MINERALS COUNCIL OF AUSTRALIA

KOREA-AUSTRALIA FREE TRADE AGREEMENT
SUBMISSION TO THE JOINT STANDING COMMITTEE ON TREATIES

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Introduction

The Minerals Council of Australia strongly supports the Korea-Australia Free Trade Agreement (KAFTA). It combines all the principal elements of a substantial FTA between two significant economies that have an important and growing trading relationship. At a strategic level, the agreement reinforces the economic and political underpinnings of the relationship, while linking Australia more firmly into evolving regional economic architecture. At a commercial level, the agreement liberalises market access for goods and services, and opens up new opportunities for investment. It also introduces more liberalising approaches across rules (such rules of origin and technical barriers to trade) and cross cutting issues (such as trade facilitation, cooperation and competition).

For Korea, resources, energy and food security are at the heart of KAFTA: nearly all of its energy requirements and over two-thirds of its food requirements are imported. The agreement provides more certainty to Korea that Australia will remain a reliable and consistent supplier of key products at a time when demand from China and India is rising strongly and is likely to remain strong for many years to come. For Australia, the agreement provides more certainty that our position in the Korean market will not be eroded over time by preferential arrangements already entered into by Korea with the United States, the European Union, ASEAN and others. This is especially important for agriculture, but is critical too for Australia's minerals and energy sector if relationships across trade, investment and technical cooperation are to reach their full potential.

No other alternatives to KAFTA exist at present to achieve these outcomes. The Doha Round of Multilateral Trade Negotiations is on virtual life support. Regional Comprehensive Economic Partnership (RCEP) negotiations are still at an early stage and their ambition is yet to be determined. And Korea is not a party to Trans Pacific Partnership (TPP) negotiations, although it is interested in joining them at some stage. KAFTA is the right agreement at the right time.

KAFTA and the economic relationship

Korea is among the world's largest economies and traders[1], is increasingly integrated in regional value chains and is Australia's fourth largest trading partner. It is our third largest export market and ninth largest source of imports. It is also an increasingly significant source of investment, especially in the minerals and energy sector. Trade in minerals and energy is the economic bedrock of the relationship, accounting for around 80 per cent of our merchandise exports – a figure that has not changed much over the past decade. Agriculture (meat and cereals) and manufactures make up the remainder of our merchandise exports. Services trade is growing but from a relatively low base.

The trading relationship is highly complementary. While Korea has developed major non-resource intensive industries like electrical and electronic goods, it is unusual as a resource deficient economy in continuing to shift towards more resource intensive (especially steel intensive) industries such as transport equipment, autos and shipbuilding. Korea's per capita steel production is now the highest in the world – a fact made possible by Australian iron ore and coal.

By clearing away or reducing some of the obstacles that constrain trade and investment flows, KAFTA provides an opportunity to expand the basic exchange of resources and agricultural products for manufactures. It also provides an opportunity to broaden the economic relationship in services and investment.

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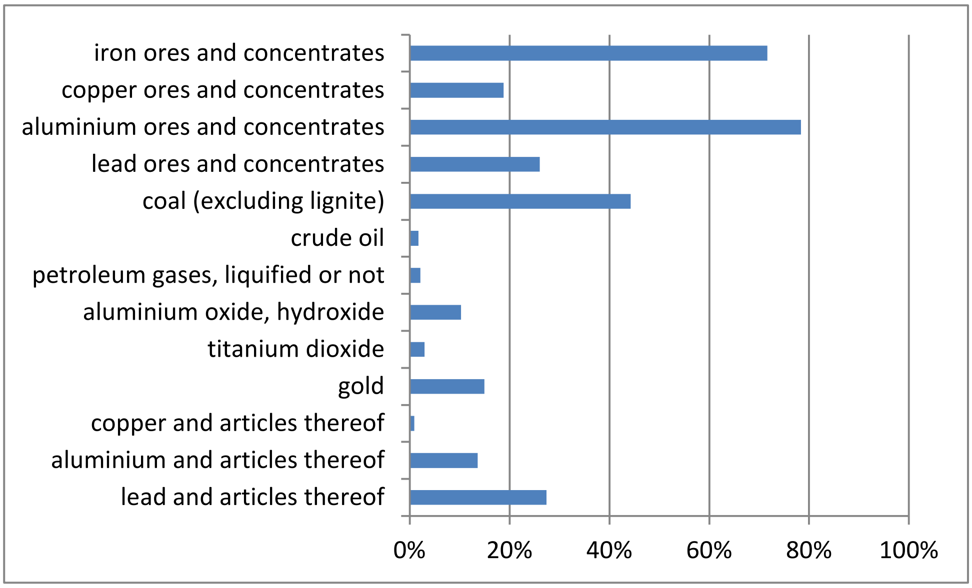
[1] Korea is the world's 8th largest exporter of goods and services – principally autos, transport equipment and electrical and electronic products. The ratio of exports to GDP is almost 60 per cent compared to a slightly over 20 per cent for Australia. In recent years Korea has become increasingly integrated in regional value chains. Its share of total value added in manufacturing in East Asia has increased from 7 per cent of the total in the mid-1990s to 11 per cent in the mid-2000s (Cusbert, Jaaskela and Stenner 2013).

KAFTA and resources exports

The minerals and energy sector is the most globalised sector of the Australian economy and, as noted previously, has strong links with Korea. The biggest Australian exports in this sector are iron ore and coal. However, there are a number of other very significant items, including crude oil, natural gas, copper ores, lead ores and gold. In particular, Australia will shortly become a major supplier of natural gas to Korea.[2] Processed metal and other products derived from minerals also make a valuable contribution to bilateral trade. Examples are aluminium, lead and copper, supplied either as unwrought metals, as articles made from them or as scrap. Australia supplies a significant (and in some cases very high) proportion of Korea's import requirements for some of these mineral ores and metals (Chart 1).

Chart 1: Australia's share of Korea's 2013 imports by value: selected commodities



Source: Calculated from data from the United Nations Statistical Division. Titanium dioxide in the above graph refers to preparations containing at least 80 per cent of this compound by weight.

The big ticket items – iron ore and coal - enter Korea largely duty free.[3] But there are a number of Australian mineral ores and related products which are affected by nuisance tariffs. Natural gas, for example, is subject to a base rate tariff under KAFTA of three per cent. The Table below gives other examples. By abolishing these remaining tariffs, KAFTA would make a modest, but valuable contribution to Australia's minerals and energy exports. Importantly, tariffs are to go to zero on KAFTA's entry into force in most of the examples given.

[2] Korea has signed three major contracts to source natural gas from Australia – with Santos (Gladstone LNG), Total (Ichthys) and Shell (Prelude). According to DFAT (2014), these contracts should see Australia provide around 25 per cent of Korea's LNG requirements from around 2015, compared with around two per cent in 2013.

[3] In the case of iron ore, for example, the 1 per cent duty applies to roasted iron pyrites, which Korea did not import from Australia in 2013. For coal, the 1 per cent duties also applies to products, such as briquettes, which Australia did not supply in 2013.

More processed metals and other resources can be subject to significantly higher duties. Various aluminium products, for example, enter Korea under a tariff of 8 per cent, although unwrought aluminium which forms the bulk of Australia's trade enters at 1 and 3 per cent. Under KAFTA, many of these aluminium products are to go to zero tariffs on entry into force, with others being phased out over periods of up to seven years. The tariffs on unwrought aluminium will go to zero on entry into force. KAFTA also provides a process for identifying and addressing non-tariff barriers.

Table 1: KAFTA and the resources sector: selected examples

	base rates, %	phase out under KAFTA	WTO bound rates, %
iron ores and concentrates	0 to 1	0 on entry into force (eif)	1
copper ores and concentrates	0	0 on eif	1
aluminium ores and concentrates	0	0 on eif	1
lead ores and concentrates	0	0 on eif	unbound
coal (excluding lignite)	0 to 1	0 on eif	1 or unbound
crude oil	3	phase out over 5 years*	unbound
petroleum gases, liquified or not	3 to 5	0 on eif	5 or unbound
aluminium oxide, hydroxide	1 to 5.5	0 on eif	1 to 5.5
titanium dioxide**	6.5	0 on eif	6.5
gold	0 to 3	0 on eif	0 to 10
copper and articles thereof	0 to 8	almost entirely 0 on eif***	0 to 16
aluminium and articles thereof	0 to 8	varying phase outs up to 7 years	3 to 16
lead and articles thereof	0 to 8	0 at eif or phase out over 10 years	3 to 13

Sources and notes: KAFTA Agreement, WTO. For petroleum gases, the range of applied rates given by the WTO differs from that in Korea's annex to KAFTA. The rates in KAFTA have been used. * The phase out over 5 years involves a reduction of five equal reductions beginning on entry into force and with the goods free from customs duty by 1 January of year five.
** Titanium dioxide in the above refers to preparations containing at least 80 per cent by weight of this compound.
*** There are two tariff lines where phasing is over three years, with goods free effective 1 January of year three.

The tariffs bound in the WTO for iron ore and coal (except for anthracite) are one per cent, indicating that there is little scope for Korea to raise most-favoured-nation tariffs for most of the products within these categories. But in the absence of KAFTA, it would be possible for Korea to raise some tariffs significantly. Tariffs on anthracite and on lead ores and concentrates are unbound in the WTO. With aluminium products, the tariff rate bound in the WTO is typically 10 or 13 per cent and can go even higher (though the bound tariff on unwrought aluminium is much lower at 5 per cent). WTO bound tariffs on petroleum gases (such as LNG) are 5 per cent in the majority of cases, but some products in this category are unbound. Binding tariffs in a bilateral agreement can thus make a valuable contribution to the security of the trade for Australian exporters in the minerals and energy sector.

Korea has negotiated free trade agreements with a number of other economies, including Chile, the European Union, the United States and ASEAN. Negotiations with Canada were concluded in March 2014. The Regulation Impact Statement submitted to JSCOT provides some limited information on comparisons between the treatment accorded to Australian resource and related products with those accorded to the United States (under KORUS) and with the European Union (under KOREU). These data indicate that Australia will receive equivalent phase-out periods for tariffs on a number of products, but longer phase-out periods for crude oil and unwrought lead than the United States and the European Union. The most important point is that Australia will need to proceed with KAFTA to maintain a broadly level playing field with other suppliers and potential suppliers. For example, in the case of the titanium dioxide (strictly, for preparations containing at least 80 per cent by weight) where Korea has historically been an important market, Australia's competitive position will be restored to that accorded to the United States. This may help Australia to regain market share.

KAFTA and resources-related investment and cooperation

The Australia-Korea investment relationship is modest and lags well behind the trade relationship, though it has grown strongly from a very low base in the past ten years. In December 2013, the level of inward investment from Korea was around $15 billion and Australian investment in Korea around $12 billion. Foreign direct investment (FDI), which involves investors having an active role in running businesses, amounted to only 10 per cent of two-way investment.[4] By comparison, the level of inward investment from Japan was around $130 billion, outward investment $50 billion, and FDI (almost all inward) over 30 per cent of total investment.

KAFTA should go some way to achieving more balance between trade and investment in the Australia-Korea relationship. Moves towards more liberal investment regimes in both countries, including raising the Foreign Investment Review Board (FIRB) threshold for vetting investment applications to align with those applying to investments from the United States and New Zealand, are welcome.

There is plenty of potential for the investment relationship to grow in both directions. In the case of minerals and energy and related activities, growth will be driven by twin security priorities: Korea's to secure the resources and energy that are central to its economic growth and Australian companies' to secure their overseas markets. Korean companies have traditionally acquired off-take rights to resources, often involving small minority equity stakes. Over the last decade or so, however, increasing competition from other investors looking to secure access to minerals and energy resources has increased Korean interest in direct equity investment. Investments in Australian coal mines by the Korea Electric Power Corporation (KEPCO) and the Pohang Iron and Steel Company (POSCO) are recent examples.[5]

Australian resources companies are keen to pursue reciprocal commercial ventures with Korean companies. BHP Billiton's collaboration with POSCO in the Mining C project in the Pilbara is well established, POSCO providing technical expertise in addition to purchasing iron ore from the project. KAFTA should promote this type of cooperation, among others, and associated direct investment flows. The agreement covers cooperation in research and development and investment in emerging technologies, and sits well with the broader narrative of closer Australia-Korea economic and institutional integration. Proposed arrangements, including the Committee on Energy and Mineral Resources Cooperation, should highlight and advance opportunities for worthwhile investments in minerals and energy products.[6]

The MCA supports the Australian Government's pragmatic approach to drafting investment provisions in trade agreements, including those associated with handling disputes. In this respect, we note the assessment in the Regulatory Impact Statement concerning Investor-State Dispute Settlement (ISDS):

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[4] Korea Zinc's $1 billion investment in the Sun Metals Corporation refinery in Queensland in the late 1990s stands out as a major Korean investment in Australia.

[5] The FIRB approved investments in minerals exploration and development of $1.9 billion in 2011-12, $1.4 billion in 2010-11 and $1.7 billion in 2009-10. These approvals would have included, for instance, an investment of $580 million in 2010 by the Korea Electric Power Corporation (KEPCO) and POSCO in a portfolio of five Australian coal mines (AKBC 2014).

[6] Article 16.14 covers research and development in exploration, extraction, processing, transport, energy efficiency, climate change abatement; and scientific information exchanges. Article 16.15 focuses on new investment, including through exchanges on emerging technology and renewable energy.

> To succeed in an ISDS claim, an investor must establish that the host government has breached an investment obligation. ... Substantive carve-outs and safeguards have been included for key policy concerns, including public welfare, health, culture, and the environment. Foreign investment screening decisions are also carved out for the scope of the ISDS-mechanism (National Interest Analysis 2014).

This pragmatic approach coupled with KAFTA's investment provisions on national treatment, most favoured nation status, guarantees against expropriation, and free transfer of funds, will increase protection of Korean investments in Australia and Australian investments in Korea. It also should flow through to increasing commercial collaboration.

Conclusion

The world owes Australia nothing. What we do unilaterally is critical to our success in driving growth, creating jobs and raising living standards. But what we do internationally works in tandem by improving access to markets, increasing competition at home and strengthening bilateral and regional relations.

KAFTA is a significant milestone along this international path in at least three respects. First, it clears away some of the minor obstacles and irritants in exchanging resources and agricultural commodities for manufactures, which is central to the Australia-Korea economic relationship now and into the future.

Second, it creates opportunities to broaden that exchange through reforms that should, in time, promote more flows of direct investment and encourage more cooperation across areas ranging from infrastructure to services to mining and agriculture.

And third, it underlines the key importance of liberalising trade and investment for both economies' long-term prosperity. KAFTA, of course, deals with bilateral aspects of liberalisation, but the relationship between liberalisation and prosperity is much broader. Australian resources are transformed into manufactures in Korea and in a web of value chains threading through East Asia. These manufactures are then consumed or used around the world. The interconnectedness of modern trading relationships puts the focus squarely on how high quality bilateral FTAs like KAFTA can contribute to a new phase of international trade policy focused on creating new rules for 21st century trade.

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