of 3 per cent over the previous year (or \$11 million in value). The top traded items in 2007-08 are set out in Table 1:

Table 1:

Top SA Exports to Korea 2007/08		Top SA Imports from Korea 2007/08	
Item	Value (million)	Item	Value (million)
Lead	120	Motor Vehicles	93
Silver	36	Combined Confidential items (i.e. defence)	26
Refined Copper	21	Colour Televisions	23
Malt	10	Flat-rolled products of iron or non-alloy steel electrolytically plated or coated with zinc	14
Wine of fresh grapes (other than sparkling)	8	Parts and accessories or machines of group 733	14

General Overview

Based on the results of a favourable report issued in April 2008 by the two non-governmental parties undertaking a feasibility study on a bilateral agreement, there appears to be considerable benefits to both the Korean and Australian economies from a high quality FTA. Australia and Korea have a complementary trading relationship and a high quality FTA would open significant new opportunities for trade, investment and bilateral cooperation. This complementary nature of trade would be likely to limit any downside risks that liberalisation could cause serious damage to industries in either country.

Just as the Australian Government undertook a feasibility study to determine the relative costs and benefits of a Korean FTA, so too did the South Australian Government to evaluate the benefits from the State's perspective. The study was undertaken by the University of Adelaide and has already been provided to the Department of Foreign Affairs and Trade for consideration.

Consequently, from a South Australian perspective any FTA with Korea, provided it is of high quality, would strengthen the State's economic ties with the region and create several new opportunities for South Australian companies. This enthusiasm is highlighted by the fact that firms consulted in the study undertaken by Adelaide University almost universally welcomed the potential of an FTA bringing new investment to the state and creating commercial opportunities for them in the Korean Market.

Given the critical importance of receiving a favourable outcome on agriculture in this FTA, the Department of Trade and Economic Development (DTED) consulted with the South Australian Farmers Federation (SAFF). Whilst fully supportive of the Australia – Korea FTA and the State Government's Submission, SAFF has pressed for DFAT to obtain better access to the heavily protected Korean beef market.

According to the University of Adelaide study, the most immediate risk identified would be a failure to negotiate terms in the Korean market that match those enjoyed by exporters from both Chile and the United States through recently negotiated FTAs. South Australian exporters, including those in the wine sector, have already seen their competitive position in the Korean market damaged by the entry into force of Korea's FTA with Chile. Others, including beef exporters, are likely to be disadvantaged relative to American competitors due to the recently concluded Korea-United States FTA (although this is yet to enter into force).

Key South Australian Issues

Tariffs in Korea

Tariffs are Korea's main instrument of trade policy and a significant source of tax revenue. The Korean tariff remains a relatively complex instrument and as such constitutes a potential distortion to competition and an obstacle to the efficient allocation of resources. Therefore, as with any FTA negotiation, the

South Australian Government would expect that any future FTA negotiations with Korea should lead to a reduction in Korean tariff rates beyond those agreed to at the World Trade Organisation (WTO), and at least as favourable as those obtained by the US and Chile

Almost all Korean tariffs are ad valorem, contributing significantly to tariff transparency. On the other hand, non ad valorem duties exist (mainly as out-of-quota duties) which tend to conceal relatively high ad valorem equivalents, which vary between the same commodities (depending on quality) and over time, provide the greatest protection when world prices are lowest. These duties undermine transparency and predictability and along with other measures (that selectively reduce tariffs on inputs), often contribute to tariff complexity and uncertainty. The South Australian Government would expect DFAT to address these issues during the course of the FTA negotiations and obtain a commitment from Korea to at least convert non ad valorem duties into ad valorem equivalents, especially for those tariff lines where bilateral trade exists.

In recent years, Korea has relied heavily on the negotiation of bilateral free trade agreements to liberalise its trading relationships. Korea now has FTAs in force with Chile, the European Union, Singapore and the ASEAN group, as well as the recently concluded negotiations with the United States. From this perspective it will be important for South Australian exporters not to be at a commercial disadvantage in comparison to other suppliers to the Korean market.

Non-tariff barriers

Along with tariff barriers, South Australian industries face a number of non-tariff barriers when entering the Korean market. This is particularly the case in health and quality sensitive sectors such as agriculture and beef. Whilst bringing tariffs to zero would benefit South Australian exporters, in order to get the best return from the FTA it is also necessary to investigate reducing the burden of complying with technical barriers to trade and sanitary and phytosanitary measures. If a mutual recognition of standards was established through demonstrating that Australia's standards are equal to or higher than Korean standards, then this would create additional benefits to the South Australian agriculture, beef, wine, dairy and seafood sectors.

Furthermore, improving rules on services, such as commercial presence would greatly improve the prospects of South Australian exporters. This would enable South Australian exporters to sell more easily to Korean retailers and consumers in an attempt to capture greater market share.

Manufacturing

Automotive Sector

In assessing the impact of an FTA on the South Australian automotive industry, it is important to recognise that the Australian market is relatively open and that the scale and output of the Australian industry is small by world

standards. More specifically, within South Australia the automotive industry has been the largest manufacturing sub-sector in the State and directly employs approximately 14,000 people, equating to around 20 percent of Australia's automotive workforce.

Whilst a lowering of tariffs (through the Korea FTA) on Australian automotive imports into Korea could create the opportunity of further exports for companies such as GM Holden, the Korean market maintains the most closed automotive market of any of the world's major auto-producing countries. The share of imports in the overall automotive market in Korea is less than 3 percent compared to, for example, a 37 percent import share in the United States market. At the same time, any lowering of tariffs on Korean-origin automotive imports into Australia would obviously increase their price competitiveness in the Australian market, adversely affecting the South Australian automotive industry, particularly given the large share of the automotive market already enjoyed by imports.

To this end, the South Australian Government believes the current automotive tariff structure, which sees tariff rates fall from 10 percent to 5 percent by 2010, should as far as practicable, be preserved in any FTA with Korea, which is in line with current State Government policy. There are few, if any, significant non-tariff barriers affecting access to the Australian market, and this being so, DFAT should push for an equivalent elimination of all non-tariff measures in the Korean market.

Automotive Component Sector

There exists some potential for new Korean investment in South Australia's automotive component industry through lower tariffs on component exports to Korea. Furthermore, (in the event of lowering tariffs through an FTA) GM Holden is well positioned to increase both its competitiveness and savings in both manufacturing inputs and retailing of imports from Korean operations given the ownership by its own parent company of GM Daewoo in Korea.

However, to the extent that the Australian Government is unable to negotiate better access for local component producers to the Korean market, it is suggested that the policy of unilaterally reducing Australian components tariffs be reconsidered. It is likely that the promise of this unilateral reduction undercuts Australia's negotiating position. As an alternative, it is suggested that the Australian Government only commit to the previously scheduled reductions in an FTA or WTO context, in a way that locks in equivalent reciprocal gains for Australia.

Agriculture and Bio-Security

Agriculture is probably the single most significant sector for Australia and South Australia in any potential FTA with Korea. Korea is already an important market for Australian agricultural exporters but it is also a market with many serious trade barriers and the reduction or elimination of these barriers would almost certainly boost the state's farm and food exports to Korea.

Korea maintains high tariffs and like Australia, strict sanitary and phytosanitary measures on imports of all agriculture goods. The average applied agriculture tariff in Korea is 48 percent, with an average bound tariff rate of 61 percent. The tariff rate applied varies considerably from one product to another.

Bringing tariffs to zero would benefit South Australian exporters. However, in order to maximise returns from low tariffs, the FTA must also seek to deliver on a number of issues, such as: (a) reducing standards and quarantine-related barriers; (b) improving access for services suppliers (facilitating marketing operations); and (c) keeping Korean exceptions to a minimum.

As one of the major producers of barley in Australia, South Australia would benefit from improved access. The benefits possible from any FTA however would again depend on the extent to which non-tariff barriers are addressed. As a significant producer and exporter of high quality oaten hay, South Australia asks that the Australian negotiators obtain access to Korea that is as favourable as that obtained by the US in its FTA with Korea.

On quarantine and bio-security, the South Australian Government's position is unequivocal; while imports of food and agricultural products from Korea are welcome, they must be safe and free from any pests and diseases. There should, therefore be no dilution to Australia's current stringent quarantine regime. Quarantine and import risk assessment measures should not be used as bargaining chips in the negotiation. The Commonwealth would be aware that in addition to Federal restrictions, South Australia has its own quarantine measures in place, especially in the Riverland area.

Beef

Australia is a principal supplier of beef to Korea and exports increased dramatically in the period 2000 to 2007. With regard to South Australia, a large proportion of total farm gate production is exported globally and a significant proportion of these exports go to Korea.

Australia is currently the principal supplier of beef to the Korean market thanks to the restrictions imposed by Korea on imports of beef from the United States, Canada and Latin America due to outbreaks of "mad-cow" disease in these markets. This situation is changing however, and recent events such as the Korean-United States FTA will see Australian beef's privileged position in the Korean market under threat.

These developments give Australia strong reasons to negotiate preferential access to the Korean beef market. Achieving this through an FTA could help to lock in its competitive position and enable Australia to maintain a dominant place in the market even as import restrictions are eased for the USA and other FTA countries.

The reduction in tariffs to zero in the Korean beef market would be of benefit to South Australian exporters, although the current constraints on supply given the present drought conditions would mean any increase in exports

could be some way off. As an aside, Australia is vulnerable to potential changes in demand in the Korean market and any change in Australia's disease-free status could mean a sudden and complete halt to these exports with very severe results.

Wine

Korea's tariffs on wine imports are simple, with a bound rate of 30 percent and applied tariffs of 15 percent ad valorem. Although there is considerable scope for increasing sales given the low level of wine consumption in Korea, the current volume is not significant enough to warrant the attention of the State's wine marketing authority. However, improved access through an FTA could change this.

Korea's FTA with Chile resulted in duty-free access (by 2010) for Chilean exporters into the Korean wine market. This had some impact on South Australian wine exporters and the growth rate of sales to the Korean market fell. Restoring the market to a situation of competitive neutrality by gaining the same duty-free access Chilean exporters enjoy could make the Korean market an attractive prospect to South Australian wine exporters.

As with other agricultural products, sanitary and phytosanitary measures and technical barriers to trade may impede current access to Korea. It would therefore be beneficial for the wine industry if mutual recognition of standards could be included in the FTA by deeming Australian standards to comply with Korean standards, provided official Korean standards were equal to or less onerous than Australian ones.

Services

Education

Education is probably the most significant services sector for Australia and South Australia in any potential FTA with Korea. Korea is already an important market for South Australian educational institutions but it is also a market with issues regarding student retention and barriers to entry such as government restrictions on recognising overseas learning. Any reduction or elimination of these barriers through an FTA would boost our education services sector ties with Korea.

At a state level, South Australia performs strongly in attracting South Korean students to study in our School sector which hosts 12.6% of all Korean primary school students across Australia. Despite the strong performance in the schools sector, the issue of retention through to higher education is a challenge and presents an opportunity for the FTA to strengthen this market segment.

One of the barriers to improved performance in higher education and Vocational Education and Training (VET) lies in the low recognition of South Australian higher education in Korea. Traditionally, Korean higher education institutions have been unwilling to recognise credits obtained from foreign universities toward a Korean degree. FTA negotiations regarding joint degree

programs and a willingness to recognise credits from foreign institutions through a “Mutual Recognition Agreement” would be beneficial to the education services sector by increasing the retention rate of Korean students through to higher education.

Furthermore, Education Adelaide, the State’s education marketing agency, has advised that the Korean Government has in place an overseas scholarship program for its post graduate students. Only a limited number of these students offered overseas scholarships choose to study in Australia, with most choosing the United States. Negotiations in an FTA could address the possibility of creating a minimum quota of these scholarships being specifically designated for Australian universities, creating additional benefits for the State.

Additional impediments to the Korean education market can be found in the Department of Immigration and Citizenship (DIAC) student visa restrictions on Korea. Whilst DIAC relaxed some of these restrictions in September 2008, additional student mobility would be of benefit to Australian educational institutions and South Australian higher education institutions would be well placed to benefit.

Investment

The mineral resource sector

One of the reasons Korea is interested in concluding an FTA with Australia is to ensure a secure supply of mineral resources. As a result there should be strong interest in joint-ventures and investment opportunities, provided South Australia can successfully capture a fair share of these opportunities.

An FTA between Australia and Korea would create opportunities for joint-ventures beyond that seen at present and it would facilitate the expansion of Korea’s growing investment in Australia. Under the Australia-US FTA, for example, US investors are exempt from government screening for investments up to AUD\$831 million. A similar threshold for Korea would provide a considerable boost to bilateral investment flows.

To this end, the South Australian Government would support administrative changes to the Foreign Investment Review Board’s screening process in order to make it easier for Korean firms to invest in Australian ventures. This would be particularly beneficial for South Australia, as Korea’s eagerness to ensure a secure supply of resources has sparked growing interest in creating joint ventures in the State’s mining and resources sector.

Furthermore, recognising the future expansion of the Olympic Dam deposit and the mining and resources industry in the State, removing or reducing resource tariffs and any associated non-tariff barriers should be a priority in any future Australia-Korea FTA.

South Australian companies would also stand to gain through imports of cheaper manufacturing and mining equipment and technological innovations

emanating from Korea such as driverless trucks and advanced metallurgy equipment.