



## Submission No 21

### **Inquiry into Australia's Relations with the Republic of Korea; and Developments on the Korean Peninsula**

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**Australian Government**  
**Department of Foreign Affairs and Trade**

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2 June 2005

Dr Margot Kerley  
The Secretary  
Joint Standing Committee on Foreign Affairs, Defence and Trade  
Department of the House of Representatives  
Parliament House  
CANBERRA ACT 2600

Dear Dr Kerley

Thank you for the invitation to provide a submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade on Australia's relations with Korea.

Please find attached the department's submission which addresses directly the Committee's terms of reference on economic, political and strategic aspects of the relationship.

Our submission highlights Korea's importance as our fourth-largest trading partner, identifying increasing opportunities for trade and cooperation arising from dynamic political, social and economic changes. In addition, it discusses the potential impacts on Australian interests of the strategic situation on the Korean peninsula

Yours sincerely

Lydia Morton  
First Assistant Secretary  
North Asia Division



**Australian Government**

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**Department of Foreign Affairs and Trade**

**Inquiry by the Joint Standing Committee on Foreign  
Affairs, Defence and Trade on Australia's  
Relationship with the Republic of Korea and  
Developments on the Korean Peninsula**

**Submission by the Department of Foreign Affairs and Trade**

**MAY 2005**

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**Inquiry by the Joint Standing Committee on Foreign Affairs, Defence and Trade  
on Australia's Relationship with the Republic of Korea and Developments on the  
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**Submission by the Department of Foreign Affairs and Trade**

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On 7 April 2005, the Minister for Foreign Affairs, The Hon Alexander Downer MP, asked the Joint Standing Committee on Foreign Affairs, Defence and Trade to inquire into Australia's relationship with the Republic of Korea (ROK) and developments on the Korean peninsula.

The following submission is made by the Department of Foreign Affairs and Trade (DFAT), including input from AusAid and Austrade, and provides an overview of bilateral relations between Australia and the ROK, addressing the inquiry's terms of reference:

*The Joint Standing Committee on Foreign Affairs, Defence and Trade shall inquire into and report on Australia's relationship with the Republic of Korea; and developments on the Korean peninsula.*

*The Committee shall review political, strategic, economic (including trade and investment), social and cultural issues; and consider both the current situation and opportunities for the future.*

## 1. Introduction

The ROK is the 10th largest economy in the world (Australia is 13th) and, remarkably, has built its economy after the devastation of the Korean War in just over 50 years.<sup>1</sup> The rapid pace of economic development has created, and continues to create, significant social and political change. This change has the potential to affect Australia's bilateral relationship with Korea, opening new opportunities for trade and political engagement.

Strategic developments on the Korean peninsula are also of significance to Australia. Australia's top four trading partners (Japan, China, the United States and the ROK) are located in or are heavily engaged with north east Asia. This region would be the most affected by the further escalation of the DPRK nuclear issue.

This submission examines the relationship between Australia and the ROK, emphasising the economic, social and political dynamics of change and identifying some of the emerging opportunities: as the ROK moves towards a more services-oriented economy, opportunities for Australia will be created in that sector; as the ROK looks to guarantee its energy security, Australia's track record as a reliable supplier of energy and resources will serve it well; as the ROK moves towards liberalising and internationalising its economy, a free trade agreement with Australia would make good economic sense. Politically, the ROK's greater focus on regions and countries beyond its immediate environs should lead to greater engagement with Australia across a range of fields and activities.

The submission also looks at developments on the Korean peninsula, with a focus on Australia's relationship with the DPRK and the implications for Australia of the DPRK's nuclear program.

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<sup>1</sup> 'Republic of Korea' is the official title of the country, though 'South Korea' and 'Korea' are often used, with 'North Korea' used to refer to the Democratic People's Republic of Korea.

## **2. Political Developments and Outlook**

### **(a) Domestic Politics in Transition**

#### *A New Democracy*

In the 20th Century, Koreans were largely subject to dictatorial rule, first by colonial Japan (1911-1945) and then by a series of Korean military regimes. Throughout this period, Koreans struggled, often at great personal sacrifice, to establish a democratic political system. Following the first democratic election of a president in 1987, successive governments have taken steps to reform political institutions and tackle corruption.

#### *A Developing Political Culture*

Regionalism runs deep in South Korean politics. Most South Koreans vote according to regional and personal affiliations - loyalty to the people from the place where they were born or educated - rather than according to ideology, class or policies.

Another feature of South Korean politics has been the sudden formation and dissolution of political parties. Since 1980, there have been more than 25 different parties in mainstream politics. Currently, the two major parties - the Uri Party and the Grand National Party - are both less than ten years old, with the Uri Party established less than two years ago. Until recently, parties were formed around one central figure, behind whom others rallied. New parties formed when a compromise between strong political figures could not be reached and alliances shifted as one individual gained greater political support.

#### *The 2002 Presidential Race*

Somewhat unexpectedly, Roh Moo-hyun secured the nomination for the Millennium Democratic Party (MDP), the party of former President Kim Dae-jung, in a hard-fought pre-selection battle in April 2002. This internal nomination ballot was conducted using a new internal selection process featuring US-style primary elections and an Australian preferential voting system. For most of the year, the outlook for Roh looked difficult. Electoral losses, ongoing internal party discord and several challenges to Roh's place as MDP presidential candidate undercut his authority. On average, the opinion polls had him lagging well behind the conservative favourite in the presidential race, Lee Hoi-chang.

#### *A New Generation*

Nonetheless, Roh demonstrated during the campaign that he was an astute and resourceful politician, seeing off a series of rivals. Roh was a generation younger than former presidents and came from outside the traditional, hierarchical social structures, which gave him a very different style to previous Korean leaders. Roh promised to continue Kim Dae-jung's engagement with North Korea, and implement corporate, finance, public and labour sector reform. He also focused on political reform,



attempting to break down 'regionalism' and increase public participation in political processes.

On 19 December 2002, Roh was elected president with 48.91 per cent of the vote. He won by a relatively small margin of 2.3 per cent over rival Lee Hoi-Chang, and with a voter turnout of 70.8 per cent. Voting patterns were divided in two ways: by region and by age. South Korea was split right down the centre geographically, with the eastern provinces voting for Lee and the western provinces (including major metropolitan areas of Seoul, Gyeonggi and Incheon) voting for Roh. Younger voters favoured Roh by a large margin. In particular, the '386' generation—people in their 30s, educated in the 80s and born in the 60s—were influential during the presidential campaign in rallying support for Roh using new technologies, including the internet and mobile phone text messaging.

### *Political Upheaval*

Roh's first year in office was marked by a political upheaval and ongoing investigations into political corruption, some of considerable magnitude. Roh focused on his agenda to reform politics and break the collusive ties between politics and business. In preparation for the April 2004 National Assembly general election, the Assembly passed several strict laws to limit drastically election funding and campaigning.

The MDP – Roh's support base in the National Assembly – remained weak and continued to fare poorly in opinion polls and at by-elections. After the MDP failed to agree on how to reform itself, 35 of Roh's supporters split to form the Uri Party in 2003. They were later joined by several members of other parties. Roh also resigned from the MDP and officially remained unaffiliated to any political party until 20 May 2004, when he joined Uri.

The remainder of the MDP joined forces with the GNP to impeach Roh (on three charges: violating the election law, knowingly allowing his aides to accept illegal funding, and mismanaging the economy). Roh's presidential powers were suspended from 12 March until 14 May, when the Constitutional Court reinstated him, ruling that he had broken the election law, but not seriously enough to warrant impeachment.

### *A More Diverse National Assembly*

Until his impeachment, Roh's approval rating had continued to drop. However, the impeachment created a wave of public support for Roh, resulting in his fledgling Uri Party winning an outright majority in the Assembly at the 15 April general election (by contrast, the MDP was reduced to only nine seats).

The 2004 general election changed the political landscape dramatically in several ways. Firstly, the left-leaning Democratic Labor Party won seats in the National Assembly. The DLP is the only truly ideologically based party with no regional constituency. Secondly, over one-third of the National Assembly members were elected for the first time. Many are younger than their predecessors and come from a broader spectrum of backgrounds. More women were elected than ever before (39 out of 299).

Since the 2004 election, the Uri Party's fortunes have taken a turn for the worse. In by-elections on 30 April 2005, the party failed to win any of the six seats contested. The result was that Uri lost its majority in the National Assembly and will now rely on support from at least one of the minor parties to pass legislation.

## **(b) International Political Outlook**

South Korea's international engagement is dominated by the 'big four' - the United States, China, Russia and Japan and by the North Korean nuclear issue. Roh's government has forged a North Korea policy which insists on greater transparency and reciprocity, while moving ahead with inter-Korean projects such as a joint industrial park at Kaesong in North Korea. South Korea has worked closely with the United States, Japan, China and Russia to seek a resolution to the North Korea nuclear issue, particularly through the six-party talks process (see later sections on North Korea and inter-Korean relations).

A close security relationship with the US has been a pillar of Korea's postwar prosperity, with the United States stationing thousands of troops in Korea since the end of the Korean War. The relationship has always had its tensions due to perceptions of the extent of US influence over Korean domestic and foreign policies and to various incidents involving US troops. However, there is a fundamental and deep recognition by the Roh administration of the importance of the US relationship to South Korean security interests. For example, Roh's administration successfully resisted student opposition to its decision in 2004 to deploy an additional 3,000 troops to Iraq. It has also cooperated closely with the United States in the fight against terrorism.

The economic rise of China, which has replaced the United States as South Korea's largest trading partner, has seen a growing weight placed on the political relationship, which only formally started in 1991 with the establishment of diplomatic ties. The relationship is strong and moving forward, including through a steady stream of high-level visits. Seoul initiated a regular Pol-Mil dialogue with Beijing in 2002.

South Korea-Japan political relations have steadily improved and the two countries are committed to annual summits. However, historical tensions run deep and the relationship is susceptible to irritation. An ongoing dispute over ownership of the Dokdo islands and South Korean accusations that Japan has glossed over wartime atrocities in school textbooks are cases in point. In the ROK-Russia relationship, key themes tend to be North Korea, given Russia's historic ties to that country, and energy, given Russia's vast energy reserves in Siberia.

The ROK's engagement with the rest of the world, including Australia, has often been trumped by its focus on its immediate region. However, the South Korean government has indicated it would like to broaden the scope of its foreign relations. South Korea's hosting of APEC in 2005 presents a key opportunity for doing so, as does its efforts to negotiate free trade agreements with extra-regional trading partners (South Korea currently has FTAs with Chile and Singapore). South Korea has also worked hard to bring together the leaders of northeast Asia in the 'plus 3' part of ASEAN+3.

### (c) **Bilateral Political Relationship**

Contact between Australia and South Korea began in 1884 when Australian missionaries began arriving in Korea. In the post-World War Two period the defining event for the relationship was Australia's participation in the 1950-53 Korean War, with more than 18,000 Australian troops serving under the UN command, sustaining 339 deaths.

Diplomatic relations between Australia and the Republic of Korea were established in 1961 (though Australian delegates to the UN Commission for the Unification and Rehabilitation of Korea had increasingly acted as diplomatic representatives from the early 1950s). Since then, substantial and growing trade links (see following section on Trade and Investment) have been the central driver of the bilateral relationship.

The pattern of Australia-Korea high-level contact has also diversified and expanded. President Kim Dae-jung visited Australia in September 1999 (where he participated in an earth-turning ceremony for the Korean War Memorial in Canberra) and Prime Minister Howard visited Seoul in May 2000 and July 2003. These visits have been augmented by those of the then Deputy Prime Minister Fischer in 1999, by Trade Minister Vaile in April 2002, and by Foreign Minister Downer in May 2001 and February 2003. Korean Foreign Minister Ban Ki-moon visited Australia in August 2004, as did then Trade Minister Hwang Doo-yun in September 2003.

Annual ministerial trade talks, held since 1965, are now complemented by annual foreign ministers' talks. Annual meetings between officials and business people encompass economic, business, security, disarmament, defence, nuclear policy, quarantine, aid and science and technology issues.

#### *Cooperation on Regional Security*

Australia has supported cooperation between the principal parties to reduce tensions on the Korean peninsula, encourage meaningful north-south dialogue, and achieve a permanent peace agreement to replace the 1953 Armistice (technically, North and South Korea are still at war). South Korea has expressed its strong appreciation for Australia's role in trying to secure peace on the Korean peninsula over the past 60 years, a role which has ranged from combat to high-level political pressure on North Korea to abandon its nuclear weapons program.

President Kim Dae-jung's commitment of Korean troops to East Timor in September 1999 signalled a new stage in bilateral security cooperation. Korea initially committed 419 troops (including a medical team and military police squad) to the Australian-led UN INTERFET force in East Timor. It withdrew its last forces in October 2003.

South Korea and Australia have both backed the war against terrorism and the fight against the spread of weapons of mass destruction. South Korean military personnel, mostly engineers and medics, are currently deployed in Afghanistan and Iraq. More than 600 South Korean troops have been deployed in Nasiriyah since mid-2003. In mid-2004 the Roh administration decided to deploy an additional 3,000 troops to Irbil in northern Iraq. Those troops are currently on the ground. Terrorists beheaded a

South Korean civilian hostage in central Iraq in June 2004.

### *Collaboration in Multilateral Forums*

South Korea is a valuable partner and ally for Australia in multilateral fora. As influential regional democracies, with often overlapping trade and strategic interests, Australia and South Korea share similar perspectives on international and regional affairs and generally support each other's positions, arguments and candidates in multilateral forums. Increasingly, Australia and South Korea act in diplomatic concert, especially within the region, to advance common global and multilateral goals.

Australia and South Korea are both members of the OECD, APEC (which was jointly launched in Seoul in 1989 by Prime Minister Bob Hawke and President Roh Tae-woo), the WTO, the ASEAN Regional Forum and the United Nations.

#### **(d) People-to-People Links**

The people-to-people aspect of the bilateral relationship is broadly based and growing. These links are built on the bedrock of Australia's contribution in the Korean War and the approximately 9000 surviving veterans. Each year the Korean Veterans Association sponsors a group of these veterans to visit South Korea, principally for the commemoration of Gapyeong Day.<sup>2</sup>

Education and tourism, as well as cultural and media exchanges, have expanded markedly over the past decade, underpinned by support from governments and the 40,000-strong Korean community in Australia. Well over 200,000 Koreans visit Australia annually, with well over 20,000 student enrolments in Australia (at the primary, secondary and tertiary levels, and at English-language institutes).

Australia and Korea have operated a Working Holiday Maker (WHM) arrangement since 1995. In 2003-04, 9,513 WHM visas were granted to Koreans, a 62 per cent increase over the previous year. More Koreans take advantage of this arrangement than Australians - in the same period, 24 WHM visas were granted to Australians for a working holiday in Korea.

These links are reinforced at the institutional level. AusAID, for example, is one of a number of government agencies that has hosted Korean secondees, in this case from the Korea International Cooperation Agency. The Australia-Korea Foundation (AKF) is another important mechanism for expanding ties. The AKF supports exchanges in a range of fields, especially culture and the arts, the media, sport, and science and technology (see separate box on the AKF and its activities).

The Australia New Zealand Chamber of Commerce in Korea (ANZCCK) provides a valuable focal point for the Australian and New Zealand business community in Seoul. With over 250 members, the ANZCCK provides business information services and networking activities, providing a key link between Australian and New Zealand

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<sup>2</sup> Gapyeong Day commemorates the battle of Kapyong where Australian and New Zealand troops held off a massive Chinese assault on 23 April 1951 in the Kapyong Valley 56 kilometres north of Seoul.

business and Korean industry and government. Formed in 2001, the ANZCCK is already recognised by the South Korean government as one of the leading foreign chambers of commerce, representing the views of a significant part of the foreign investor and business community in South Korea.

The Australia-Korea Business Council (AKBC) and its sister organisation the Korea-Australia Business Council (KABC) were formed in 1978 in recognition of the need for improved knowledge and liaison between the business communities of Australia and Korea. The AKBC and KABC boasts membership of world-leading companies such as POSCO, Macquarie Bank, Korean electric power generators, BHP-Billiton, the Korean Gas Company (KOGAS) and Woodside Energy.

#### AUSTRALIA-KOREA FOUNDATION

The Australia-Korea Foundation (AKF) aims to broaden and deepen the relationship between Australia and the Republic of Korea.

The Foundation was established in 1992. It comprises an external Board of part-time members and a Secretariat located in Canberra and Seoul. The Board provides advice to Government and runs programs in the fields of commerce and industry, science and technology, education, and arts/the media. It receives funding (currently \$740,000 pa) through DFAT's International Relations Grants Programme. Several of its current projects are listed below.

*"Investigating Australia" multi-media study kit.* The kit aims to inform young Koreans about the lifestyles of their counterparts in different regions of Australia. The kit, which comprises an interactive CD-ROM and associated website ([www.auskorea.com](http://www.auskorea.com)), was developed to address misunderstandings of Australia's economic diversity, scientific strengths and immigration policies. The kit has been distributed to over 3,000 lower-secondary schools in Korea and elements have been incorporated into the official Korean school's curriculum.

*Australia-Korea Broadband Summit.* This major information and communications technology meeting, held on the Gold Coast in May 2003, was an initiative of the AKF Board. The summit highlighted Australia and Korea's complementary strengths in telecommunications, broadband and software services. The AKF is co-sponsoring a second Summit that will be held in Seoul in June 2005.

*George Rose photographs – touring exhibition and photographic book.* George Rose, an Australian photographer, visited Korea in 1904. Rose photographed scenes of everyday life in Korea, revealing day-to-day aspects of Korea's history.



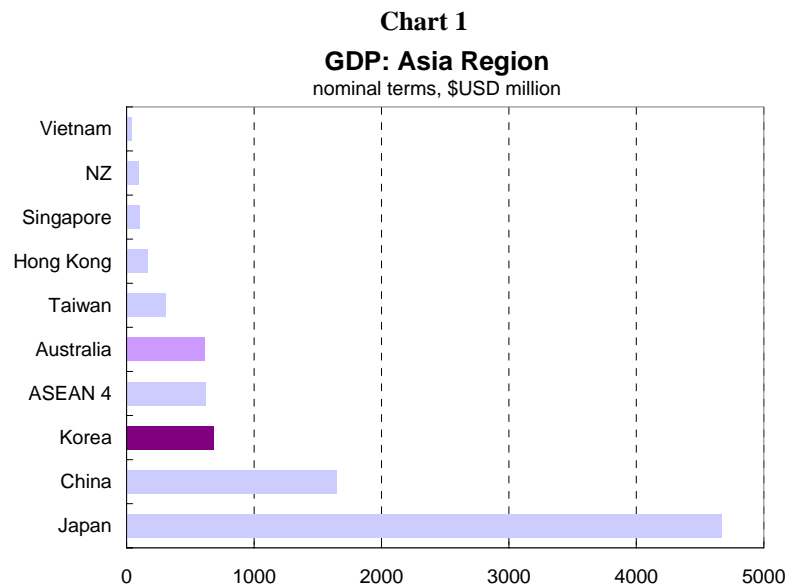
The AKF has been exhibiting the photos throughout Korea since April 2002 and produced a book of the photographs, *1904 Korea Through Australian Eyes*.

### 3. Recent Economic and Social Developments in the ROK

#### (a) Korean Growth Performance and Outlook

The Republic of Korea has made remarkable economic progress over the past 60 years. When the Japanese occupation ended in 1945, South Korea was an impoverished, agrarian economy. Since then, sustained high economic growth has seen living standards rise steadily and South Korea has emerged as an internationally competitive and highly industrialised economy.

On a market exchange rate basis, South Korea is now the 10th largest economy in the world (Australia is 13th), with a per capita GDP of \$US14,098 (compared to \$US30,445 in Australia). In terms of size, South Korea is the third largest economy in Asia, after Japan and China and equal to the combined economies of Malaysia, Thailand, Indonesia and the Philippines (Chart 1).

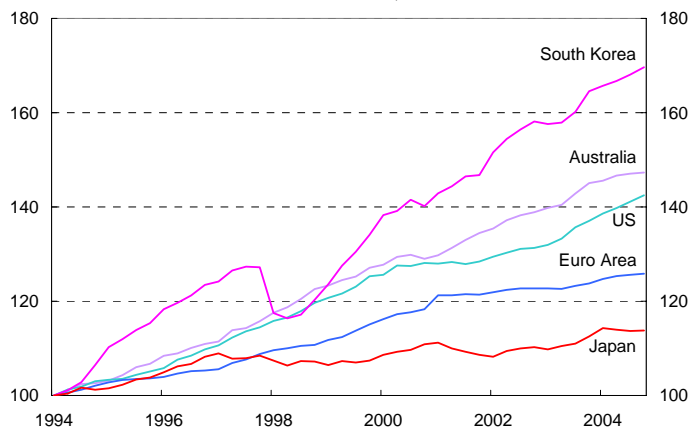


'ASEAN 4' is Thailand, Malaysia, Indonesia and the Philippines combined.  
Source: International Monetary Fund.

South Korea's economic turnaround can be traced from 1962, when under President Park Chung-hee, South Korea embarked on a series of five-year plans (stretching to 1982) to promote large-scale, government-directed industrial development. The focus of the five-year plans was the domestic production of previously imported intermediate and capital goods and the development of new strategic export industries such as textiles, iron, steel, shipbuilding, electronics and petrochemicals.

By the 1980s the economy was expanding rapidly and South Korea's focus shifted to encompass more technology-intensive industries such as automobiles, aerospace technology and advanced electronics (semiconductors and computers). Annual GDP growth averaged 8 per cent between 1970 and 1996, and South Korea was admitted to the OECD in 1996 (Chart 2).

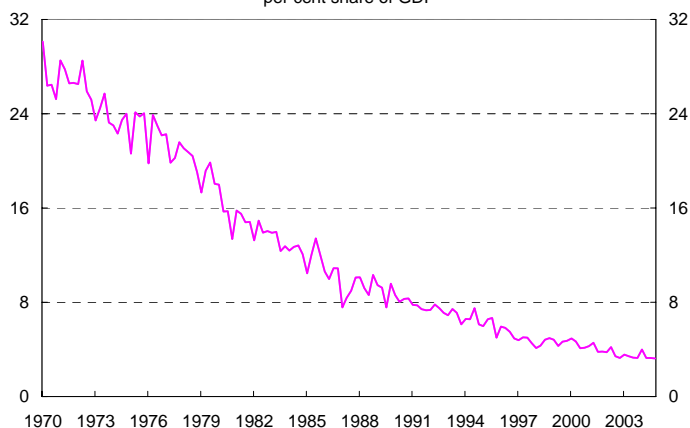
**Chart 2**  
**GDP by Select Country/Region**  
 Index: March 1994=100, real terms



Source: Reserve Bank of Australia.

**Chart 3**  
**Korean Agricultural Sector**  
 per cent share of GDP

The rapid transformation of South Korea's economy can be seen in its agricultural sector, which, as a share of GDP, fell from 27 per cent in 1970 to 3 per cent in 2004 (Chart 3). This steady decline comes despite the heavy levels of protection that South Korea affords the rural sector.



Source: CEIC Asia Database.

The South Korean economy was badly affected during the 1997 East Asian financial crisis. While its interventionist-style development system proved effective in promoting economic and industrial growth, it fostered serious inherent structural weaknesses. In particular, capital was routinely allocated on the basis of government directive rather than market principles, meaning banks did not lend on a market basis nor develop risk management systems. In addition, the large corporations (or *chaebol*) chased market share rather than profit, leading to inefficient resource allocation. These weaknesses were revealed in the crisis when the bankruptcy of several large conglomerates, rapidly growing non-performing loans and the accumulation of huge short-term foreign debts forced the government to seek emergency IMF assistance.

In response, South Korea adopted an extensive \$US58 billion IMF reform program in December 1997. The IMF program targeted four areas for reform – financial markets, the corporate sector, the labour market and the public sector. The first stages of the program, to which Australia pledged \$US1 billion (although this was not drawn upon), were implemented quickly and led to a return of domestic and foreign investor

confidence and stabilisation of the economy. The reforms have been more far-reaching than in most other Asian economies hit by the financial crisis and have transformed the South Korean economy.

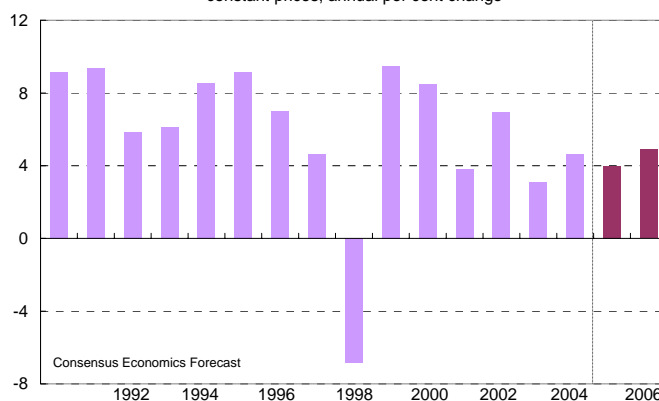
The South Korean economy grew by a relatively modest 3.1 per cent in 2003, dragged down by negative growth in private consumption as consumer sentiment was depressed by the credit card crisis (which greatly raised the level of household debt), high world oil prices, fears of a fall in Seoul property prices, a range of increases in government charges and uncertainty about South Korea's future economic prospects.

In contrast, the South Korean economy expanded by a firmer 4.6 per cent in 2004, underpinned by very strong growth in exports, particularly to China (Chart 4). Domestic demand remained weak in 2004, however, with private consumption continuing to decline, and business investment increasing very modestly. Economic growth prospects are more modest, however, with the Ministry of Finance and Economy forecasting economic growth of 5 per cent in 2005, while the private sector-based Consensus Economics reporting analysts believe growth will slow to 4.0 per cent.

Encouragingly, domestic consumption in 2005 is expected to increase for the first time since 2002, though it remains at low levels, driven by lacklustre consumer sentiment. Business investment is also weak, though a modest pick-up is expected in 2005. Exports are forecast to remain a key driver to growth in 2005, albeit it at a slower pace than the breakneck pace seen in 2004.

**Chart 4**

**South Korea: GDP Growth**  
constant prices, annual per cent change



Source: CEIC Asia Database, Consensus Economics.

Looking ahead, South Korea has ambitious goals to continue its rapid development, and hopes to re-shape itself as an Asian business and economic 'hub', including through the development of free economic zones. In order for South Korea to achieve these goals, it is assisting the further development of the services sector, the promotion of SMEs, boosting infrastructure investment, developing capital markets, and further increasing the transparency in business/chaebol sector. The ability to capitalise on the dynamic Chinese economy is also becoming increasingly important to South Korea.

The South Korean government has also identified regulatory reform as a key initiative. Reforms include a review of regulations involving distribution, logistics, architecture, construction, the corporate investment environment, the service sector, taxation, information and communications, labour, industrial safety, fair competition, and the environment. These reforms should provide a further boost to transparency in the business (chaebol) sector.



The South Korean government is moving ahead with proactive market opening initiatives that include free trade agreements and the Doha Development Agenda round of WTO negotiations. Foreign direct investment will be promoted along with market opening by improving the investment environment.

The South Korean government plans procedural improvements to attract top-notch overseas educational and medical institutions into Incheon, Busan, and Gwangyang Free Economic Zones. Comprehensive support will be available for domestic companies seeking to make inroads into emerging overseas markets, with a focus on oil producing countries.

## **(b) Social and Demographic Changes in the ROK**

### ***Korean Society***

Steeped in Buddhism and Confucianism, Korea is a homogeneous society where the group/family is considered more important than the individual. Koreans trace their origins to the Tungusic branch of the Ural Altaic family that migrated from eastern Europe via Mongolia and settled on the Korean peninsula some 5,000 years ago. Their language is related to Mongolian. Koreans use an indigenous alphabet, Hangul.

Through close links over the last two millennia, Korea absorbed many of China's religious, artistic and scientific developments. These subsequently moved on to Japan, often with Korean refinements or modifications. In the sixteenth century, when Korean celadon was regarded as the most advanced in the world, hundreds of Korean artisans were transported, some forcibly, to Japan, where they formed the basis of the now renowned Japanese ceramics industry.

Christianity is prevalent among South Korea's leaders and about a quarter of South Koreans are Christians. Numerous religions coexist peacefully. Buddhism is widespread and strong in influence - Buddhist practices and Confucian rituals are common even among Christians.

South Korea is, however, in the midst of significant social change, with changing attitudes toward marriage, childbearing, cohabitation and divorce illustrating a society in the throes of a social transformation. While South Korea is still anchored in the Confucian values of family and patriarchy, it is embracing many aspects of Western society, albeit at a slower rate than many of its Asian neighbours. South Korean culture remains deeply conservative with a strong imperative to follow the societal norm in terms of fashion, behaviour and life choices.

A number of factors have driven these changes in South Korean society. Its roots can be traced to the greater freedoms allowed following the end of authoritarian rule in 1987, with the lifting of strict military conventions that had long dominated Korean society. Social observers have given credit for more recent changes to the rise of the internet, with its facilitation of the rapid exchange of information and thoughts from around the world. Credit also lies with South Korea's youth, and in particular its less risk averse university students, who have had a long history of pushing the social democratic reform agenda.

South Korea's younger generation is increasingly questioning the views and beliefs of the older –typically more conservative – generation, many of whom remain deeply affected by the lingering impacts of the Korean War and the South's long, uneasy relationship with the DPRK.

The role of women in Korean society has also been evolving rapidly, driven particularly by younger (increasingly well-educated) Korean women. South Korea's younger women are demanding a greater role in their society, and continue to push for a greater say in their lives. Korean women are now no longer content to fall back on their traditional roles, but are forging their own careers and lifestyles. They are also starting to outperform men in the academic world. Nevertheless they still carry almost all the burden of household duties.

Korea's popular culture is making inroads in the rest of Asia, catching many by surprise and putting to rest the tag of 'Hermit Kingdom'. Instead, there is talk of the 'Korean Wave', representing the rapidly increasing popularity of Korean culture throughout Asia. Bored with tired love songs and manufactured pop, Asian youth are tuning in to 'K-pop' (Korean pop) with its characteristic dance sequences and hip-hop style music. Korean cinema is enjoying a renaissance, with its film industry achieving regional acclaim for a series of blockbusters such as Cannes 2004 Grand Prix winner 'Old Boy', the action-romance 'Swiri' (whose post-production work was carried out in Australia), the murder-mystery 'JSA' (set in the Joint Security Area between North and South Korea), and the historical 'Musa'.

### *Demographic Issues*

Korea is currently facing two key demographic issues: a low birth rate, coupled with a rapidly ageing population (the 'dual shock').

The birth rate in Korea has fallen to 1.19, the lowest level of all OECD member countries.<sup>3</sup> It has been forecast that after reaching a peak of some 49.9 million in 2020, Korea's population will begin to decline thereafter. The main factors behind the low birth rate include the high costs of child rearing; an increase in the number of single people; higher divorce rates; women's growing participation in social activities and the workplace; and older child-bearing age. Reports indicate the increasing trend towards later marriages and the growing number of singles in recent years stem from economic downturn, the high unemployment rate and changing values with regard to marriage, especially among women.

Korea also has to face up to its rapidly ageing population. While the ratio of senior citizens over 65 years of age was 7.2 per cent in 2000, this is expected to increase to more than 20 per cent by 2026. Korean society has aged in a shorter period of time than other advanced countries, including France (156 years), the U.K. (91 years), the U.S. (88 years), Germany (78 years) and Japan (36 years). Today, an average of 8.6 people between the ages of 15 and 64 support one elderly person. But by 2030, it is estimated that there will be only 2.8 people to support each elderly individual. The number of elderly receiving

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<sup>3</sup> The birth rate is defined as the average number of babies born to women during their reproductive years, between the ages of 15 and 49.

retirement benefits was 600,000 in 2001, but it is expected to increase to 2.4 million in 2010, 6.6 million in 2030, and 10.3 million in 2050. Some social commentators have argued that generational conflicts over ballooning financial assistance for the elderly will likely undermine social integration, and fuel public discord.

There are significant social and economic effects arising from the low birth rate and ageing population. The Korea Economic Research Institute reports the major consumer bracket has shifted from people in their 30s to 60s to senior citizens as a result of the low birth rate, leading to sagging consumption and lower economic growth. The Institute also attributes sluggish investments to a lower private savings rate stemming from ageing. It has been estimated that these demographic factors will result in Korea's potential economic growth rate falling from the current 5 per cent to around 4.2 per cent in 2010 and 2.9 percent in 2020. Health insurance costs are expected to almost double from the current level of 4.21 per cent of GDP to 8.3 percent of GDP in 2020 due to rising healthcare costs of senior citizens.

The Korean government is attempting to address the 'dual shock' issues of low birth rates and the ageing population. On 26 April 2005, the Korean National Assembly passed the 'Low Birth Rate and Ageing Society Act'. The Act recognises that Korea's current low birth rate will cause labour shortages, higher social welfare costs and negatively affect economic growth in the future. The Act sets up a 'Low Birth Rate and Ageing Society Committee' to be chaired by President Roh. The Committee will advise government ministries on actions they can take to prepare for an ageing society. The Act also instructs the Minister for Health and Welfare to develop a five-year plan to deal with the low birth rate and ageing issues. The Ministry plans to release the plan for 2006-2010 by the end of this year. It will map out the mid to long-term direction and budgetary planning for government measures to deal with these issues.

The Korean government will consider expanding immigration as one alternative to address the ageing of the population. South Korea currently does not have an immigration program. (Since it introduced a refugee program in 2001, it has accepted 37 refugees.)

Korea has introduced a staged plan to increase pensions as well as the number of elderly who qualify to receive them. Pensions will increase from the current amount of W35 000-50 000 (\$44-\$62) to around W100 000 (\$125) per month by 2008. The income cut-off will be slowly raised from the current rate of 65 percent of the average adult wage to 100 percent in 2008. As a combined result of the relaxed requirements and the ageing of society, the number of people receiving the aged pension is expected to rise from 630,000 this year to 1.16 million in 2008.

In May 2005, the National Assembly passed a revision to the 'Equal Employment Act'. The Act recognises that 'the burden of pregnancy, birth and child-care negatively affects women's economic activities' and aims to 'stabilise the employment status of working women and allow their spouses to take paternity leave'. By moving the burden of maternity leave payments away from the employer, government hopes to reduce discrimination against employing women. Currently, the government funds 30 days of maternity leave (through unemployment insurance), with the employer funding the remaining 60 days. From 2006, under the revised Act, the government will bear the cost for the full 90 days for companies with under 300 employees. From 2008, it will also extend this benefit to companies with more than 300 employees. The new provisions also

entitle women to paid maternity leave of ‘not less than 30 days’ in the case of a still-born child or abortion. From 2006, paternity leave will be increased from one to five days of paid leave. The Ministry of Planning and Budget has announced the government will provide (unspecified) financial support for child-care to 60 percent of low-income families by the end of 2005, increasing to cover all low-income families by 2008. Since March 2005, the government has commenced making payments of W30 000-60 000 (\$37-\$75) per month to low-income families with more than two children.

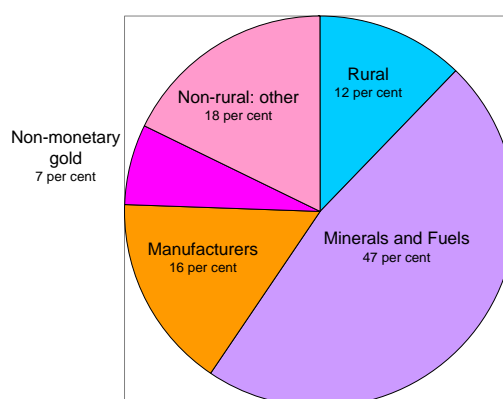
## 4. Bilateral Trade and Investment Trends

### (a) Merchandise Trade

#### *Exports*

Korea has been a major Australian export market since the 1960s, and the complementarities between Korea's manufacturing strength and Australia's abundant natural resources have brought significant benefits to both countries. This relationship broadened considerably during the 1990s with growth in manufactured and services exports, investment linkages and expanding Australian imports from Korea (Chart 5). Korea was Australia's fourth largest merchandise export market, and fourth largest merchandise trading partner in 2004.

**Chart 5**  
**Australian Merchandise Exports Share to Korea**  
 by broad category, 2004



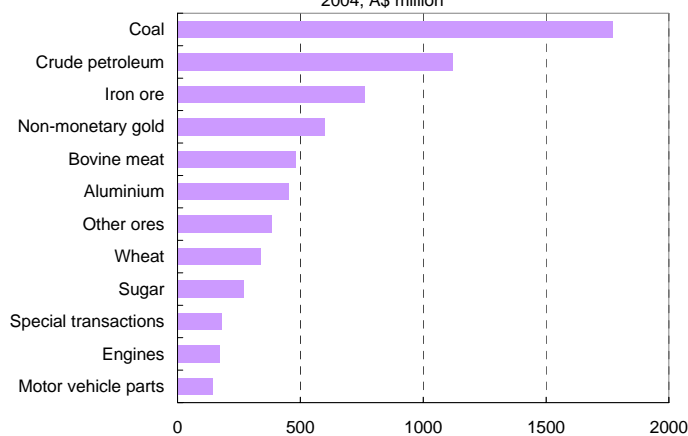
Almost half of Australia's exports to Korea are made up of minerals and fuels.

The four largest export items from Australia to Korea in 2004 include coal (A\$1.8 billion), crude petroleum (A\$1.1 billion), non-monetary gold (A\$599 million) and iron ore (A\$765 million) (chart 6). Beef exports make up almost one half of total rural exports, while wheat and sugar are other key rural export items.

Manufactured good exports in 2004 were dominated by sales of internal combustion engines (A\$173 million), motor vehicle parts (A\$145 million) and medicaments (A\$124 million).

Source: Department of Foreign Affairs and Trade.

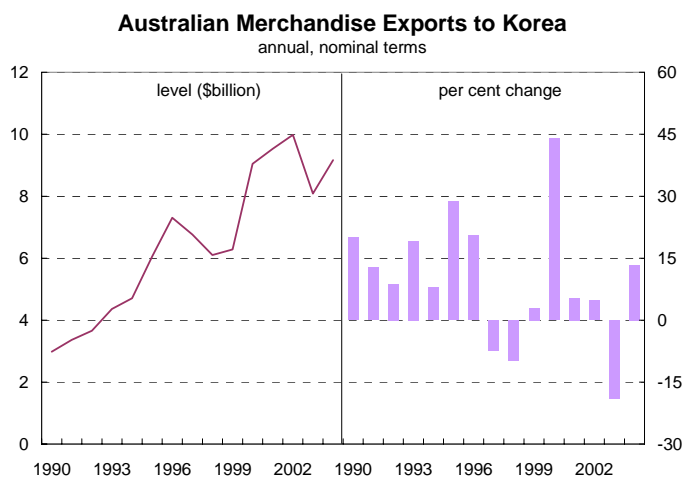
**Chart 6**  
**Major Exports to South Korea**  
 2004, A\$ million



Source: Australian Bureau of Statistics, Department of Foreign Affairs and Trade.

In 2004 Australian merchandise exports to Korea increased by 13 per cent to A\$9.1 billion (Chart 7). The increase was underpinned by the recovery from drought

**Chart 7**

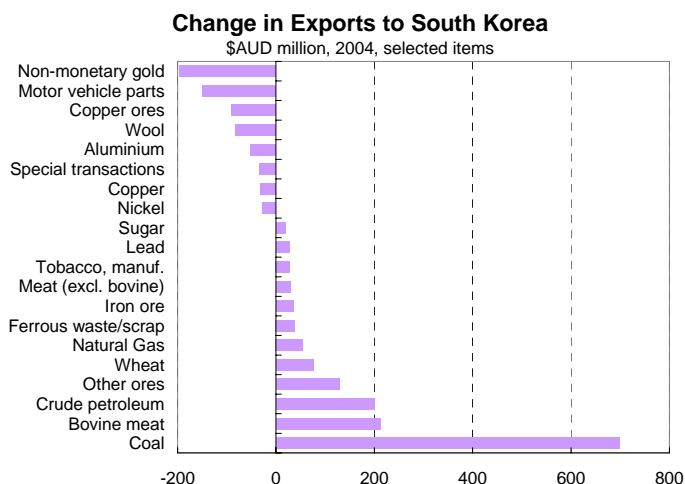


Source: Australian Bureau of Statistics.

The value of exports to Korea in 2004 was also boosted by increased commodity prices (particularly for non-rural resources<sup>4</sup>)

The most significant increase in merchandise exports in 2004 was for coal, as Chinese coal exports to Korea were re-directed to satisfy Chinese domestic demand, thus opening the market to Australian coal suppliers (Chart 8). Bovine meat, crude petroleum, other ores and wheat and natural gas exports also increased strongly in 2004. These rises were partially offset by lower exports of non-monetary gold, motor vehicle parts, copper ores, wool and aluminium.

**Chart 8**



Source: Australian Bureau of Statistics, Department of Foreign Affairs and Trade.

This rise in merchandise exports comes despite a 13 per cent appreciation of the AUD-USD exchange rate in 2004, which worked to decrease unhedged export income received by Australian exporters<sup>5</sup>.

<sup>4</sup> Non-rural commodity prices (AUD terms) increased by 11 per cent in 2004; of which base metal prices (AUD terms) increased by 21 per cent.

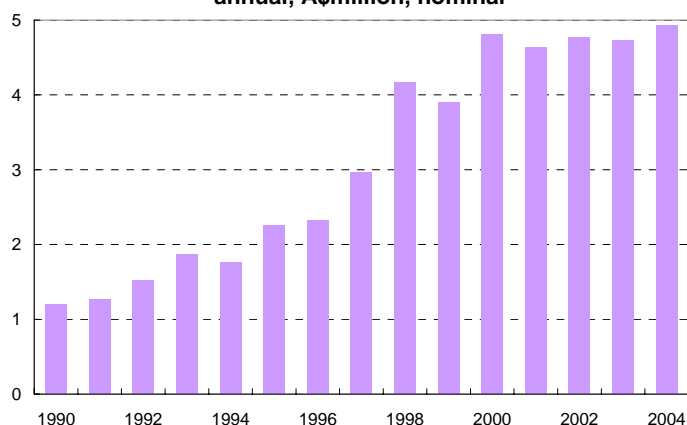
<sup>5</sup> This rise follows a 20 per cent appreciation of the average AUD-USD exchange rate in 2003.

## Imports

Australian merchandise imports from Korea increased by a moderate 4 per cent in 2004 to A\$4.9 billion. However, looking over recent years, import levels have been broadly flat since 2001. This outcome partly reflects the lower trend in worldwide manufactured good prices, as well as exchange rate effects from the appreciation of the Australian dollar (Chart 9).<sup>6</sup>

Australia is a major importer of Korean manufactured goods. In 2004, this included telecommunications equipment (A\$973 million), automobiles (A\$657 million), computers (A\$228 million), televisions (A\$334 million), and household type equipment (A\$204 million).

**Chart 9**  
Merchandise Imports From Korea  
annual, A\$million, nominal

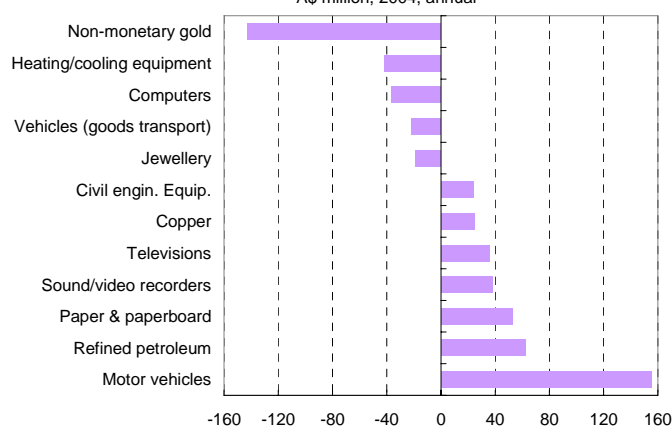


Source: Australian Bureau of Statistics.

In volume terms, Korea exported 73,272 motor vehicles to Australia in 2004, a 25 per cent increase over 2003. Other major increases (in value terms) recorded in 2004 included refined petroleum (up 160 per cent), paper and paper board products (up 62 per cent) and sound/video recording equipment (up 49 per cent) (Chart 10).

These increases were partially offset by a sharp decrease in imports from Korea of non-monetary gold, which declined by 72 per cent in 2004. Korea's exports of non-monetary gold to Australia are highly volatile; after excluding this component, merchandise imports from Korea actually increased by 7 per cent in 2004. Falls were also recorded in heating and cooling equipment, computers and vehicles used for the transportation of goods.

**Chart 10**  
Change in Korean Exports to Australia  
A\$ million, 2004, annual



Source: Australian Bureau of Statistics, Department of Foreign Affairs and Trade

<sup>6</sup> For example, between 2001 and 2004, imported consumption goods prices fell 14 per cent, while imported capital goods prices fell 23 per cent.

In 2003, Australia was Korea's 11<sup>th</sup> largest merchandise export destination, taking 1.7 per cent of merchandise exports.

Companies such as Samsung, Hyundai and LG have built strong brand names in Australia in recent years. Samsung and Hyundai are the major sponsors of two of Australia's most successful football teams, while Kia sponsors the Australian Open tennis tournament.



High labour costs in Korea have made labour intensive manufactured exports, such as textiles and footwear, increasingly uncompetitive compared with manufactured products from China. Korea's export share of those items has subsequently declined.

Korea does from time to time raise market access concerns about Australian anti-dumping measures on goods from Korea. Australia's anti-dumping system is WTO compliant and Australian anti-dumping measures broadly follow the global trend in applying most frequently to metals and plastics/chemicals. Whitegoods have also emerged as an active area. These types of goods are big export items for Korea.

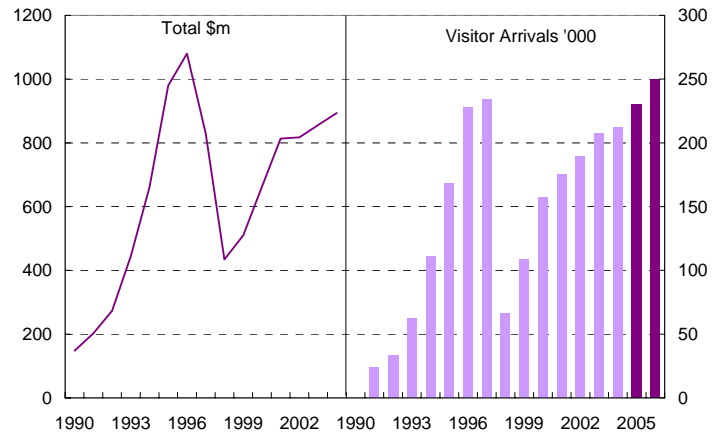
## **(b) Services Trade**

Tourism and education dominate services exports, which totalled A\$894 million in 2004, an increase of 4 per cent from 2003. Korea is the seventh largest source of short-term overseas visitor arrivals to Australia, and in 2004, 211,800 Koreans visited Australia, a modest 2 per cent increase on 2003 (Chart 11). The Australian Tourist Commission expects that short-term overseas visitor arrivals from Korea will steadily rise over the coming years to reach more than 300,000 by 2009.



**Chart 11**  
**Service Exports: South Korea**

The market for Korean students in Australia also continues to grow strongly; currently, Australia's share of the overseas student market is 18.8 per cent (22,159 students). Korea is the second largest source of overseas students for Australia.



Source: Australian Bureau of Statistics, Tourism Australia.

A number of Australian service providers are now active in the Korean market. Macquarie Bank, for instance, has a range of joint ventures that see it managing Korea's first private road infrastructure fund, managing property funds, providing advice on IT infrastructure and participating in derivatives markets. In leisure services, the highly successful Busan Aquarium is an Australian venture, while another Australian company is establishing the ROK's first yacht club.

Much growth potential also remains for service exports, with student and tourist numbers still below pre-financial-crisis (1997) levels and Australia's image as a clean, safe and relaxed destination firmly entrenched.

### (c) Two-way Investment

#### *Direct Investment*

Korea did little to encourage foreign direct investment (FDI) prior to the 1997 financial crisis, and was left vulnerable partly because its foreign capital inflows were strongly biased towards short-term foreign borrowing. However, since late 1997 the Government has gradually removed most restrictions on foreign investors and introduced new programs to attract FDI.

Investment links between Australia and Korea are strengthening. Direct investment ranges from Oceanis Australia's investment in an aquarium in Busan to Macquarie Bank's large, expanding presence in Korea.

Korean investment in Australia too is expanding. In the resources sector, Korea Zinc has made a A\$1 billion investment in a zinc refinery in Gladstone and POSCO has made a major investment in a new iron ore mine in Western Australia. In addition, there are Korean forestry investments in Western Australia and Tasmania while Daewoo, Samsung and LG have invested in the electronics sector.

#### **(d) Export Growth Potential**

Significant growth potential remains for Australian exporters in the Korean market. In the *rural* sector, Australian beef exports are increasing rapidly in Korea's deregulated beef market. In the medium term the main factors driving this growth are the growing brand image of Australian beef as 'clean and safe' and the combination of rising incomes and a strong beef eating culture. Growth potential exists also in the dairy and wine markets as Korean tastes become increasingly westernised.

In the *energy* sector there is potential for Australia to become a major LNG supplier to Korea. Australia secured a mid-term contract in 2002 which provides a foothold in the market and positions Australia to compete for new contracts in the future. Uranium exports are also growing strongly, and if plans to expand Korea's nuclear power industry are realised, further strong growth is likely.

Among *manufactures*, Australian exports of car engines and parts to Korea were A\$318 million in 2004. Engine exports dropped sharply between 1999 and 2002 due to the bankruptcy of Daewoo Motor, which was a major purchaser of Holden engines. However, Holden's future in this market now looks bright following GM's takeover of Daewoo Motor in 2002 (via an investment by Holden). In 2005, the motor vehicle trade is set to receive a boost with the commencement of exports of the Holden Statesman to Korea.

#### **(e) ROK Barriers to Australian Trade and Investment**

Despite the strength of the bilateral trading relationship, a number of barriers remain which hinder access of Australian goods and services to the Korean market. Korea's protection of its agricultural sector through prohibitive tariffs and subsidies to farmers, in particular, stifles opportunities for Australian producers. Other restrictions on entry to the services sector and investment have a similar effect.

##### ***Korea's Agricultural Tariffs***

At present, three of Australia's four largest agricultural exports to Korea have tariff rates of 3 per cent or less - wheat (3 per cent), sugar (3 per cent) and cotton (1 per cent). However, across the sector as a whole the average tariff is still 55 per cent. Specific tariffs on products of interest to Australia are much higher. For example, tariffs on dairy goods range between 36 and 176 per cent; on honey, 243 per cent; oats, 554 per cent; and on fruit and vegetables from around 40 to 300 per cent. Beef, one of Australia's top four agricultural exports to Korea, faces a tariff of 40 per cent.

### *Services Sector Barriers*

Korea has made significant strides in liberalising its services sector in recent years, particularly in the financial sector and telecommunications market. However, barriers remain:

- There are limits on lending by foreign banks to Korean customers;
- ROK banking regulations only allow a banking license for banks which have retail banking arms;
- Regulations covering financial products lack transparency

At the same time, foreign lawyers and accountants are not allowed to practice in Korea (though Korean professional firms may hire foreigners as consultants) and it is not possible for foreign law or accounting firms to set up shop in Korea.

#### **(f) Role of Government in Promoting Commercial Relations**

The Australian Government plays a significant role in advocating Australia's trade and economic interests in Korea. Regular trade talks at the senior officials' and ministerial level (under the banner Ministerial Joint Trade and Economic Commission, MJTEC) provide a bilateral forum for discussing specific trade issues, as well as exploring ways of moving the relationship forward. Other bilateral talks on energy and resources and quarantine complement the MJTEC process.

The Australian Government, via its embassy in Seoul and high-level bilateral meetings and visits, and through close work with the Australian Trade Commission (Austrade) strongly advocates Australia's trade interests. For example, Australian ministers and senior officials have strongly pushed Australia's credentials as a secure and reliable energy supplier as Australian LNG suppliers pursue contract opportunities in Korea.

With the completion of an FTA with the United States in 2004 and the announcements in early 2005 of the launching of FTA negotiations with China and of an FTA study with Japan, Korea is the only one of Australia's top four trading partners with which there has been little progress towards an FTA. The complementarity of the two economies means an FTA makes good economic sense, but agricultural sensitivities mean Korea views any prospect of an FTA with Australia with great caution.

## Korean Market Opportunities - AUSTRADE Overview

Austrade's mission is to contribute to community wealth by helping more Australians succeed in export and international business. In Korea, Austrade organises trade promotions and product showcases as well as assisting individual Australian companies enter the market.

The changing nature of Korean society and more sophisticated patterns of consumer spending have created a diversification in the nature of Australian exports to Korea, with a greater emphasis on emerging lifestyle enhancing areas such as knowledge-based industries, IT, financial and education services, the performing arts and culture, wine and organic food, fashion, jewellery, furniture and cosmetics.

The increasing wealth of Korean society has presented Australian companies with a discrete group of extremely wealthy Koreans looking for a range of foreign products. The emergence of the "x-generation" of younger people exerting a strong influence on society will continue to drive demand for improved quality of life, new products and services in education, entertainment, telecommunications and lifestyle. The adoption of a 5- day working week in 2004 has added fuel to this.

Exceptionally strong growth in Korean exports driven by the Chinese economy has continued to provide demand for Australian inputs, particularly of resources and raw materials. Austrade has also identified a growing desire on the part of Korean companies to enter into technology based joint venture or co-operation agreements, or to undertake small-scale technology investments in Australia, driven by their desire to stay one step ahead of China. At present there is significant interest from Korea in technology tie-ups in the ICT, automotive, biotechnology, and resources processing industries.

Austrade is also assisting Australian companies to capitalise on the ongoing "Well-Being Boom", which has resulted in increased

demand for health or lifestyle boosting products. This boom provides a marketing platform for a wide range of products spanning cosmetics, aromatherapy, health food, wine, sporting equipment, and pets. There is a strong opportunity for organic food and organic ingredients in Korea associated with lifestyle concerns. At present the Koreans do not have their own regulatory regime for organics and Australian certification is recognised. This window of opportunity is unlikely to last very long.

Other export prospects include the opportunity to engage with large Korean corporate entities as they continue to demand international expertise and services to transform themselves into truly global players. The expanding operations of discount hypermarket chains provide opportunities for suppliers of foodstuffs and consumer goods. Australian wine has become the brand of choice with exports expanding 120% between 2002-3 & 2003-4 and Australia now enjoying 8% market share.

Some recent success stories in 2005 include:

- the import of over 150 Australian race horses by the Korean Racing Association and individual horse owners in 2004;
- Technology partnership between CSIRO and Korea's leading research institute ETRI for the development of digital contents applications;
- Cochlear achieved official reimbursement for its implants under the Korean national health insurance scheme, and celebrated over 2,000 implants in Korea;
- Australian jarrah supplied by Gunns was selected as the preferred timber for the newly opened prestigious Samsung Leeum Museum and
- Holden successfully negotiated the sale of the *Statesman* to GM Daewoo, supplementing its substantial existing business supplying engines to Korea.

## 5. North Korea

### (a) Political Situation

The DPRK political system is a communist dictatorship, controlled by the Korean Worker's Party (KWP) and its leader Kim Jong Il. In 1972 the now deceased President Kim Il Sung supplemented Marxist-Lenist principles with 'Juche', a constitutionally enshrined ideology of national self-reliance and independence. Although open to mass membership, access to the KWP is limited to those with a 'reliable' class background, and membership is necessary for political standing and social status. Important positions in the government, economy and the military are held by KWP members or officials, and KWP Secretaries exercise great authority over policy and administrative issues. Since its establishment in 1948, the DPRK government has only experienced one leadership change. This occurred in 1994 when Kim Jong Il took power following the death of his father President Kim Il Sung (who was made President for eternity). The DPRK regime, to date, has survived famine, economic decline and international isolation.

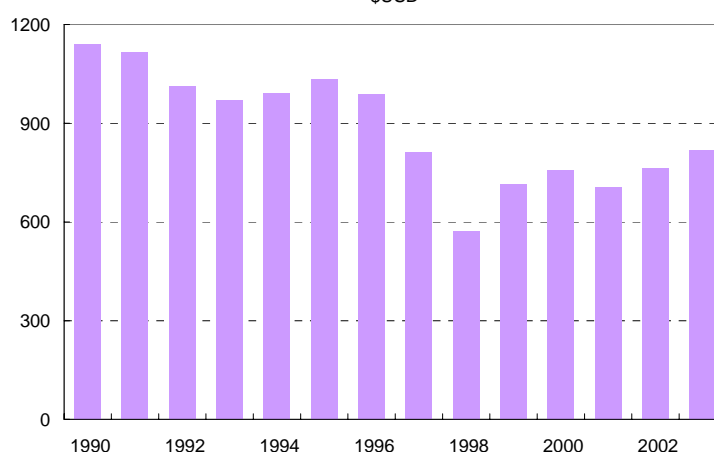
### (b) Economic Situation

The DPRK does not publish economic data for reasons of national security, and reliable information is difficult to obtain.

Chart 12

DPRK: GNI per Capita  
\$USD

The DPRK remains one of the poorest countries in the world with estimates indicating Gross National Income per capita of around US\$816 in 2003, down from its most recent peak of US\$1,034 in 1995 (Chart 12).



Source: Bank of Korea

With the goal of boosting economic performance and increasing state control of the informal sector, the DPRK introduced a series of economic reforms in July 2002, the first real departure from the central planning system introduced in 1945. The reforms included a withdrawal of subsidies to state-owned enterprises, a dramatic scaling up of wages and the prices of many essentials, the legalisation of farmers' markets and

greater autonomy for state enterprises to sell manufactured products in markets. These reforms have progressed with limited and inconsistent momentum, yielding mixed results.

In the agricultural sector, reforms are having a positive impact on production, but effects in other areas appear muted. Poor energy supply and distribution, and a short supply of intermediate inputs have limited the supply response to the price increases that have been implemented, and remain major obstacles to reform success and economic growth. There is also a real risk of hyper-inflation. A UN report released in November 2004 said that soaring inflation and ongoing chronic food shortages had pushed the price of a kg of rice on the private market to about 30 percent of a typical monthly wage. The black market exchange rate has also depreciated dramatically, reflecting the surge in domestic prices. There seems little prospect for any sustained improvement in DPRK economic growth sufficient to deliver real gains to the general population. Overall, the best chance for The DPRK to revive its economy lies in addressing the international community's concerns about its nuclear program.

### **(c) Food Shortages and International Aid**

A series of natural disasters, beginning in the mid-90s, and a general economic downturn has left the DPRK with extreme food shortages, deteriorating public health, unsafe water supplies and poor sanitation. At least 37 percent of DPRK children and one third of mothers are chronically malnourished and anaemic according to a March 2005 joint UNICEF-WFP-DPRK government survey. According to a 26 March 2005 press release by the UN World Food Programme (WFP), 70 percent of the 23.3 million population remain dependent on the government-run Public Distribution System (PDS). In January, the PDS cut rations from 300g to 250g per day, providing less than 40 per cent of the internationally recommended minimum. Economic reforms introduced in mid-2002 have exacerbated the situation further with rapidly rising food prices and sharply lower incomes for millions of factory workers rendered redundant or now employed part-time.

In 2005, the WFP has targeted its assistance at 6.5 million people, the same as in 2004, and estimates that existing stocks and pledges will satisfy full cereal rations for beneficiaries only until June 2005. While domestic food production has been rising slightly, WFP estimates the 2005 cereal gap at almost 900,000 tonnes. WFP's Director for Asia, Tony Banbury assessed that tighter restrictions by the DPRK in 2004 on WFP food aid monitoring has undermined international support for WFP programs in the DPRK.

### **(d) Australia-DPRK Bilateral Relations**

Australia recognised the DPRK in August 1973, and the two countries established diplomatic relations in July 1974. However, this relationship was severed in November 1975 when the DPRK expelled the Australian Embassy from Pyongyang without pretext, and Australia-DPRK contact during the 1980s was uneventful. In the 1990's, there was a very limited exchange of delegations at the Australian parliamentary level and the Korean Worker's Party (KWP) level, and in September 1999 Mr Downer met the DPRK Foreign Minister Paek Nam-sun in New York. Australia and the DPRK resumed diplomatic relations in May 2000, and in May 2002

the DPRK opened an Embassy in Canberra. Following the DPRK's escalation of the nuclear issue, in November 2002, Mr Downer deferred the opening of an Australian Embassy in Pyongyang pending a resolution of the issue.

Australia has placed a high priority in its diplomatic efforts to urge the DPRK to return to the six-party talks and make substantive progress toward a peaceful resolution of the nuclear issue. The department has worked to ensure the DPRK understands that Australia-DPRK bilateral relations remain on hold pending DPRK progress in dismantling its nuclear weapons programs.

Australia has also made it clear to the DPRK that there is strong international resolve for verifiable dismantlement of its nuclear weapons program and to contain the associated security risks of such a program. To this end, Mr Downer sent a senior officials' delegation to the DPRK in January 2004, and Ambassador-designate to the DPRK, Dr Alan Thomas, to Pyongyang in April 2004 to present credentials; and made a ministerial visit to Pyongyang in August 2004. The Australian Government had delayed presenting Ambassador Thomas' credentials for one year to underline its concern over the nuclear issue.

Australia's bilateral trade with the DPRK is very limited (A\$13.7 million for 2003/2004), and outside irregular niche commercial deals there is little likelihood of burgeoning trade until the nuclear issue is resolved and the DPRK's economic performance improves. The Australian government neither supports nor discourages Australian companies from doing business with the DPRK, and has no specific trade restrictions, embargoes or sanctions in place against it. However, given concerns about the DPRK nuclear issue, the Australian Government will not be sponsoring any business visits or activities with the DPRK. There has been some niche bilateral trade activity in the gold and coal mining sector, technical training exchanges in the fields of biotechnology and medicine, malt exports, an engineering project to modernise Pyongyang's water supply, and the importation of automotive parts from a ROK firm operating in the Kaesong industrial zone.

Australia provides humanitarian assistance to the DPRK through multilateral channels on a case-by-case basis as a separate consideration from progress on the nuclear issue. (For detailed figures, see separate box).

### **Assistance through AusAID**

Australia has provided a total of almost \$74 million in development assistance to the DPRK since 1994/95. Most of this (\$51 million) was humanitarian assistance provided through multilateral channels, including \$44.5 million in food aid to the World Food Program, \$3.6 million to UNICEF, \$750,000 to WHO and \$1,250,000 to the Federation of Red Cross including \$250,000 in response to the Ryongchon train disaster. Australia does not provide aid directly to the DPRK Government.

In addition to humanitarian assistance, Australia, as the largest non-Executive

Board financial contributor to Korean Peninsula Energy Development Organisation (KEDO), provided A\$22 million to help the DPRK to meet its energy needs while freezing its indigenous nuclear program. Australian contributions to KEDO have been used to provide heavy fuel oil for electricity generation and heating.

Australia has also provided limited and targeted training to DPRK officials in the areas of market economics, nutrition statistics and nuclear safeguards. All non-humanitarian assistance ceased in 2002 due to issues surrounding the DPRK's nuclear program.

The Australian Government remains concerned about the persistent humanitarian crisis in the DPRK and the current program with DPRK focuses exclusively on humanitarian assistance.

### **Assistance through the Australian Centre for International Agricultural Research (ACIAR)**

To improve food production in the DPRK, and thereby help address the humanitarian crisis, the Australian Centre for International Agricultural Research (ACIAR) is conducting training, research

and development cooperation activities with the DPRK under a bilateral Memorandum of Understanding signed in November 2000. Current activities include a three-year project on improving soil fertility, which commenced in January 2002, and a project on integrated pest management for Brassica crops, which commenced formally in July 2003 and will finish by mid-2006.

In addition to direct bilateral dialogue, Australia co-sponsored a resolution carried by the UN Commission on Human Rights in Geneva in April 2004 on the human rights situation in the DPRK. The department also worked closely with regional partners, and supported Mr Downer, at the ASEAN Regional Forum, to ensure the DPRK understood the extent of international concern over its nuclear programs.



## **6. Developments on the Korean Peninsula**

### **(a) Brief History**

The Korean Peninsula has been divided at the 38<sup>th</sup> parallel since the end of Japanese colonial rule in 1945 when the US and USSR occupied the South and North respectively. In June 1950, a US-led 16-member coalition took collective action against a DPRK invasion of the ROK, and after China's entry on the DPRK side, a stalemate ensued for two years until armistice negotiations were concluded in July 1953. Following the end of the Korean War in 1953, the DPRK signed a UN Armistice Treaty, but the two Koreas remain technically at war. From 1953, the North-South relationship was extremely volatile, with tensions climaxing in the 1980s after two terrorist incidents; the 1983 assassination attempt on ROK President Chun Doo-hwan, killing 4 ROK Cabinet Ministers and 13 other senior ROK officials; and the 1987 bombing of civilian KAL 858 flight killing 115. Since the 1987 bombing, the DPRK has remained on the US State Department's list of states supporting international terrorism, and in accordance with US law, is subject to several US sanctions regimes, including financial and foreign assistance restrictions and export controls.

In July 1988, renewed efforts by ROK President Roh Tae-woo to promote North-South exchanges resulted in the 1991 signing by the two Koreas of the Agreement on Reconciliation, Non Aggression, Exchanges and Cooperation (the "Basic Agreement") and the Declaration on the Denuclearisation of the Korean Peninsula (the "Joint Declaration"). However, in the early 1990's, the DPRK's nuclear weapons program surfaced as a major issue of concern, and a lack of progress on an inter-Korean nuclear inspection regime mandated through a North-South Joint Nuclear Control commission (JNNC) resulted in a series of escalations in 1993. Following diplomatic negotiations, the US and the DPRK signed the 1994 Agreed Framework undertaking to implement an IAEA verifiable freeze of the DPRK's nuclear program in exchange for energy assistance in the form of heavy fuel oil and a light water reactor project sponsored by the Korean Energy Development Organisation (KEDO). The United States also agreed to move toward full normalisation of political and economic relations with the DPRK.

The inter-Korean summit and Joint Declaration of June 2000 marked a high point in North-South relations, promising 'reconciliation and cooperation' on the Korean Peninsula. This was further underpinned by the signing of a DPRK-US Joint Communique in October 2000. This optimism was short lived however, and the ROK was confronted with an ever more difficult balancing act between its 'Sunshine Policy' toward the North and its relationship with the United States following the DPRK's rising tensions over the nuclear issue with the new Bush administration. The DPRK's nuclear weapons program violates the North-South Joint Declaration, the 1994 Agreed Framework, the DPRK's IAEA safeguards agreement, and the Non-Proliferation Treaty (NPT).

These tensions heightened when, on 16 October 2002, the United States alleged that the DPRK had admitted to a visiting US delegation that it was pursuing a highly enriched uranium (HEU) program—a confirmed HEU program would be in contravention of its agreed international obligations—allegations the DPRK quickly

denied. On 14 November 2002, the KEDO executive board suspended further heavy fuel oil shipments to the DPRK, and the light-water reactor project remains suspended pending progress on the nuclear issue. On 12 February 2003, the IAEA Board of Governors resolved that the DPRK was in further non-compliance with the obligations under its safeguards agreement and referred the nuclear question to the UN Security Council.

Between late-2002 and mid-2003, the DPRK undertook a sequence of carefully calibrated escalations to raise the stakes: the 22 December expulsion of IAEA inspectors from its Yongbyon facility; the 10 January announcement of its intention to withdraw from the Non-Proliferation Treaty; the 12 February threat to abandon the 1953 Armistice Agreement; the 24 February firing of a test-missile in the Sea of Japan hours before ROK President Roh's inauguration; the 2 March intercept of a US reconnaissance plane in international airspace; and the 23-25 April announcement of intention to develop a nuclear deterrent. On 1 August 2003, the DPRK agreed to participate in six-party negotiations with China, Russia, the ROK, the US and Japan.

### **(b) Six-Party Talks**

The six-party talks were set up in 2003 as a forum for the countries most affected by the DPRK's nuclear program to negotiate an end to this program. A recurring tension in the talks is that the DPRK wants to negotiate directly with the United States as it did on the 1994 Agreed Framework while others, including Australia, see the issue as a regional one requiring a regional solution.

The first two rounds of talks largely focused on procedural issues. During the first round (26-28 August 2003), the six parties stated their positions to establish a baseline for negotiations. At the second round (25-28 February 2004), the parties agreed to regularise the talks and establish a working group to continue interim efforts. Key substantive differences began to emerge during the second round of talks. The DPRK repeated its first round offer to 'freeze' its nuclear activities in return for reciprocal measures, including removal of the DPRK from the US list of countries supporting terrorism, lifting of US sanctions, and provision by the United States and others of fuel oil and other energy supplies. The United States and others stipulated a freeze should be only a first step toward complete, verifiable and irreversible dismantlement (CVID).

Atmospherics during the third round of six-party talks (23-26 June 2004) had notably improved, but substantive differences remained. The US did not use its CVID terminology, and presented a proposal requiring a clear commitment by the DPRK to dismantle its nuclear weapons program, including its highly enriched uranium (HEU) program, in exchange for an international aid package and a provisional multilateral security assurance. The DPRK repeated its freeze proposal (only plutonium processed since 2003) and continued to deny the existence of an HEU program. The United States also disagreed with the ROK, Russia and China that the DPRK be given rewards merely for a freeze through 'simultaneous' actions.

Despite its previous agreement, the DPRK refused to attend the fourth round of six-party talks, (initially scheduled for September 2004), and has continued to do so, citing 'US hostile policies' and ROK revelations in September 2004 that in January-February 2000 ROK scientists had undertaken undeclared experiments in uranium

enrichment in contravention of the ROK's IAEA safeguards obligations. The DPRK issued a statement on February 10 2005 that it had manufactured nuclear weapons and would indefinitely suspend its participation in the six-party talks. On 2 March, the DPRK demanded an apology for US 'hostile policy' and declared the DPRK was no longer bound by a 1999 self-imposed long-range missile moratorium. On 31 March, the DPRK issued a further statement declaring the DPRK's status as a "fully-fledged nuclear weapons state" and demanding that the six-party talks be negotiated on an "equal footing" as "disarmament talks".

There is still no firm sense of when the DPRK might return to the six-party talks, and the United States and Japan remain steadfast that the DPRK re-engage 'without preconditions', and not be rewarded simply for participating in the talks. The firm US line on the nuclear issue was underpinned by Secretary of State Condoleezza Rice's May 2 warning following the DPRK's 30 April short-range missile test into the Sea of Japan, that the United States possessed significant deterrent capability to contain "North Korean nuclear ambitions or gains on the peninsula". During her 14-21 April tour of Asia, Rice commented that 'other options' were available in the absence of an agreement by the DPRK to resume the six-party talks. Dr. Rice made it clear that the United States remained committed to a peaceful resolution of the nuclear issue, recognised the sovereignty of the DPRK, and had no intent to use military force.<sup>7</sup> During a 4 May media interview, Mr Downer said that Australia was strongly opposed to the DPRK's nuclear weapons program, and emphasised the importance that the DPRK engage in the six-party talks "and through diplomatic negotiation abandon their nuclear programs".

### **(c) Implications for Australia**

The Korean Peninsula remains one of the region's most volatile flashpoints where the strategic interests of the key global powers intersect. The demilitarised zone is the most militarised border in the world with combined armed forces in the North and South of approximately 1.6 million. A conventional armed conflict would be devastating for the ROK in particular and the region as a whole. With three of our most important trading partners, the ROK, Japan and China likely to be the countries most affected by any conflict or instability, the DPRK nuclear issue is of vital strategic and economic interest to Australia.

Australia's participation in the Korean War over 50 years ago underscores the long-standing recognition by Australia of the importance of developments on the Korean Peninsula. Australia's continuing commitment to Korean Peninsula security is demonstrated by our participation in the UN Command Military Armistice Commission that oversees the armistice between the UN and the DPRK.

More broadly, Australia has a strong tradition of regional engagement with all key economies in North Asia. Australia occupies a unique position in regional security advocacy, and as a non-six-party player, is free from the historical considerations which characterise relations between many of the six-party players. Unlike the ROK, the United States and Japan, Australia maintains diplomatic relations with the DPRK.

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<sup>7</sup> Given the fluidity of this issue, the circumstances defining the status of the six-party talks and the DPRK's nuclear weapons program are constantly changing. This information is current as of 23 May 2005.

Given all these factors, Australia has been able to play an active advocacy role on the DPRK nuclear issue by pressing the DPRK to address international concerns about its nuclear program and by engaging the other five parties.

Australia has also made strong diplomatic representations at multilateral fora on regional security issues, such as the DPRK's pursuit of nuclear weapons. Australia's practice of embracing proactive initiatives to contain the spread of WMD in the region and globally, such as the Australia Group initiative, has brought greater credibility and weight to our capacity to positively influence regional security dialogue.

The US strategic presence in the ROK and Japan in tandem with the constructive roles of China, the ROK and Japan in positively shaping the regional security environment is fundamental to Australia's national security interests. In particular, Australia has a vital interest in supporting long-term US strategic engagement in North Asia. Australia's active diplomatic engagement with all these countries reflects the importance of these relationships.

However, the DPRK's continued pursuit of nuclear weapons is an affront to the international norms and obligations that bind the international community, and represents a serious threat to regional and global security—and by extension, Australia's healthy engagement and integration with North Asia. Australia has made strong bilateral representations to the DPRK that international resolve stands firm in its commitment to a peaceful resolution of the nuclear issue.

#### **(d) Inter-Korean Relations**

ROK President Roh Moo-hyun marked his inauguration in February 2003 with a 'Peace and Prosperity' policy to replace former President Kim Dae-jung's 'Sunshine' policy. The Peace and Prosperity policy was underpinned by the principles of dialogue, mutual trust and reciprocity, international cooperation and popular domestic support. In 2003, this policy got off to a good start with a total of 38 inter-Korean exchanges, including ministerial, military, economic, Red Cross, sports and special envoy discussions. In April 2004, the fourteenth round of ministerial talks was held, followed by a second round of general-level military talks in June 2004 to establish confidence building measures along the land and naval borders, including a military hotline and the removal of propaganda material. In mid July 2004 the two Koreas held their tenth round of family reunions at Mt Kungang. Whilst promoting friendly cultural relations, the family reunions have also generated revenue for the North. The DPRK has refused to participate in the fifteenth round of ministerial talks, which was scheduled for August 2004. In mid May 2005, however, the two Koreas agreed to hold Cabinet level talks in June 2005.

However, the ROK's relations with the North have had to be balanced against mounting international concerns over the DPRK's failure to make substantive progress toward a resolution of the nuclear issue. Against this backdrop, inter-Korean economic cooperation and NGO links, though limited, have sustained momentum, but high-level military and political dialogue and family reunions remain suspended following the DPRK's objections in July 2004 to the ROK's acceptance of 468 DPRK defectors through Vietnam. Implementation of confidence building measures flowing from the military talks in early 2004 has also stalled.

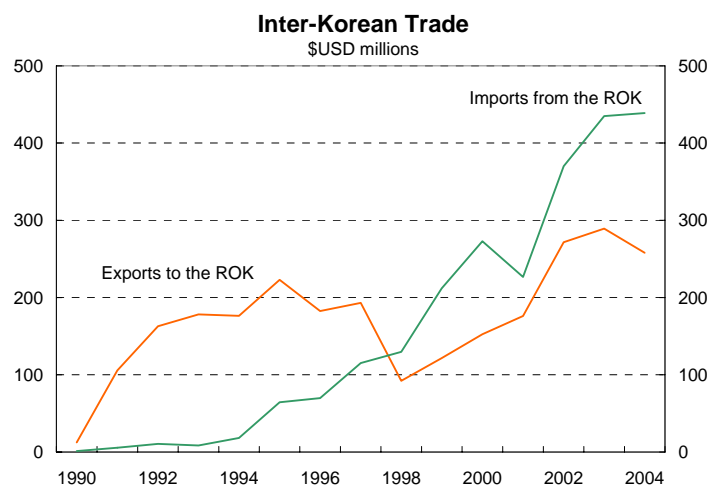
The three main areas of inter-Korean economic cooperation are the Kaesong industrial zone, the Mt Kumgang tourism project, managed exclusively by the ROK's Hyundai Asan, and re-connection of inter-Korean railways and roads. The Kaesong industrial zone, which provides the impetus for ROK investment in manufacturing enterprises in the DPRK through access to the DPRK's relatively low cost labour, has been very popular with ROK SMEs. In Kaesong's first phase fifteen companies are operating in the zone, with more companies to be chosen in mid-2005, however the project is moving at a slow pace.

Mt Kumgang saw a dramatic increase in ROK visitors to the complex in 2004. Hyundai has pledged US\$942 million, due by 2005, to the DPRK for business rights to the DPRK for 50 years, and has also invested US\$83 million in the Mt Kumgang area, with further expenditure committed for the development of resort accommodation and other tourist facilities.

While the two new highways on the east and west coasts were officially opened in December 2004, temporary inter-Korean roads connecting North-South joint ventures have been operational for some time. A temporary road on the east coast linking the South's Gangwon Province to the Mt. Kumgang tourist project was opened to the public in September 2003. The ROK hopes to complete an inter-Korean railroad on the east coast by December 2005. The inter-Korean railroad on the west coast has been completed, but has remained dormant following the breakdown in inter-Korean dialogue. These inter-Korean transport connections have brought a fundamental change to the character of the DMZ; where crossings used to be a rarity, they are now routine involving hundreds of people each month.

Chart 13

Inter-Korean trade is also closely related to inter-Korean cooperation. In 2004, inter-Korean trade was stagnant, falling 3.9 percent to \$697 million, about half that with China (\$1.38 billion) (Chart 13). The Kaesong industrial zone is expected to increase inter-Korean trade levels in 2005.



Source: Bank of Korea

Along with China the ROK is now the major bilateral aid provider to the DPRK. The ROK has provided some 800,000 tonnes of food aid per year since around 2000. Humanitarian aid for 2004 rose over 63 percent from 2003 levels to \$263 million, principally due to the ROK's assistance for the April 2004 Ryongchon train disaster. The ROK usually also provides around 300,000 tonnes of fertilizer per annum. It has declined to meet a DPRK request through the Red Cross for 500,000 tonnes of additional fertiliser aid. The ROK has insisted such requests for aid must be made

directly through North-South channels. Following a Vice Ministerial exchange in mid May 2005, the ROK agreed to provide 200,000 tonnes of fertiliser aid.

Other important strands of the Roh administration's efforts to improve North-South relations are efforts to relax the legislative parameters for North-South engagement through the inter-Korean exchange law and a controversial attempt to abolish a draconian National Security Law.

Sudden reunification would have significant economic consequences for the ROK and the region (the estimated cost of the ROK absorbing the DPRK varies from US\$150 billion for a sudden event to US\$700 billion or more for a more gradual merging, with some estimates reaching into the trillions of dollars); in reality absorption would be an overwhelming social and economic event for the ROK.

Looking forward, the course of North-South relations will remain hard to plot. On the one hand the overwhelming majority of ROK public opinion supports inter-Korean cooperation and ROK humanitarian aid to the North. On the other hand, aside from existing joint North-South projects and humanitarian aid, any further inter-Korean cooperation will be linked to progress on the nuclear issue.

## 7. Conclusion

The Republic of Korea is important to Australia economically, strategically and politically and DFAT pursues a broad range of policies to increase bilateral engagement with the ROK.

The ROK is Australia's fourth-largest trading partner (for merchandise trade), and our trade relationship is one of Australia's most complementary. Australia has the capacity to continue to supply the energy, mineral products and other raw materials to drive the ROK's economy. Australia has a track record as a reliable source of high-quality petroleum products that will be increasingly essential for the ROK to maintain energy security. In particular, the ROK's demand for LNG will grow significantly in coming years and Australian suppliers, supported by government advocacy, are well positioned to take advantage of these emerging opportunities. In return, the ROK exports competitively-priced telecommunications equipment, household electronics and motor vehicles that enhance the living standards of Australians.

Bilateral services trade relations with the ROK continue to diversify and flourish, particularly in the tourism and education sectors. The ROK is a mainstay of Australian industry in these sectors and further growth in this important market is expected in the next few years. Further liberalisation of the ROK's services sector is in Australia's economic interests, particularly as it applies to financial, legal and accounting services. DFAT will continue to pursue this goal, both bilaterally and multilaterally.

The ROK is the only one of Australia's top five trading partners with which we have not commenced either an FTA feasibility study or negotiations towards an FTA. Agriculture has been an impediment to ROK consideration of an FTA with Australia but now that the ROK has begun exploring the possibility of FTAs with other agricultural exporters (such as Canada, the United States and Mercosur), DFAT will keep pursuing the idea of an FTA study. Successful negotiation of an FTA would move the economic architecture of the bilateral trade partnership forward and would significantly raise the profile of Australia's economic relationship with the ROK in the Australian business community.

Australia's trade and other links with the DPRK, on the other hand, remain modest, and any significant expansion of the bilateral relationship is contingent on successful resolution of the nuclear issue.

Australia and the ROK often have similar agendas in multilateral forums such as APEC, ASEAN, the UN, G20 and international sporting and environmental bodies. Australia and the ROK share strong views on the de-nuclearisation of the Korean peninsula, the stabilising role of long-term US strategic engagement in the region, and the containment of potentially destabilising strategic competition among the major regional powers through constructive bilateral and multilateral processes.

Australia plays an active role in regional security advocacy, and has maintained a high level of representation on the nuclear issue bilaterally with all six-party players, and in multilateral fora. Australia is committed to registering its concerns about the DPRK's nuclear program at the highest levels in the DPRK. Australia stands firm with the

international community in working towards a peaceful resolution to the DPRK nuclear issue. The Australia-DPRK bilateral relationship will remain on hold pending positive steps by the DPRK to address these concerns.

Australia's bilateral relationship with the ROK extends beyond the economic and strategic spheres, and is grounded in historical ties, cultural exchanges and shared liberal democratic values. Australia's commitment to the defence of the ROK during the Korean War has laid the foundations for lasting people-to-people ties that help underpin the formal bilateral relationship. A bilateral social security agreement, currently under negotiation, would enhance people-to-people links by facilitating greater cross-country workforce participation.

Although strong, the Australia-ROK relationship is perhaps not as vibrant as that which Australia enjoys with Japan or China. High level visits have played an important role in raising the profile of the relationship, and the Government will continue to look for opportunities to host visits by senior and/or influential ROK Government and community figures. Both sides should pursue these and other opportunities to develop a relationship which is of value and importance to each, and which will continue to be so for the foreseeable future.