Submission No 3

Inquiry into Australia's trade and investment relationship with Japan and the Republic of Korea

Organisation: North East Asia Branch
Department of Foreign Affairs and Trade

Joint Standing Committee on Foreign Affairs, Defence and Trade

THE HON DR CRAIG EMERSON MP

MINISTER FOR TRADE

19 JUL 2011

Ms Janelle Saffin MP
Chair
Joint Standing Committee on Foreign Affairs, Defence and Trade
Trade Sub-Committee
Parliament House
Canberra ACT 2600

Janelle

Dear ~~Ms~~ Saffin

I welcome the decision by the Trade Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defence and Trade to hold an inquiry into Australia's trade and investment relations with Japan and the Republic of Korea (ROK). I enclose joint submissions from DFAT and Austrade, with input from the Export Finance and Insurance Corporation (EFIC), to assist the Sub-Committee in its deliberations.

Australia's long-standing strong economic relations with Japan and the ROK have made a vital contribution to Australia's prosperity. Japan and the ROK are Australia's second and fourth-largest two-way trade partners respectively, with combined two-way trade worth more than $96 billion in 2010. Maintaining and expanding our trade and investment relations with Japan and the ROK continues to be a high priority for the Australian Government.

The primary contact in DFAT on this matter is Mr Gerald Thomson, Assistant Secretary, North East Asia Branch (02 6261 2303, gerald.thomson@dfat.gov.au).

I trust the enclosed submissions are of assistance. I look forward to reading the Sub-Committee's report.

Yours sincerely

Craig C

Craig Emerson

Australian Government
Department of Foreign Affairs and Trade

Australian Government
Austrade

Inquiry by the Joint Standing Committee on Foreign Affairs, Defence and Trade into Australia's Trade and Investment Relationship with the Republic of Korea

Submission by the Department of Foreign Affairs and Trade,
and the Australian Trade Commission

July 2011

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Abbreviations

ACTA	Anti-Counterfeiting Trade Agreement
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
BSE	Bovine Spongiform Encephalopathy
CEPEA	Comprehensive Economic Partnership in East Asia
CPA	Certified Public Accountant Act
CSQ	Country Specific Quotas
CTA	Certified Tax Accountant Act
EAFTA	East Asia Free Trade Agreement
EAS	East Asia Summit
ECA	Export Credit Agency
EFIC	Export Finance and Insurance Corporation
EFTA	European Free Trade Association
ETM	Elaborately Transformed Manufactures
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FIRB	Foreign Investment Review Board
FTA	Free Trade Agreement
G20	Group of Twenty
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
IP	Intellectual Property
KEPCO	Korea Electric Power Corporation
KEXIM	Korea Export-Import Bank
KOGAS	Korea Gas Corporation
KORES	Korea Resources Corporation
KOREU	Korea-EU FTA
KORUS	Korea-US FTA
KOTRA	Korea Trade-Investment Promotion Agency
KT	Korea Telecom
K-Sure	Korea Trade Insurance Corporation
MFN	Most Favoured Nation
OECD	Organisation for Economic Cooperation and Development
POSCO	Pohang Steel Corporation
ROK	Republic of Korea
TPP	Trans-Pacific Partnership
STM	Simply Transformed Manufactures
TRIPS	Trade-related Aspects of Intellectual Property Rights
WHO	World Health Organization
WTO	World Trade Organization

Inquiry by the Joint Standing Committee on Foreign Affairs, Defence and Trade into Australia's Trade and Investment Relationship with Japan and the Republic of Korea

Submission by the Department of Foreign Affairs and Trade and the Australian Trade Commission

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On 21 April 2011 the Minister for Trade, The Honourable Dr Craig Emerson MP, asked the Committee to inquire into and report on Australia's trade and investment relationship with Japan and the Republic of Korea.

The following submission is made by the Department of Foreign Affairs and Trade (DFAT) and the Australian Trade Commission (Austrade). The submission provides an overview of Australia's trade and investment relationship with the Republic of Korea. It accompanies a submission, also made by DFAT and Austrade, on Australia's trade and investment relationship with Japan. Both submissions address the inquiry's terms of reference:

> *The Trade Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defence and Trade will inquire and report on Australia's trade and investment relations with Japan and the Republic of Korea with particular reference to:*
>
> - *the nature of Australia's existing trade and investment relations;*
> - *emerging and possible future trends in these relations;*
> - *barriers and impediments to trade and investment with Japan and the Republic of Korea for Australian businesses;*
> - *opportunities for deepening existing commercial links, and developing new ones, with Japan and the Republic of Korea; and*
> - *the role of the government in identifying new opportunities and assisting Australian companies to access existing and potential opportunities in Japan and the Republic of Korea.*

Overview

The Republic of Korea (hereafter, Korea[1]) is a modern, developed economy with significant and enduring links with Australia. Since the late-1960s, Korea's economic development and industrial transformation has raised the living standards of Koreans and created significant opportunities for bilateral trade and investment for Australia. Korea is Australia's fourth-largest trading partner and third-largest export market.

The Australian and Korean economies are approximately the same size and share a vibrant and complementary trading relationship. Energy and minerals/metals dominate Australia's exports to Korea and have been the bedrock of the relationship to date. Australia is a reliable and stable supplier to Korea of raw materials (such as coal and iron ore) and food (such as beef and sugar), while Korea provides Australia with industrial products (such as vehicles) and processed materials (refined petroleum, paper, chemicals). Australia is now also a substantial exporter to Korea of services, such as education and tourism, as well as elaborately-transformed manufactures, such as pharmaceuticals. Korean industrial exports to Australia now include information technology equipment, specialised maritime platforms and high-value consumer durables, such as flat-screen televisions. The contribution of investment to the bilateral economic relationship is also increasing.

Australia's importance to Korea as a reliable and stable supplier of resources, energy and food and as a host to Korean investment seems set to continue, although Korea faces challenges which will influence the evolution of this successful relationship. They include Korea's heavy reliance on exports to drive its growth, its dependence on external sources of energy and resources, as well as its rapidly-aging population and low service-sector productivity.

Although Korea has made significant progress in liberalising its economy and has negotiated bilateral FTAs with some of its major trading partners, it maintains significant barriers to trade and investment. Korea claims developing country status in the WTO and to date has exercised all flexibilities available to developing countries with regard to limiting agricultural liberalisation. Addressing these barriers bilaterally and multilaterally will increase efficiency in Korea and benefit Australian exporters and investors.

Korea's existing FTAs with other trading partners, including Chile, India, EFTA (Liechtenstein, Iceland, Norway, and Switzerland), and ASEAN, the entry into force of the Korea-EU FTA in July 2011, and the anticipated ratification of the Korea-US FTA, will place Australian exporters at a disadvantage in the Korean market. Early agreement on a comprehensive and ambitious FTA with Korea is a high priority for

[1] 'Republic of Korea' is the official name 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.

the Australian Government. The negotiations are now in their final stages. Prime Minister Gillard and President Lee of Korea agreed, during their meeting in April 2011, to aim for conclusion of negotiations by the end of the year. The final agreement will be comprehensive and ambitious and will provide opportunities to deepen commercial links.

Australia and Korea, as like-minded, trade-oriented middle powers, will continue to cooperate in multilateral fora, such as the WTO and APEC, to achieve further regional and global trade liberalisation and investment facilitation.

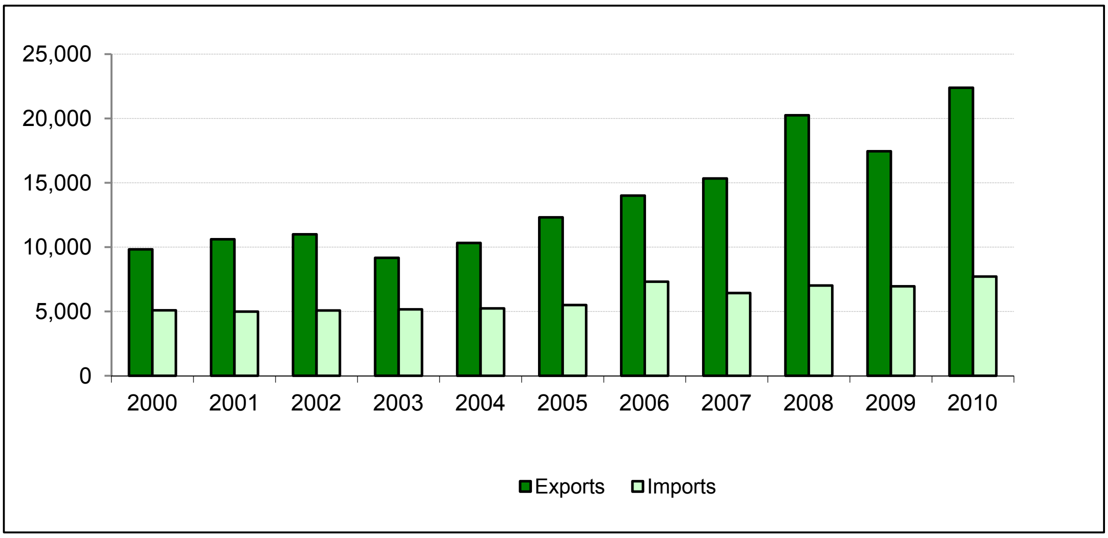
Through their offices in Australia and Korea, the Department of Foreign Affairs and Trade and the Australian Trade Commission (Austrade), supported by the Export Finance Insurance Corporation, are working to identify new opportunities and assist Australian companies to access existing and potential opportunities in the Republic of Korea.

Chapter One:
Trade and Investment Relationship with Korea

1.1 Australia's goods trade with Korea

Australia's trade with Korea has developed rapidly since the 1960s when Korea began pursuing industrialisation policies requiring large quantities of industrial raw materials, laying the foundations of a broader, vibrant and complementary trade and investment relationship with Australia. From 2000 to 2010, two-way goods and services trade increased at an average annual rate of 8 per cent, with Australia's exports to Korea continuing to substantially exceed imports from Korea (Figure 1.1). In 2010, Australian trade in goods and services with Korea reached $30.1 billion, with Korea being Australia's third-largest export market after China and Japan. Korea currently takes 8.8 per cent of Australia's total exports. On a per capita basis, Australian exports to Korea are 9.5 times larger than exports to China and 1.3 times larger than exports to Japan, making Korea our second-largest per capita export market in North Asia after Hong Kong.

Figure 1.1 Australia's total goods and services trade with Korea (A$m)



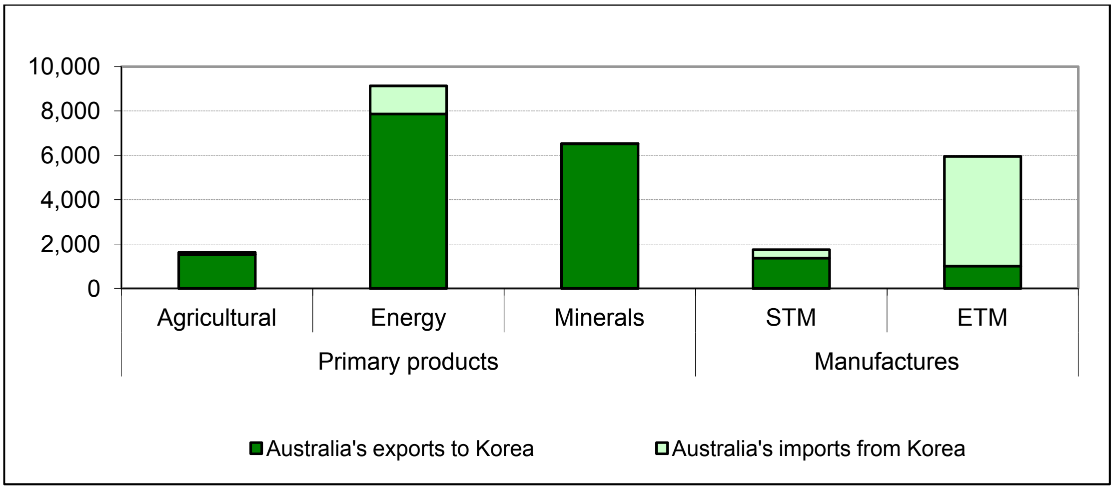
Source: ABS data on DFAT STARS database at 8 June 2011

Australia's growing energy and mineral/metal[2] exports continue to form the basis of the trade relationship, accounting for around two-thirds of Australia's total exports to Korea in 2010 (Figure 1.2). Australia also exports to Korea a range of elaborately transformed manufactures (ETMs), such as pharmaceuticals. For Korea, Australia has been a significant market for cars for some years and is now a growing market for a broader range of manufactured products, such as mobile telephones, information

[2] Australian exports of unwrought iron and steel and non-ferrous metals such as nickel, aluminium, lead, zinc, tungsten, and titanium are classified as simply-transformed manufactures.

technology equipment, specialised maritime platforms and high-value consumer durables such as flat-screen televisions.

Figure 1.2 Complementarity in two-way trade, 2010 (A$m)



Source: ABS data on DFAT STARS database at 8 June 2011

Australia's merchandise exports to Korea increased by 126 per cent, from below $10 billion in 2000 to $20.5 billion in 2010 (Figure 1.3). Energy, minerals and simply transformed manufactures such as unwrought aluminium and unwrought zinc dominate Australia's exports to Korea which was the largest global market for Australian coal, iron ore, crude petroleum and copper in 2009-10. This marked a good recovery from the decline seen in 2009 (when coal and iron ore prices fell from the peaks of 2008) and surpassed the 2008 figure of $18.4 billion.

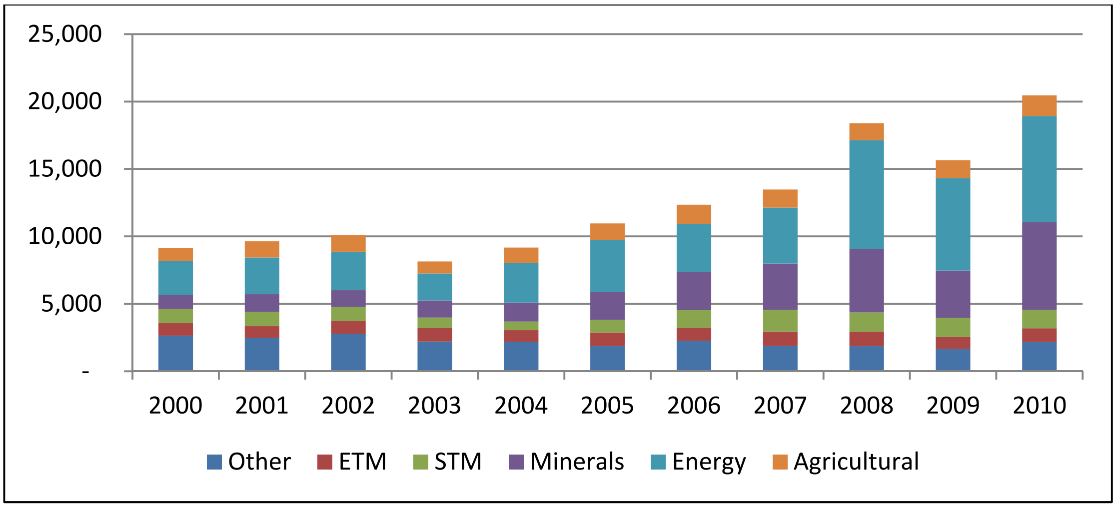
Between 2000-10, energy - principally coal, but also crude oil - benefitted from substantial increases in price as well as quantities shipped, accounting for an average of 36 per cent of Australia's total exports and growing by an average 17 per cent per annum. Between 2007-10, the value of coal exports rose by 76 per cent to $5.4 billion while the value of crude petroleum exports rose 26 per cent to $2.4 billion. Korean refineries are the largest overseas processors of Australian crude and some of their production is re-exported, including to Australia. Between 2007-10, LNG has been Australia's fastest growing export, increasing (from a low base) by 229 per cent. Australia currently meets only 3 per cent of Korea's total market for LNG, so there is considerable potential for Australian exports to increase further.

Australian mineral exports grew at the higher average annual rate of 23 per cent between 2000-10. Exports of iron ore and concentrates accounted for over 20 per cent of Australia's exports to Korea in 2010 and increased by 150 per cent between 2007-10. Other metals and ores also make significant contributions to Australia's exports - exports of copper ores and concentrates, Australia's fourth-largest export, have more than doubled since 2007 to $943 million and exports of aluminium, Australia's fifth-largest export, continued to increase steadily to $848 million.

Australia’s agricultural exports to Korea have expanded steadily, at an average annual rate of 6 per cent between 2000-10, and Korea is Australia’s fifth-largest agricultural export market. Korea is also Australia’s third-largest export market for beef, which accounts for an average of 45 per cent of Australian agricultural exports to Korea. In 2010, Australia’s beef export reached $633 million, an 18 per cent increase from the previous year. Australia maintains the largest share of the Korean beef import market (53 per cent), followed by the US (37 per cent) and New Zealand (10 per cent).

Korea is also a significant market for Australian sugar, with annual exports of more than $530 million in 2010 (January-September), wheat ($250 million in 2010), dairy products (cheese and milk powders, $91.6 million in 2010), malt ($52.2 million in 2010), animal feed ($30 million in 2010), horticultural products ($9.5 million in 2010) and wine ($7.2 million in 2010) (see Appendix on Australia’s top 50 exports).

Figure 1.3 Composition of Australia's exports to Korea (A$m)



Source: ABS data on DFAT STARS database at 8 June 2011

Australia's merchandise imports from Korea totalled $7.2 billion in 2010, a 7.8 per cent increase from 2009. This growth was largely due to a 42.2 per cent year-on-year increase in the value of passenger motor vehicle imports, which accounted for 30 per cent of total imports or $2.1 billion. Over the past 10 years, passenger motor vehicles have been responsible for much of the growth of Korean imports, with an annual growth rate of 14 per cent since 2000. Other major imports include refined petroleum, telecommunications equipment (such as mobile telephones), and television sets.

Australia’s top 10 exports to Korea accounted for 81.0 per cent of total exports in 2010. Recent export data is provided below in Table 1.1.

Table 1.1 Australia's top 10 merchandise exports and imports with Korea, 2007-10

Rank	**2007**	**2008**	**2009**	**2010**	***Share***
	$A'000	*$A'000*	*$A'000*	*$A'000*	*%*
Exports					
1 Coal	1,647,536	5,620,974	4,915,124	5,372,976	*26.3*
2 Iron ore & concentrates	1,779,375	3,349,850	2,360,795	4,443,872	*21.7*
3 Crude petroleum	2,403,179	2,274,288	1,908,142	2,396,927	*11.7*
4 Copper ores & concentrates	462,308	525,928	468,058	942,199	*4.6*
5 Aluminium	791,877	711,487	869,316	847,739	*4.1*
6 Beef, f.c.f.	803,970	701,882	534,269	632,742	*3.1*
7 Sugars, molasses & honey	289,708	417,738	488,618	534,297	*2.6*
8 Gold	173,979	205,300	359,818	466,082	*2.3*
9 Natural gas	130,045	176,117	631,073	427,311	*2.1*
10 Medicaments	226,357	266,018	417,073	408,174	*2.0*
Total exports	**13,469,000**	**18,393,000**	**15,643,000**	**20,457,000**	
Imports					
1 Passenger motor vehicles	1,357,604	1,066,135	1,499,333	2,131,592	*10.4*
2 Refined petroleum	342,964	1,077,922	1,171,097	1,247,167	*6.1*
3 Telecom equipment & parts	839,018	678,420	663,529	508,250	*2.5*
4 Monitors, projectors & TVs	318,323	262,460	264,173	183,289	*0.9*
5 Gold	163,469	209,433	423,476	163,008	*0.8*
6 Rubber tyres, treads & tubes	144,832	144,862	145,800	135,809	*0.7*
7 Electrical machinery & parts	106,933	122,939	100,816	131,788	*0.6*
8 Paper & paperboard	168,863	37,498	113,101	131,191	*0.6*
9 Goods vehicles	18,664	66,009	95,164	130,036	*0.6*
10 Copper	94,684	118,113	83,608	123,136	*0.6*
Total imports	**5,940,000**	**6,427,000**	**6,628,000**	**7,146,000**	

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

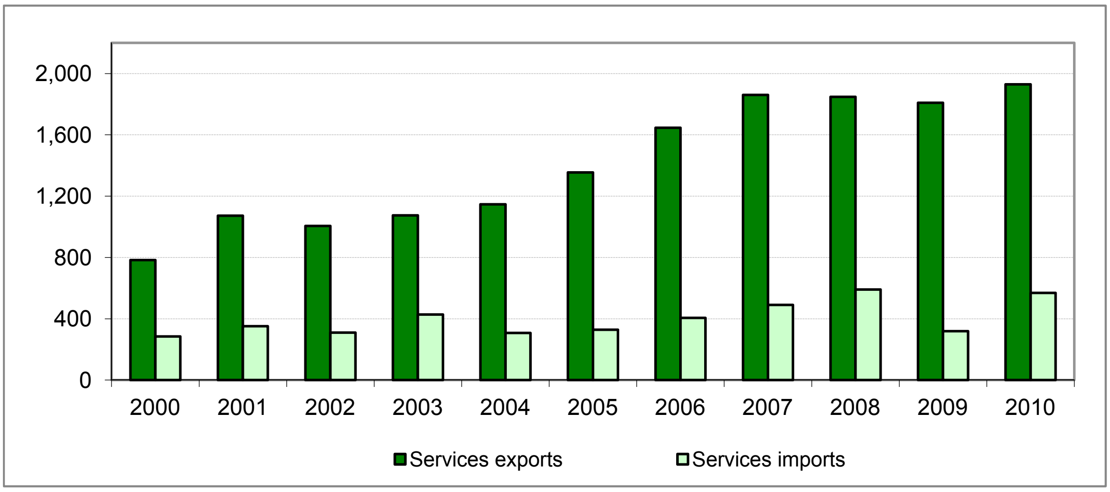
Source: DFAT STARS Database, based on ABS Cat No 5368.0, April 2011 data; ABS Special Data Service; Korean customs data on the GTIS Global Trade Atlas database.

1.2 Australia's services trade with Korea

From 2000, Australia's services exports grew at an average annual rate of 15 per cent to reach $1.9 billion in 2010 (Figure 1.4), with particular strength in education and tourism, which together comprise 91 per cent of services exports (Table 1.2). [3]

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

Figure 1.4 Australia's services trade with Korea (A$m)



Source: ABS Catalogue 5368.0.55.004

Table 1.2 Australia's services trade with Korea, 2010 (A$m, % of share)

	Exports		Imports	
Travel services	1,749	91%	135	24%
Business	*82 (4%)*		*35 (6%)*	
Personal	*1,666 (86%)*		*101 (18%)*	
education-related	*1,036 (54%)*		*10 (2%)*	
other	*630 (33%)*		*91 (16%)*	
Transport services	117	6%	342	60%
Other services	*66*	3%	92	16%
Total	**1,930**		**569**	

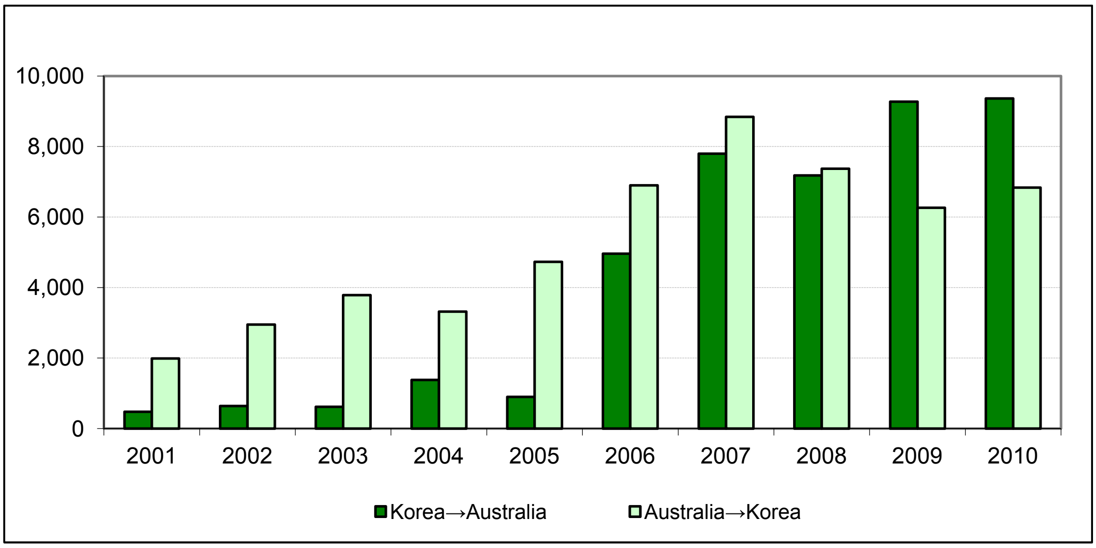
Source: DFAT STARS database.

In education, Korea ranked as Australia's third-largest source of foreign enrolments (after China and India). In 2010, enrolment figures for Korean students in Australian institutions were 33,986 (down from 35,708 in 2009). Australia's export of education-related travel services to Korea in 2009-10 totalled $1.1 billion, consistent with the previous two financial years. Tourism is also important, with 196,100 Korean visitor arrivals in Australia in 2009-10 (Korea is Australia's 8th largest source of tourism). In 2009-10, 40,300 Australian tourists listed Korea as their primary overseas destination, up 8 per cent from 2008-09.

1.3 Australia's investment relationship with Korea

In recent years, the importance of investment in the bilateral economic relationship has increased markedly. Australia's stock of investment in Korea has grown three-fold since 2001, reaching $6.8 billion in 2010 (Figure 1.5), with foreign direct investment (FDI) accounting for just over 10 per cent. Korea's stock of investment in Australia has grown 20-fold since 2001, reaching $9.4 billion in 2010 of which $2.1 billion was FDI.

Figure 1.5 Balance of stocks of total investment in Australia and Korea (A$m)



Source: ABS, International Investment Position, catalogue 5352.0, May 2011

There is potential for Australian investment to increase, as Korea ranks only 18th as a destination for Australian investment abroad. There is also much scope for additional Korean investment in Australia. According to data from the Foreign Investment Review Board, there were 49 Korean investment proposals submitted during the 2009-10 financial year – 60 per cent of which represented interest in mineral exploration and development – with an approved amount of $2.9 billion. The noticeable increase in Korea's foreign investment in Australia in recent years partly reflects an attempt by Korean firms to diversify their suppliers of resources.

1.3 Emerging trends

Korea continues to enjoy strong economic growth, with GDP expanding by 6.1 per cent in 2010 and forecast to reach 4.5 per cent in 2011 and 4.7 per cent for 2012. Exports account for about 50 per cent of Korea's GDP, but the country continues to face increasing competition in regional and emerging country markets.

Three emerging trends are likely to affect trade and investment links with Korea in the medium term:

- increasing Korean concern over resource, energy and food security in light of its increasing dependence on external supplies, and increasing competition for these, particularly from China, India and other newly-industrialising countries;
- the need to entrench foreign markets for Korean products and secure Korea's continuing economic growth; and
- the increasing political and consumer-driven demands of Korea's growing middle class.

The Korean Government sees developing Green Technology as one effective response to these trends. The Korean Presidential Committee on Green Growth's "Low Carbon, Green Growth" proposes a National Strategy with three objectives: the mitigation of climate change and energy dependence; creating new engines for economic growth; and improvement in quality of life and enhanced international standing. On 20 June 2011, at the Global Green Growth Summit in Seoul, President Lee announced Korea would establish a Global Green Technology Centre, jointly with the ROK-led Global Green Growth Institute (of which Australia is a core partner), the Korea Advanced Institute of Science and Technology and leading foreign research institutes.

Korea is currently the world's 10th largest energy consumer (240 million tons of oil-equivalent in 2010) and imports 97 per cent of its energy needs. In 2009, in order to address climate change and promote energy independence, the Korean Government formulated a 'Low Carbon, Green Growth' national strategy, which aims to increase its supply of clean energy to 5 per cent of the total national-energy requirements by 2011. The Government has also adopted targets for nuclear-power generation. Korea is the world's fifth-largest producer of nuclear power, which accounts for 36 per cent of Korea's electric power generation. In 2010, the Korean Government announced that by 2024 the country aims to meet 48.5 per cent of its electricity needs from nuclear sources.

The focus on creating and investing in clean technologies also positions Korea to address one of its leading strategic challenges: to maintain its technological/pricing edge relative to Japan and China. In international markets, much of Korean industry is vulnerable to price competition from the emerging-industrialised countries, particularly China. The emergence of China, however, is also an opportunity for Korea – China became Korea's largest export market in 2003 and now accounts for 24 per cent of Korea's total exports. Korea feels vulnerable to competition on style, technology and quality from longer-established industrialised countries such as Japan and the EU. It has responded to these challenges by increasing investment in foreign resources and production facilities, and increasing investment in research and development, and marketing.

Korea continues to focus on increasing its food self-sufficiency, most recently through overseas investment. At present, Korea imports 70 per cent of its food needs, valued at around US$50 billion per annum. Foreign investment is increasingly seen as a way to help overcome agricultural production problems at home, in particular a shortage of arable land and outbreaks of animal diseases such as foot and mouth. Ownership of foreign food production facilities is also seen as providing some insurance against increasing food prices, and these concerns are driving Korean investment in agribusiness overseas.

English language proficiency is recognised as important for success in Korea's export-driven economy and the strong demand among Koreans for overseas education is likely to continue. Korean perceptions of the price/quality ratio of Australian education will remain the key factor determining Australian enrolments. The aging of Korea's population puts additional pressure on its low-productivity service industries and will result in additional emphasis on up-skilling Korea's work force, further increasing demand for overseas education.

Chapter Two:
Trade Barriers in Korea

2.1 Tariff barriers

Korea's average applied tariffs, at 12.1 per cent, are high by OECD country standards.[4] The average applied tariff on agricultural products is 48.6 per cent, which is more than 7 times higher than for non-agriculture goods (6.6 per cent). Of particular interest to Australia are Korea's high tariffs on our major export commodities, including beef (40 per cent), dairy (up to 176 per cent), malt and barley (up to 513 per cent), maize (up to 328 per cent), animal fodder (100 per cent) and horticulture (up to 304 per cent). In addition, Korea maintains some tariffs in areas of high export volume for agricultural products, such as sugar and wheat.

Korea maintains nuisance tariffs in areas of high export volume for non-agricultural products. This affects around 31 per cent of Australia's non-agricultural exports to Korea (by value), including 3 per cent for crude petroleum, LNG, gold, nickel, lead and copper cathode; 8 per cent for pharmaceuticals, cars, car engines and gear boxes; 6.5 per cent for titanium dioxide pigment; 1 per cent to 3 per cent for aluminium; and 1 per cent for salt and ammonia.

2.2 Non-Tariff barriers

2.2.1 Tariff-rate quotas

Korea applies tariff-rate quotas on 179 agriculture products, with in-quota rates ranging from zero to 50 per cent and prohibitive out-of-quota rates of up to 887 per cent. Tariff-rate quotas apply to commodities such as milk powder, butter, cheese, malt and malting barley, animal fodder, potatoes and citrus.

These quotas are operated by 22 different organisations, including government ministries, state trading enterprises and producer organisations. In some cases, the administering authority is owned by domestic producers competing with the imported product. Quotas are administered through different mechanisms, including auctioning of quotas, allocation to designated agencies, first-come-first-served allocation, or a combination thereof. State trading enterprises impose additional mark-ups on top of tariffs for products such as rice, garlic, onions, nuts, seeds, beans, spices and soybeans.

Malt and malting barley quotas are an example. Malt and malting barley enter via a 70,000 tonne combined WTO quota at a tariff of 30 per cent and through so-called autonomous (ad hoc) tariff quotas released on an annual basis (214,000 tonnes for

[4] World Trade Organization: World Tariff Profiles 2010.

malt and malting barley at 15 per cent tariff in 2010). Korea's out-of-tariff quotas are prohibitively high (269 per cent for malt and 513 per cent for malting barley).

2.2.2 Rice

Rice imports in Korea are subject to a quantitative-import quota. This is allowed under Annex 5 of the WTO Agreement on Agriculture. As part of its WTO commitments, Korea must progressively increase its annual rice quota by around 20,347 tonnes every year from 205,228 tonnes (on a milled basis) in 2004 to 408,700 tonnes in 2014 (almost 8 per cent of domestic consumption). The quota is distributed as country-specific quotas for China, the United States, Thailand and Australia (9,030 tonnes), as well as a global quota on a Most Favoured Nation basis.

2.2.3 Special agricultural safeguards

WTO members may restrict imports of a product temporarily, that is, take safeguard action by increasing tariffs, if a surge of imports injures or threatens to injure its domestic industry. In the case of special agricultural safeguards, it is not necessary to demonstrate that injury is being caused to the domestic industry.

Korea has reserved the right to take special-safeguard action on 124 agricultural products. It has taken safeguard action consistently on imports of soya and adzuki beans, buckwheat, starches, and groundnuts, and has substantially impaired trade in these products as a result.

2.2.4 Flexible tariffs and adjustment duties

In addition to special safeguards, Korea sometimes applies temporary higher tariffs (which it terms 'flexible tariffs') than those set out in its customs tariff schedule. Authorities are able to increase or decrease tariffs at their discretion, with differentials as high as 40 per cent above or below the fixed tariff rate. The only constraint on the increase in tariffs is that it must be below the maximum tariff Korea has agreed to under the WTO: that is, below its binding. This provides considerable scope to discourage (or encourage) the import of particular products. For example, Korea recently reduced its tariffs temporarily on many dairy products to zero. This was so that imports could make up for a shortfall in domestic production stemming from the slaughter of dairy cows during a major outbreak of foot-and-mouth disease in Korea in late 2010/early 2011.

2.2.5 Subsidies

Direct government support to Korean agricultural producers averaged 52 per cent of farmers' income in 2007-09. According to the OECD, 91 per cent of the Korean government's direct support to agricultural producers is of the most distorting type: payments linked to output and variable input use. Prices received by Korean farmers were almost two times higher than world prices in 2007-09 and this reflects the distortions created by the significant tariff and non-tariff barriers in Korea.

2.3 Barriers to trade in services and investment

Korea has made significant progress in liberalising its services and investment regime in recent years, but maintains a number of barriers to access for foreign providers. Broadly speaking, foreign service-providers' main complaint about Korea relates to national-treatment limitations, including barriers related to Korean state-owned enterprises, business ventures having to be Korean-organised and residency requirements. Some examples of barriers in areas of potential interest to Australia are set out below.

2.3.1 Accounting and taxation services

To provide services in Korea, foreign-chartered public accountants and foreign-certified tax accountants must be licensed and registered under Korea's *Certified Public Accountant Act* (CPA) or the *Certified Tax Accountant Act* (CTA) respectively, which requires field experience of two years in Korea after passing the CPA (or CTA) examination. The requirement is six months in the case of tax accountants. Australian service providers are unable to invest in Korean accounting or tax agency corporations.

2.3.2 Agricultural services

Korea has restrictions on wholesale and retail-trade services, including storage and warehousing services, in relation to certain agricultural products and services incidental to agriculture.

Korea has foreign-investment limits on agriculture and agriculture services, including a 50 per cent equity limit on beef-cattle farming, and does not allow foreign investment in rice and barley farming.

2.3.3 Architectural services

Foreign architectural companies can only provide services in Korea through a joint venture with a Korean-licensed architect. Foreign architects must hold a Korean architect licence to practise, which requires passing an examination.

2.3.4 Education

Korea has strong defensive interests in education. Korea currently has no General Agreement on Trade in Services (GATS) commitments on education. Only non-profit foreign higher-education institutions approved by the Korean Minister of Education, Science and Technology can operate in Korea, and therefore are unable to repatriate earnings. At least 50 per cent of board members of a private higher-education institution must be Korean nationals, or, where a foreigner contributes over half of the institution's property, up to two-thirds can be foreign nationals. Foreign universities are able to provide joint-curricula programs with Korean universities. Korea also reserves the right to restrict the establishment of education institutions and the number of students studying certain fields in the Seoul metropolitan area. Foreign entities cannot establish higher education institutions that train primary school teachers or supply higher-education services through broadcasting.

2.3.5 Energy

Korea's major energy suppliers, such as Korea Electric Power Corporation (KEPCO) and Korea Gas Corporation (KOGAS), are government-owned and operated, and Korea maintains limits on foreign holdings of 30 per cent in the aggregate for KOGAS and 40 per cent in the aggregate for KEPCO. In addition, the aggregate foreign share of power-generation facilities in Korea cannot exceed 30 per cent and aggregate foreign share of electric-power transmission, distribution and sales businesses cannot exceed 50 per cent.

2.3.6 Financial services

Korea does not allow the provision of cross-border financial services, but does allow foreign financial-services providers to establish branches within Korea. A licence is required for each branch established in Korea by a foreign financial institution, although a branch of a banking subsidiary, including one owned or controlled by investors of another country, does not require such a licence. Korea's banking and securities laws consider branches of foreign banks or securities companies to be separate legal entities from their parent organisations, and as such require them to supply and maintain operating funds within Korea.

Korea maintains restrictions on the types of business a foreign-bank branch can operate, including prohibiting credit unions, mutual-savings banks, specialised capital-finance companies, foreign and won-currency capital-brokerage firms, credit-information companies, general fund-administration firms, collective-investment-vehicle-appraisal companies, and bond-appraisal companies. Foreign financial institutions are also prohibited from acquiring real estate for non-business purposes. Korea has stringent rules relating to use of data by financial-services providers, and requires that most or all of their IT systems be located in Korea.

Investment restrictions stipulate that foreign-financial institutions cannot hold more than 10 per cent of the shares of a Korean commercial bank or bank-holding company unless they are approved as an internationally recognised financial institution by Korean regulators. Korea also maintains restrictions on inbound and outbound capital flows, including on the repatriation of capital from foreign-bank branches.

2.3.7 Legal services

Korea's legal-services market is largely closed to foreign firms, and Korea's current GATS commitments do not cover legal services. In general, foreign law firms cannot establish practices in Korea, and foreign lawyers cannot provide any form of legal advice. To qualify as a lawyer, a foreigner must pass the Korean bar examination and undertake two years of professional education.

2.3.8 News services

Foreigners can only provide news services through commercial contracts with a Korean news-agency and cannot provide news services directly. The Korean government maintains a monopoly over news channels. Foreign enterprises cannot publish periodicals, and Korea has foreign-investment limits of 30 per cent for newspapers and 50 per cent for other periodicals.

2.3.9 Telecommunications and broadcasting

Korea maintains restrictions on communications and broadcasting services. Public telecommunications-services licences are only granted to Korean entities, and foreign investment in terrestrial-television broadcasting is not allowed. Korea has a 49 per cent limit on foreign investment in facilities-based public-telecommunications services, cable-television operators and signal-transmission-network operators. Foreign ownership limits apply to the Korea Telecom (KT) Corporation and satellite broadcasters.

Chapter Three:
Other Issues

3.1 Korea's investment regime

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

Following the Asian financial crisis in 1998, the country was required to implement FDI-friendly policies in order to meet conditions for IMF assistance. In the past decade, Korea has devised a new FDI policy regime to augment investment activities, including the promotion of greenfield investment[5] and mergers/acquisitions.

But FDI in Korea remains relatively low, despite progress. In 2008, the stock of FDI as a share of GDP in Korea was the second-lowest in the OECD and the share in services was the third-lowest.[6] In the low-productivity service sector, foreign affiliates accounted for only 8 per cent of service-sector turnover and 4 per cent of employment in 2004, well below the OECD averages of 19 per cent and 10 per cent respectively.

In 2010, Korea was the sixth most restrictive country on the OECD FDI Restrictiveness Index, following Iceland, Mexico, New Zealand, Japan and Canada. The index focuses on four types of measures: 1) equity restrictions; 2) screening and approval requirements; 3) restrictions on foreign key personnel; and 4) other operational restrictions. The highest score for any measure in any sector is 1 (the measure fully restricts foreign investment in the sector) and the lowest is 0 (there are no regulatory impediments to FDI in the sector). OECD and non-OECD index figures and those for Australia and Korea are provided in Table 3.1 below.

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[5] A greenfield investment refers to FDI that either creates new production capacities in a host country or expands existing production capacity.
[6] OECD (2011) *A framework for growth and social cohesion in Korea*

Table 3.1: OECD FDI Restrictiveness Index (2010) by Sector: Selected Countries

Sector	**OECD**	**non-OECD**	**Australia**	**Korea**
Agriculture & Forestry	0.163	0.128	0.100	0.375
Fishing	0.324	0.320	0.100	0.500
Mining	0.153	0.122	0.100	0.000
Manufacturing	0.040	0.030	0.100	0.000
Electricity	0.123	0.123	0.100	0.417
Construction	0.057	0.055	0.100	0.000
Retail/Wholesale Distribution	0.062	0.029	0.100	0.000
Hotels & Restaurants	0.047	0.030	0.100	0.000
Transport	0.249	0.227	0.243	0.500
Media	0.228	0.180	0.210	0.400
Telecom	0.121	0.092	0.300	0.500
Financial Services	0.081	0.053	0.150	0.020
Business Services	0.102	0.067	0.128	0.000
Real Estate	0.281	0.283	0.300	0.000
Total FDI Index	**0.117**	**0.095**	**0.138**	**0.142**

Still, FDI in Korea continues to increase, reaching a 10-year high in 2010 at US$12.9 billion – an increase of 12.1 per cent compared with 2009.[7] The Korean Government's target is to attract US$15 billion of FDI in 2011. The OECD has recommended Korea take a number of steps to capitalise on this momentum, including reducing foreign ownership ceilings in key service sectors and liberalising product market regulations. In addition, the OECD has suggested creating a more FDI-friendly climate by enhancing the transparency of tax and regulatory policies and reforming the labour market.

3.2 Intellectual property

The Australian Government addresses intellectual property (IP) protection and enforcement through a strong commitment to a rules-based trading system under the WTO. As a WTO member, Korea, like Australia, has implemented obligations in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) which establishes minimum levels of IP protection and enforcement that each government has to give to the IP of fellow WTO members. This means that Australian IP stakeholders are assured certain minimum levels of protection and enforcement when exporting their IP to Korea.

Australia has sought to enhance the WTO system by seeking additional commitments on IP protection and enforcement through FTAs. As IP laws in Australia and Korea

[7] (2010) 'S.Korea targets higher foreign investment in 2011' *Reuters*. Available at: http://www.reuters.com/article/2010/12/29/korea-economy-fdi-idUSSUL00021720101229

provide a high standard of IP protection, FTA negotiators are exploring commitments beyond our existing TRIPS obligations.

Australia has also worked closely with Korea in successfully concluding a treaty with 35 other countries to establish a new international agreement dedicated to improving IP enforcement and reducing the trade in counterfeit material – the Anti-Counterfeiting Trade Agreement (ACTA). There is long-standing bilateral and multilateral cooperation between Australian and Korean IP offices.

The Government's IP work in the WTO, the Australia-Korea FTA and in relation to the ACTA will create a more secure trading environment for Australia's innovative and creative industries by strengthening the protection and enforcement of IP rights in Korea.

3.3 Anti-dumping

Dumping has not been a significant issue in Australia's trade relationship with Korea. The WTO reports that since 1995, Australia has initiated 21 anti-dumping investigations against Korea and imposed 11 anti-dumping measures. Australia currently has an anti-dumping measure in force on greyback cartonboard from Korea: this measure has been in force since 28 July 2005 and has been extended once, so is now due to expire on 28 July 2015. Korea has neither investigated nor imposed anti-dumping measures on Australian products.

3.4 Quarantine

The absence of quarantine protocols on a number of Australian products restricts Australian access to Korean markets and the negotiation of new protocols can require extensive involvement across a number of Australian Government departments and agencies over an extended time period. For example, Tasmanian cherries were first allowed into the Korean market at the beginning of 2010, following a three-year period of negotiations involving the Department of Agriculture, Fisheries and Forestry, Biosecurity Australia and Korean Government agencies.

Korea is a member of the three key quarantine-standard-setting bodies: 1) FAO/WHO Codex Alimentarius Commission; 2) World Organization for Animal Health; and 3) the FAO International Plant Protection Convention. Korea generally applies its plant and animal-quarantine requirements based on relevant international standards. But Korea is highly sensitive to food-safety concerns and can propose up to 128 changes or additions to its sanitary and phyto-sanitary regulations per year. For example, nationwide concern over the safety of beef in 2008 led to the introduction of onerous beef-traceability requirements. Australia led other WTO members in putting forward a submission opposing Korea's new regulations.

Chapter Four:
Impact of Korea's Other FTAs on Bilateral Trade and Investment

4.1 Korea's other FTAs

Korea has undertaken a very active FTA negotiation schedule in recent years with agreements concluded or negotiations underway with a number of Australia's major competitors in the Korean market. Korea already has FTAs in force with Chile, Singapore, ASEAN, EFTA and India. Korea ratified its FTA with Peru on 29 June 2011 and that looks set to enter into force on 1 August this year. Korea's FTA with the European Union came into force on 1 July and negotiations have been completed with the United States, with ratification by both legislatures likely later this year for entry into force on 1 January 2012 (see *Table 4.1* below). If Australia were not to conclude a FTA with Korea, the concessions provided in these FTAs would cause Australian exporters to lose market share, particularly in agricultural commodities.

Korea is currently negotiating FTAs with Australia, Canada, Columbia, Japan, Mexico, New Zealand and the Gulf Co-operation Council. It is negotiating a trilateral investment treaty with China and Japan. Possible FTAs with China, China and Japan, Israel, Turkey, the Russian Federation, MERCOSUR and the Southern Africa Customs Union are under formal examination or consideration.

Table 4.1: Korea's Free Trade Agreements

Status		Percentage of Korean tariff lines where customs duty was eliminated
Chile	Took effect in 2004	96.3% by 2014
Singapore	Took effect in 2006	91.6% by 2016
EFTA	Took effect in 2006	95.4% by 2013
ASEAN	Took effect in 2006	92.4 %by 2012[8]
India (CEPA)	Took effect in 2010	93% by 2010
EU	Took effect in July, 2011	98.7% by 2018
Peru	Ratified in June 2011	97.4% by 2021
US	Signed in 2007	98% within 10 years of implementation

Sources: OECD, EU, WTO

[8] The tariff concession structure of the Korea-ASEAN FTA consists of a 'Normal Track' and a 'Sensitive Track.' Of Korea's total tariff lines, 92.4 per cent belong to the Normal Track, while 7.6 per cent are in the Sensitive Track.

4.2 Impact of Korea's other FTAs on commodity trade

Korea's FTAs contain concessions on agriculture that will result in the eventual elimination of many of Korea's very high tariff barriers for its FTA partners. In FTA negotiations with Korea, Australia is seeking improved market access that protects the competitive position of our key agriculture exports. Examples of the results of other FTA negotiations that are of particular interest are as follows:

4.2.1 Beef

Australia is the largest supplier of beef to the Korean market, with exports of $633 million in 2010. The US is the second largest beef supplier to Korea and, prior to BSE-related import restrictions, was the largest supplier. On the implementation of KORUS, Korea's 40 per cent tariff on beef imports would phase to zero for the US over 15 years (with a safeguard).

4.2.2 Sugar

Korea is Australia's largest market for raw sugar, with exports of more than $530 million in 2010. Thailand secured elimination of the 3 per cent tariff when the ASEAN-Korea FTA entered into force on 1 January 2010. The US and EU have also secured a 16 year phase-out of the 40 per cent tariff on refined sugar (with a 20 year safeguard).

4.2.3 Wheat

Korea is Australia's fourth-largest wheat export market, with exports totalling $250 million in 2010. The US, our main competitor, has secured the elimination of the 1.8 per cent tariff on the entry into force of its FTA with Korea.

4.2.4 Dairy

Australian-dairy exports to Korea were worth $91 million in 2010. Korea operates a number of WTO tariff rate quotas on dairy imports (milk powder, butter and infant formula) with significant in-quota tariffs and very high out-of-quota tariffs. Korea has allocated substantial duty-free dairy quotas to the US and EU under the KORUS and KOREU FTAs. These quotas are in addition to the small existing WTO Korean quotas for dairy products. The EU now enjoys duty-free access for sizable quantities of milk powder, whey, butter and butter oil, cheese and infant formula, and from day one of its FTA with Korea entering into force the US will enjoy similar access.

4.2.5 Malt and malting barley

Australia's malt and malting-barley exports to Korea were worth $52.2 million (110,977 tonnes) and $3.0 million (13,102 tonnes) respectively in 2010. Australia supplied 70 per cent of malt imports and virtually 100 per cent of Korea's malting-barley imports.

Under KORUS, the US will receive a duty-free quota volume for malt and malting barley of 9,000 tonnes, which will grow over a 14-year period to become unlimited in the 15th year of FTA implementation. Similarly, the EU will receive a duty-free quota volume of 10,000 tonnes under KOREU, which will grow over a 15 year period to become unlimited in the 16th year of FTA implementation.

4.2.6 Wine

Australia exported $7.2 million worth of wine to Korea in 2010. Korea applies a 15 per cent tariff on wine imports, but Chilean and EU wine currently enters Korea duty free as a result of their respective bilateral FTAs. In addition, the US will receive immediate elimination of the 15 per cent tariff upon the implementation of KORUS.

4.2.7 Horticulture

Korea is not a large market for Australian horticultural exports, accounting for less than 1 per cent - $9.5 million - of our total horticulture exports in 2010. However, Korea is an important prospective market for Australia. The EU, Chile and ASEAN countries currently enjoy (and when KORUS is implemented the US will also enjoy) improved market access under their respective FTAs for many horticultural products, including table grapes, nuts, citrus, cherries, summer fruit, mangoes, potatoes, asparagus and carrots.

4.3 Impact of other FTAs on services trade and investment

The KORUS and KOREU FTAs contain commitments covering the majority of service sectors, and many of these commitments go well beyond Korea's GATS obligations. Examples of commitments of particular interest to Australia include their liberalisation of aspects of its legal, accounting and tax-accounting services markets. KORUS and KOREU also remove some of the foreign investment limits relating to telecommunications described above, and contain commitments on liberalising aspects of Korea's education sector. In addition, the KORUS and KOREU outcomes on financial services are WTO-plus in that they remove a number of the restrictions on commercial presence in Korea's current GATS obligations and its 2005 revised GATS offer.

Other areas in which Korea's FTAs have produced strong outcomes include audiovisual services and express-delivery services (KORUS); liberalisation of some specific environmental services such as treatment of waste water, soil remediation and consulting services (KOREU); and improvements in Korean commitments on air-transport services, maritime-transport services, and some rail and road services.

Chapter Five:
Opportunities for Deepening Commercial Links

5.1 Resources

Securing energy and mineral resources is central to the ongoing development of the Korean economy, and this trade and associated investments will continue to form the bedrock for the bilateral economic relationship. The Korea Government's most recent overseas resource development plan, released on 23 December 2010, aims to meet 30 per cent of Korea's petroleum and gas consumption from Korean developments overseas by 2019. This proportion is three times higher than the target rate in the previous report (released in 2007). It also aims to meet 42 per cent of Korea's needs for seven strategic resources (coal, uranium, steel, copper, tin, zinc and nickel) from overseas resources development by 2019 (25 per cent in the 2007 report).

Korean companies are now increasingly active in resource development, including infrastructure development, mining development and procurement deals. For example, one of the largest Korean investments in Australia is Korea Zinc's $500 million stake in a zinc plant in Townsville which processes ore from a number of mines in Queensland. Other major Korean firms, including SK Energy and POSCO, have invested in coal mines and iron ore resources in partnership with Korea's state-owned resources investment agency, KORES. In Australia, Korea is an increasingly active player in both green-field LNG projects and in coal and iron ore. The major Australian mining companies are well represented in Korea to market their output, with the Australian Government also assisting by promoting Australia as a reliable supplier of high-quality energy and resources, and by providing Australian-resource exporters with advice and facilitating high-level access, particularly with the Korean Government. Government agencies, including Austrade, also focus on attracting Korean investments in major resources developments.

Korean firms are increasingly involved in industrial-plant construction, including off-shore oil and gas platforms and LNG-processing plants onshore. Hyundai Heavy industry won a $3 billion contract to build the LNG processing trains for the Gorgon gas project in Western Australia. Samsung Heavy Industries has been commissioned by Shell to build the world's first fully floating LNG processing facility for the off-shore Prelude project, also in Western Australia.

Opportunities also exist to increase rare-earth exports: a group of 17 elements that are critical inputs into many high-end technologies. In late 2010, China temporarily cut off supplies of rare earths to Korea and other countries and substantially reduced export quotas. China has 97 per cent of known rare-earths-metal reserves. Countries that manufacture such products, including Korea, have since sought to diversify supply. Australia stands ready to be a long-term, reliable supplier of rare earths.

5.2 Clean technology

Energy security is a key element in the Korean government's industry development strategy. Opportunities exist for Australian clean energy and environment technologies to be introduced to Korean companies as well as facilitation of Korean investment in Australia's renewable energy industry sectors, including wind, solar, bioenergy and geothermal. Korea's Green Growth policy is encouraging rapid expansion of production capacity in areas such as wind and solar-generation equipment and energy-efficient vehicles. Korean companies are keen to enter international wind and solar projects as equipment suppliers and project investors. There is considerable interest from Korean groups in participating in the future expansion of Australia's wind generation capacity.

Opportunities also exist for Australian organisations to transfer or co-develop technology and skills in areas such as: carbon capture and storage; coal and gas to liquid fuels; advanced photovoltaic solar cells; fuel cells; energy storage; smart grids; and carbon measurement and trading.

5.3 Agribusiness

There is potential for Korea to become a more significant customer for and investor in, Australian agribusiness, including due to increased food-security concerns. Opportunities exist to expand further agriculture-commodities-based investment and trading, particularly in the beef and dairy sectors. Close partnerships between Australian Government agencies and other major players, such as Wine Australia, Dairy Australia, Meat and Livestock Australia, and the state governments will continue to be very important in further developing these opportunities.

Austrade has also received enquiries for the supply of Australian live cattle to help restock Korea's dairy herds devastated by the 2010 and 2011 outbreak of Foot and Mouth Disease. There are also good prospects for increased supply of grains for human consumption and stockfeed. Dairy products are also in strong demand.

5.4 Automotive

Korea is the fifth-largest producer of automotive vehicles in the world. Many Korean automotive companies are seeking new technologies to enhance their business capabilities in the competitive world market and maintain their position vis-à-vis China and Japan. In particular, opportunities exist in the areas of light-weighting, vehicle electrification and gas fuels.

5.5 Services

Opportunities exist for Australian capabilities in the areas of funds management, superannuation, infrastructure funds and financial support services to be introduced to the Korean market. For example, since 2000 Macquarie Bank has built up a successful and diversified group of financial services businesses in Korea employing over 300 staff. The Australia Korea Financial Service Forum established by Australian and Korean financial-industry organisations provides networking and business opportunities. Currently there are ongoing, high-level discussions on the creation of an Asian ‘Funds Passport’ that would potentially create more bilateral business opportunities between Korea and Australia in the financial services sector.

Korea has a very strong IT industry with a tech-savvy consumer base, almost universal broadband access and a strong demand for content. Australian-made content in the areas of advertising, education, internet, television and other media are possible areas of export growth. Australia is actively engaged with Korea through the annual “Korea, Australia, New Zealand (KANZ) Broadband Summit” involving annual meetings of communications ministers of the three countries. Operating since 2003, the Summit provides annual business networking opportunities for Australian companies in the communications and media industry. Australia’s development of a National Broadband Network has seen a lot of interest from Korean firms in partnering with Australian firms in offering new products and services relevant to a market place with high speed internet. In addition to the annual KANZ Broadband Summit, Austrade, in partnership with the Australia Korea Foundation organises annual missions of Australian IT, media content and children’s television content firms to Korea for business networking.

The Korean student market is very important to Australian universities and colleges wanting to diversify their foreign student enrolments. Increasing enrolments in tertiary studies will be the major focus of Austrade’s work over the next three years, with a target of doubling the number of Korean students in tertiary studies in Australia by 2015. The recent addition of two staff to the Austrade Seoul’s education team will provide sharper focus on promotion of study in Australia, institutional linkages and agent support. The annual “Study in Australia” education show in Seoul is the largest such Austrade-organised event in a North East Asian market.

5.6 Creative industries

Opportunities exist for Australian companies across Korea’s creative industry sector. Major Australian events such as the “Performing Arts Masterclass 2010” attracted 52 performing arts companies, and 13 Australian performing arts groups have either toured or confirmed that they will tour Korea in the first half of 2011, with another 10 companies in discussion for tours in the second half of 2011. In visual arts, there are opportunities for Australian artists, a number of whom are scheduled to participate in the Korean International Arts Fair (KIAF) in September 2011. Australia has been awarded the official role of “Guest Country” at the KIAF this year.

Chapter Six:
The Role of Government in Ensuring Opportunities are Identified, Developed and Utilised

6.1 Bilateral engagement on trade and policy issues

Our bilateral engagement on trade and investment issues with the Korean government and Korean firms is comprehensive and frequent. Australian government agencies, and the Australian Embassy in Seoul, devote considerable resources to it. Australia's Prime Minister and key economic ministers, including the Trade Minister, engage regularly with their Korean counterparts, both bilaterally and in regional and global fora. The Australia-Korea Ministerial Joint Trade and Economic Commission (MJTEC) is a formal mechanism through which the Australian and Korean trade ministers meet to discuss key bilateral, regional and global trade issues. At the last MJTEC held in May 2009 in Melbourne, then-Minister for Trade, Simon Crean, and Korea's Minister for Trade, Kim Jong-hoon, launched the opening round of bilateral FTA negotiations. The FTA is currently the main focus of our bilateral trade and investment engagement with Korea and has formed the basis of recent meetings between Minister for Trade, Craig Emerson, and Korea's Minister for Trade, Kim Jong-hoon.

Individual Commonwealth departments have established additional mechanisms for ensuring effective trade and economic engagement.

The Australia-Korea Joint Committee on Energy and Minerals Consultation and Cooperation is an annual senior-officials dialogue of long-standing led by the Department of Resources, Energy and Tourism for the Australian Government. The Joint Committee is a bilateral-engagement mechanism enabling discussion of key issues affecting two-way resources and energy-related trade and investment, both in the short and longer term. Areas of interest include new-policy developments; commodity trade and investment; low-emission technologies; education (resources and energy training) and research opportunities. Strong participation in discussions and cooperative activities by industry and other key stakeholders is a notable feature of the Joint Committee process. The 26th meeting of the Joint Committee on Energy and Minerals Consultation and Cooperation is proposed for later this year in Korea.

The Australia-Korea science and technology relationship is facilitated by the 1999 *Agreement between the Government of Australia and the Government of the Republic of Korea on Scientific and Technological Co-operation*. Recent collaboration has included an Australian-funded 'Australia-Korea Green Growth Workshop,' held in Melbourne from 17-18 March 2011, which focused on renewable and low-carbon energy generation systems, carbon capture and energy efficiency.

The Korea-Australia Forestry Co-operative Committee was established in 1997 to promote mutual cooperation in forestry. It meets biennially, with the last meeting held in Korea in July 2009.

The annual Bilateral Plant Quarantine Technical meetings were last held on 12 and 13 October 2010 in Australia.

The first Animal Health Meeting was held in Australia in August 2009. The second is not yet scheduled.

6.2 Austrade's role and priorities

Austrade is the Australian Government's trade and investment development agency. Austrade assists Australian companies to succeed in international business, attract productive FDI into Australia and promote Australia's education sector internationally.

Austrade provides coverage in Korea with one post in Seoul, comprised of a Senior Trade Commissioner, a Trade Commissioner and 15 locally engaged staff. Austrade's Seoul post is also responsible for Mongolia and the Democratic People's Republic of Korea. Korea is a challenging market for Australian exporters and unique assistance from Austrade Korea includes:

Business Partner Identification: Knowledge of Korean business relationships in any given market sector is critical for Australian companies wishing to succeed in Korea. There is little transparency in many such relationships. So advice from experienced Austrade staff is valuable to many Australian firms entering the market.

Government Imprimatur: Foreign government representations carry weight in Korea. Events have typically more interest when organised by Austrade as part of the Australian Embassy. Use of the Australia Unlimited brand will improve consistency in image projection for Australian industry and help individual businesses.

In 2009-10, Austrade Korea provided in-market support to 609 Australian businesses, which contributed to securing export deals valued at $565 million. The value of Austrade assisted FDI into Korea was $1 million and the value of Austrade assisted Korean FDI into Australia was $110 million.[9]

Austrade's priorities in Korea are based upon developing initiatives and opportunities that will deliver the greatest value-add for Australian business.

These trade and investment initiatives are aimed at working with other Australian departments and agencies dealing with Korea to:

- build better brand awareness of Australian capability;

[9] Source: Austrade SCP dated April 2011

- break down barriers to market entry;
- develop new market sectors for Australia;
- create new pathways to market; and
- expand market share.

The Korea Trade-Investment Promotion Agency (KOTRA) is Austrade's Korean equivalent. The Austrade-KOTRA relationship was formally established in 1988 with a MOU on mutual cooperation between the two organisations. Austrade and KOTRA have worked together in many industry sectors of mutual interest, including automotive, clean energy, food and beverage, consumer goods and investment. A joint meeting is held every two years between the CEO of Austrade and the President of KOTRA to discuss mutual interests between Korea and Australia.

6.3 EFIC's role and priorities

The Export Finance and Insurance Corporation (EFIC) is Australia's export-credit agency (ECA) and provides export credit, guarantee and insurance services to viable Australian exporters and companies investing overseas where the private finance and/or insurance markets are unwilling or unable to provide support. EFIC's Korean counterparts are the Korea Export-Import Bank (KEXIM), which is mandated to provide finance and guarantee support, and the Korea Trade Insurance Corporation (K-Sure), which is mandated to provide investment and export credit insurance. Australia has strong links with Korean ECAs both bilaterally and through multilateral fora such as the OECD, the Berne Union and the Asian EXIM Banks (AEB) Forum.

Korea has identified the development of natural resources (including exploration, development, production, and mergers/acquisitions) to secure steady supplies of natural resources as a strategic priority, shaping ECA activity in the sector. KEXIM reports that the mining sector received the greatest amount of Korean investment (US$ 7.2 billion) in 2009-10, buoyed by government activities to promote investment in this area. Examples of export credit activity facilitating resource development in Australia include:

- KEXIM has been involved since 2010 in supporting Korean steel-maker POSCO's acquisition of a 24.5 per cent stake in Australian Premium Iron, a company developing iron ore resources in the West Pilbara region of Western Australia.
- KOGAS has assumed a 15 per cent stake in the Gladstone Coal Seam Gas project.

The demand for large-scale project financing is expected to continue, with Asian ECAs keen to expand involvement in growth-engine projects in areas such as infrastructure and natural resources and EFIC and other export-credit and finance agencies are likely to maintain their important roles, supporting trade and project development in the Australian market.

6.4 Free Trade Agreement negotiations

On 12 April 2011, the Government released a new Trade Policy Statement, *Trading our way to more jobs and prosperity*. This Statement positions trade policy as a central element of the government's broader economic reform agenda, with Australia’s commitment to trade liberalisation contributing to growing prosperity and to more and better jobs. The Statement makes clear that the Government's trade negotiating agenda ‘will steer a middle course of championing and protecting the multilateral system while seeking to negotiate high-quality, truly liberalising sectoral, bilateral and regional trade deals that do not detract from but support the multilateral system’. The Trade Policy Statement reaffirmed that an FTA with Korea was a priority for Australia.

In concluding FTAs, the Government is seeking to ensure that Australian businesses can compete on equal terms with our competitors, particularly in markets where our trading partners have provided preferential treatment to them. Australian FTAs also aim to deliver substantial commercial and wider economic benefits to Australia more quickly than would be possible through the multilateral process. Our FTAs are designed to promote stronger trade and commercial ties, open up opportunities for Australian exporters and investors and secure Australia’s competitiveness with key trading partners.

Before negotiations with Korea began, a joint non-government FTA feasibility study was undertaken. The report, released in April 2008, concluded that a FTA between Australia and Korea that liberalised substantially all barriers to trade and investment offered significant opportunities to further strengthen our highly complementary and growing bilateral trade and investment relationship and deliver gains to both countries through closer economic integration.

In December 2008, the Australian Government called for public submissions on the expected impact of the FTA. As part of this process, DFAT received more than 60 submissions, predominantly from individual companies and peak industry groups. Most submissions supported the idea of a FTA with Korea. A common concern then was that Korea’s FTAs with Australia’s competitors risked reducing the competitiveness of certain food and agricultural products in the Korean market. Other Australian industries identified some sensitivity towards imports from Korea, most particularly in the manufacturing sector. Korean restrictions on capital flows, and regulatory requirements, were noted as barriers to investment that could be addressed through a FTA. Other submissions also judged that a FTA could potentially encourage Korean investment in Australia (including mining, agriculture and service sectors).

Negotiations commenced in May 2009 and, as at July 2011, there have since been five rounds and five intersessional technical meetings held. Rapid progress has been made on textual negotiations including the substantive completion of most chapters. The negotiations are now in their final stages, with both sides committed to concluding the FTA as quickly as possible. Prime Minister Gillard and President Lee of Korea agreed, during their meeting in April, that negotiations were now in their final stage and reaffirmed their joint goal to conclude the negotiations this year (2011). That timeframe would allow for the FTA's entry into force during 2012, which would help support Australian trade interests in respect of competition from Korea's other key trading partners who have received concessions.

The final agreement will be comprehensive and ambitious and will provide many opportunities to deepen commercial links. It will be one of the strongest bilateral-trade agreements that Australia has concluded. The FTA will include a highly-liberalising and transparent negative-list approach to services and investment commitments. Australian investments in Korea will benefit from the investment protections under the Investment Chapter, including on expropriation, transfers of funds and guarantees on minimum standards of treatment. Australian services providers will benefit from liberalising commitments that go beyond GATS obligations in the FTA's services chapters, including the Cross-Border Trade-in-Services Chapter, Telecommunications Chapter and the Financial Services Chapter.

6.5 Cooperation in regional and international organisations

6.5.1 World Trade Organization

Australia and Korea work closely together in the WTO in pursuit of our shared commitment to an open-rules-based multilateral trading system. We are both committed to resisting protectionism and taking concrete actions towards the conclusion of the WTO Doha Round, including through cooperation in G20 and APEC. We are like-minded across a number of Doha Round negotiating agenda. Australia welcomes Korea's support for an ambitious services package as part of the Doha Round outcome. We continue to encourage Korea to be more ambitious in agriculture negotiation.

6.5.2 Asia Pacific Economic Cooperation

Korea was an active supporter of Australia's efforts to establish APEC in 1989, and along with Australia, became a founding member of APEC. It continues to play an active and constructive role across APEC's trade and economic and human security agendas. Korea last hosted APEC in 2005.

Australia and Korea have a good working relationship in APEC, with both countries like-minded on most APEC issues. Korea supports Australia's efforts to promote domestic structural reform and is a strong proponent of aid-for-trade capacity building efforts. Australia supports Korea's efforts to strengthen capacity building for trade negotiators in developing APEC economies. The aim is to increase the ability of developing economies to participate in the global trading system, including by negotiating and entering into high quality free-trade agreements. In order to meet the Asia-Pacific's considerable infrastructure needs, Australia and Korea also cooperate in APEC to facilitate the growth of sustainable infrastructure development in the region, including through public-private partnerships.

Australia and Korea are leading work under APEC's Supply-Chain Connectivity Framework, endorsed by APEC Leaders in November 2010, which aims to deliver a 10 per cent improvement in the reliability, timeliness and cost of regional supply chains by 2015. Australia is leading work on addressing inadequate transport-logistics infrastructure and inconsistent logistics-standards, while Korea is leading work to streamline customs documentation.

Australia and Korea have worked together to support the analytical arm of APEC - the Policy Support Unit (PSU) - with Korea now making substantive financial contributions to the PSU to sustain this important aspect of APEC's work.

6.5.3 East Asia Summit

Regional economic integration is a key East Asia Summit (EAS) priority for Australia. Australia strongly supports work on a possible Comprehensive Economic Partnership in East Asia (CEPEA), including a possible future EAS-wide FTA covering all 10 members of ASEAN, and ASEAN's +1 FTA partners (currently Australia, New Zealand, Japan, Korea, China and India).

Australia continues to work with our EAS partners, including Korea, on CEPEA and regional economic-integration issues. We have been participating in four officials-level ASEAN Plus Working Groups, which were set up to consider the recommendations of studies on CEPEA and the East Asia Free Trade Agreement (EAFTA – a possible agreement covering only ASEAN, Japan, China and Korea) in parallel. ASEAN's FTA partners, including Australia and Korea, have been participating in all of the four ASEAN Plus working groups (Rules of Origin, Tariff Nomenclature, Economic Cooperation and Customs Procedure).

6.5.4 Group of Twenty (G20)

Australia works closely with Korea in the G20, the premier forum for international-economic cooperation. The G20 played a key role in responding to the global financial crisis and averting a global depression, including through coordinated fiscal and monetary-stimulus packages. As the global economy moves towards recovery, the focus of the G20 has shifted away from crisis response to rebalancing of global economic growth, strengthening financial regulation and international financial institution governance reform. Australia worked particularly closely with Korea in the lead-up to its hosting of the G20 Summit in Seoul in November 2010.

At the first G20-Leaders Summit (Washington, November 2008), G20 Leaders underscored the critical importance of avoiding protectionism and requested two international organisations – the Organisation for Economic Cooperation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD) – to provide ongoing monitoring of their pledge to avoid implementing protectionist measures. At the Toronto Summit (June 2010) G20 Leaders renewed, until the end of 2013, their commitment to 'refrain from raising barriers or imposing new barriers to investment or trade in goods and services, imposing new export restrictions or implementing World Trade Organization-inconsistent measures to stimulate exports', and committed to rectify such measures as they arose. G20 Leaders reaffirmed this pledge, known as the standstill commitment, at the most recent G20 Summit (Seoul, November 2010). G20 Leaders, including in Seoul in 2010, have also consistently provided their support for an early, comprehensive, ambitious, and balanced conclusion to the WTO's Doha Development Round.

Australia continues to work closely with the Republic of Korea in the lead-up to the next G20 Summit, which France will host in Cannes on 3 and 4 November 2011.

Appendix: Australia's top 50 merchandise exports and imports with Korea, 2010

Rank	Commodity	Value
	Australia's Exports	**$A'000**
	All Commodities	20,465,940
1	Coal	5,372,976
2	Iron ore & concentrates	4,443,872
3	Crude petroleum	2,396,927
4	Copper ores & concentrates	942,199
5	Aluminium	847,739
6	Beef, f.c.f.	632,742
7	Sugars, molasses & honey	534,297
8	Gold	466,082
9	Natural gas	427,311
10	Medicaments (incl veterinary)	408,174
11	Nickel	374,277
12	Ingots & other primary forms of iron or steel	297,530
13	Precious metal ores & conc (excl gold)	274,201
14	Lead ores & concentrates	264,360
15	Wheat	250,426
16	Manganese ores & concentrates (incl manganiferous iron ores & concentrates with a manganese content of 20% or more calculated on the dry weight)	185,399
17	Zinc ores & concentrates	159,364
18	Uncoated flat-rolled iron & steel	129,672
19	Animal feed	123,390
20	Nickel ores & concentrates	113,607
21	Internal combustion piston engines	106,317
22	Copper	105,479
23	Inorganic chemical elements	93,871
24	Non-ferrous waste & scrap	92,007
25	Meat (excl beef), f.c.f.	78,579
26	Vehicle parts & accessories	77,515
27	Liquefied propane & butane	73,378
28	Lead	71,983
29	Sodium Chloride (Salt)	62,338
30	Cereal preparations	61,713
31	Pigments, paints & varnishes	55,115
32	Cotton	50,423
33	Silver & platinum	49,787
34	Milk, cream, whey & yoghurt	41,391
35	Wool & other animal hair (incl tops)	38,877
36	Cheese & curd	36,004
37	Fixed vegetable oils & fats, soft	35,942

38	Measuring & analysing instruments	28,893
39	Edible products & preparations, nes	27,392
40	Wood, rough	24,278
41	Other non-ferrous metals	21,807
42	Ships & boats (incl hovercraft)	21,640
43	Ferrous waste & scrap	19,301
44	Zinc	19,233
45	Misc manufactured articles, nes	16,831
46	Animal oils & fats	16,320
47	Pharm products (excl medicaments)	15,247
48	Refined petroleum	14,613
49	Ores & concentrates of molybdenum, niobium, tantalum, titanium, vanadium & zirconium	14,573
50	Butter	14,237
	Australia's Imports	
	All commodities	7,143,910
1	Passenger motor vehicles	2,131,592
2	Refined petroleum	1,247,167
3	Telecom equipment & parts	508,250
4	Monitors, projectors & TVs	183,289
5	Gold	163,008
6	Rubber tyres, treads & tubes	135,809
7	Electrical machinery & parts, nes	131,788
8	Paper & paperboard	131,191
9	Goods vehicles	130,036
10	Copper	123,136
11	Household-type equipment, nes	112,127
12	Vehicle parts & accessories	104,244
13	Heating & cooling equipment & parts	79,511
14	Civil engineering equipment & parts	76,582
15	Electronic integrated circuits	73,399
16	Electrical distributing equipment	64,211
17	Plastic plates, sheets & film	51,269
18	Office machines	46,665
19	Tubes & pipes of iron or steel	45,567
20	Aluminium	43,573
21	Coated flat-rolled iron & steel	40,374
22	Other primary plastics	33,055
23	Hydrocarbons & derivatives	31,376
24	Plastic articles, nes	31,262
25	Manufactures of base metal, nes	30,878
26	Computers	29,282
27	Organo-inorganic compounds	28,380
28	Primary ethylene polymers	27,192
29	Mechanical handling equip & parts	26,996

30	Carboxylic acids & derivatives	26,399
31	Primary polyacetals	26,229
32	Miscellaneous chemical products, nes	25,471
33	Uncoated flat-rolled iron & steel	25,370
34	Computer parts & accessories	23,257
35	Fertilisers (excl crude)	23,109
36	Sound & video recorders	23,070
37	Steam & other vapour turbines	21,557
38	Taps, cocks & valves	21,168
39	Primary styrene polymers	20,993
40	Flat-rolled alloy steel	20,192
41	Synthetic fibres	20,140
42	Pumps (excl liquid pumps) & parts	19,866
43	Knitted or crocheted fabrics	18,191
44	Paper & paperboard, cut to size	16,916
45	Mineral manufactures, nes	16,752
46	Electrical circuits equipment	16,573
47	Nitrogen-function compounds	16,313
48	Tractors	16,290
49	Specialised machinery & parts	16,131
50	Edible products & preparations, nes	15,614

Note: f.c.f. = fresh, chilled or frozen; Partner country data has been adjusted from a cif basis to a fob basis.

Source: DFAT STARS Database, based on ABS Cat No 5368.0, May 2011 data; ABS Special Data Service; Korean customs data on the GTIS Global Trade Atlas database; DFAT STARS Database, based on ABS Cat No 5368.0, May 2011 data.

Australian Government
Department of Foreign Affairs and Trade

Australian Government
Austrade

Inquiry by the Joint Standing Committee on Foreign Affairs, Defence and Trade into Australia's Trade and Investment Relationship with Japan

Submission by the Department of Foreign Affairs and Trade
and the Australian Trade Commission

July 2011

Contents

Abbreviations

ABS	Australian Bureau of Statistics
ACTA	Anti-Counterfeiting Trade Agreement
AJBCC	Australia-Japan Business Cooperation Committee
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
BOT	Build, Operate and Transfer
BSE	Bovine Spongiform Encephalopathy
CEPEA	Comprehensive Economic Partnership in East Asia
CSQ	Country Specific Quotas
EAFTA	East Asia Free Trade Agreement
EAS	East Asia Summit
ECA	Export Credit Agency
EFIC	Export Finance and Insurance Corporation
EPA	Economic Partnership Agreement
ETM	Elaborately Transformed Manufactures
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
FIRB	Foreign Investment Review Board
FTA	Free Trade Agreement
G20	Group of Twenty
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GPIF	Japan's Government Pension Investment Funds
IP	Intellectual Property
JABCC	Japan-Australia Business Cooperation Committee
JETRO	Japanese External Trade Organisation
LNG	Liquefied Natural Gas
MAFF	Japanese Ministry of Agriculture, Forestry and Fisheries
METI	Japanese Ministry of Economy, Trade and Industry
MFN	Most Favoured Nation
MRL	Maximum Residue Limits
NAMA	Non-agricultural Market Access
OECD	Organisation for Economic Cooperation and Development
PPP	Public Private Partnership
TPP	Trans-Pacific Partnership
SPE	Sanitary and Phytosanitary
STE	State Trading Enterprise
STM	Simply Transformed Manufactures
TRIPS	Trade-related Aspects of Intellectual Property Rights
WHO	World Health Organisation
WTO	World Trade Organization

Inquiry by the Joint Standing Committee on Foreign Affairs, Defence and Trade into Australia's Trade and Investment Relationship with Japan and the Republic of Korea

Submission by the Department of Foreign Affairs and Trade and Austrade

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On 21 April 2011 the Minister for Trade, The Honourable Dr Craig Emerson MP, asked the Committee to inquire into and report on Australia's trade and investment relationship with Japan and the Republic of Korea.

The following submission is made by the Department of Foreign Affairs and Trade (DFAT) and the Australian Trade Commission (Austrade). The submission provides an overview of Australia's trade and investment relationship with Japan. It accompanies a second submission, also made by DFAT and Austrade, on Australia's trade and investment relationship with the Republic of Korea. Both submissions address the inquiry's terms of reference:

> *The Trade Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defence and Trade will inquire and report on Australia's trade and investment relations with Japan and the Republic of Korea with particular reference to:*
>
> - *the nature of Australia's existing trade and investment relations;*
> - *emerging and possible future trends in these relations;*
> - *barriers and impediments to trade and investment with Japan and the Republic of Korea for Australian businesses;*
> - *opportunities for deepening existing commercial links, and developing new ones, with Japan and the Republic of Korea; and*
> - *the role of the government in identifying new opportunities and assisting Australian companies to access existing and potential opportunities in Japan and the Republic of Korea.*

Overview

Japan has been Australia's closest and most consistent partner in Asia for decades, and the relationship is of fundamental importance to both countries' strategic and economic interests. Prior to 2009, Japan was Australia's largest export destination for a period spanning over 40 years, and it should remain our second-largest trade partner by a considerable margin for a long time to come.

The rising economic power of China and India – and the overwhelmingly positive impact that their growth has had on Australia's economy – does not diminish Japan's economic importance to Australia. Two-way trade with Japan in 2010 was worth \$66 billion,[1] equivalent to more than five per cent of Australia's gross domestic product (GDP). Exports were worth \$45.7 billion, while imports were worth \$20.4 billion. In addition to bilateral trade, demand for Australian goods and services in faster-growing Asian economies is also being generated by Japanese offshore firms. Japan is Australia's third-largest source of foreign investment and Japanese investment has been crucial in the development of some of Australia's key industries. Chapter one provides an overview of Australia's current trade and investment relationship with Japan.

Though already substantial, there are challenges and opportunities in Australia's economic relationship with Japan. This submission outlines a number of key events and emerging trends that will influence the relationship in coming years.

At the forefront is the Japanese Government's enormous challenge in managing the recovery and reconstruction effort following the terrible 11 March earthquake and tsunami disaster, and the subsequent problems at the Fukushima Daiichi nuclear-power plant; and how this challenge will impact on the Japanese Government's pursuit of much-needed broader economic and trade reforms.

Prior to 11 March, in November 2010, the Japanese Government unveiled an ambitious new Basic Policy on Comprehensive Economic Partnerships. The Policy outlines a plan of trade liberalisation, including the early conclusion of Free Trade Agreement negotiations with Australia, backed by domestic economic reforms. It aims to rejuvenate Japan's economy – characterised in recent years by low growth and weak domestic demand – by deepening Japan's economic relationships with 'Asian and emerging countries…and resource-rich countries'.[2]

Understandably, the Japanese Government's focus in recent months has been on handling the aftermath of the earthquake, and it has had to delay progress on implementing elements of the Basic Policy. Nevertheless, the continued pursuit of

[1] All figures in this submission are in nominal Australian dollars, unless otherwise noted.
[2] Japanese Ministerial Committee on Comprehensive Economic Partnerships, *Basic Policy on Comprehensive Economic Partnerships*, Japanese Ministry of Foreign Affairs, Tokyo, 2010

trade liberalisation and economic reforms remains strongly in Japan's – and Australia's – long-term interests, and the Australian Government will continue to advocate for this reform. An economically strong Japan is unambiguously good for Australia, and the broader Asia-Pacific region.

While exports and imports equate to almost 30 per cent of Japan's GDP, it still maintains a significant number of barriers to trade and investment, especially in sectors considered sensitive, such as agriculture. These barriers are discussed in chapters two and three.

Chapter four outlines opportunities for Australian businesses to deepen commercial links with Japan. The events of 11 March provide Australia with an opportunity to support Japan's process of reconstruction and reform. A wide-ranging debate on energy policy is likely in Japan in the coming months, and Australia – as an established and reliable exporter of energy and a partner in energy efficiency – is well positioned to help Japan to meet its future energy needs. Changes to Japan's food supply chain, including by diversifying production offshore, could see opportunities for Australian companies to assist Japanese firms in managing and leading offshore operations, and to provide supply-chain advisory services based around contingency planning. The Australian education sector may be able to support both Japan's efforts at internationalising tertiary education and its training needs for a more global workforce.

Beyond this, there are further areas with particular potential for deepening ties. There is scope to increase bilateral services trade, including in business and financial services, construction, logistics, education, tourism, and other services. There are opportunities for infrastructure cooperation to take advantage of Australian firms' expertise in finance and Japanese firms' strength in construction, whether in Australia, Japan or third countries.

Concerns around food safety and traceability have increased substantially in Japan, owing to a rising number of food product scares in recent years, and Australia's already strong reputation as a reliable supplier of high-quality food products provide an opportunity for food exporters to expand their market share. Japan has shown an increased interest in investments in Australia's rare-earths sector, as it seeks to secure a stable and diversified supply of these raw materials. Japanese retail sales are generally weak, but on-line retailing is one of the few growth areas in Japan and opportunities exist for Australian firms in this area. And Japan's drive for international competiveness can be well supplemented by Australia's exports of education services, including in English language ability, cross-cultural understanding and global leadership skills.

Deepening commercial links – and developing new ones – need not occur only in Japan or Australia. The size of the Australia-Japan two-way trade may be Australia's second-largest, but it still does not reflect the entirety of the economic relationship.

Increasingly, Australian companies are exporting to Japanese firms in third countries, including China. There is notable potential for Australia to benefit from strong existing trade links and shared business culture with Japan to build partnerships with Japanese companies to win business in third markets.

Chapter five discusses the Australian Government's role in advancing Australia's trade and investment relationship with Japan. The Department of Foreign Affairs and Trade (DFAT) and the Australian Trade Commission (Austrade) continue to work to ensure that opportunities in the Japan-Australia economic relationship are identified, developed and utilised. DFAT facilitates frequent ministerial contact between the two governments and supports ministerial initiatives, including the Japan and Australia Trade and Economic Ministerial Dialogue. In light of the Government's new Trade Policy Statement, *Trading our way to more jobs and prosperity,* a high priority for DFAT continues to be working with Ministers and with Japanese Government officials to develop a comprehensive, high-quality and mutually-beneficial Free Trade Agreement. DFAT is also cooperating with Japanese officials in regional and international organisations that have an economic and trade component, including the World Trade Organization (WTO), APEC, the G20, and the East Asia Summit (EAS).

Austrade continues to provide extensive coverage in Japan, providing in-market support to Australian businesses, generating new Japanese investment leads, and developing initiatives and opportunities that will deliver the greatest value add for Australian business. Austrade's approach is predicated on viewing Japan's challenges as opportunities for renewed or new engagement with Australia, and are primarily driven by Japan's need for minerals and energy security; food security; solutions to its aging population and declining productivity; technological leadership as a competitive edge; and developing new markets in growing economies.

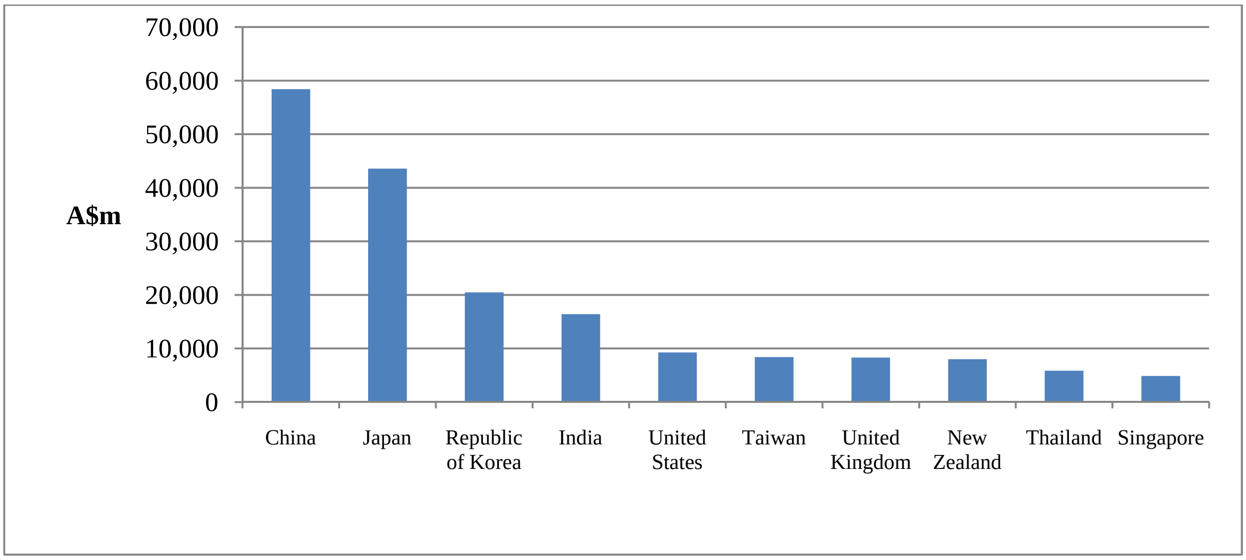
Chapter One
Australia's Trade and Investment Relationship with Japan

1.1 Australia's goods trade with Japan

1.1.1 Australian merchandise exports to Japan

Japan is a crucial partner in Australia's goods trade and will remain so for the foreseeable future. Japan bought almost 19 per cent of Australian goods exports in 2010, worth $43.6 billion, more than India, the United States, the United Kingdom and New Zealand combined.

Figure 1.1 Australia's top ten goods export markets, 2010



Source: DFAT STARS database.

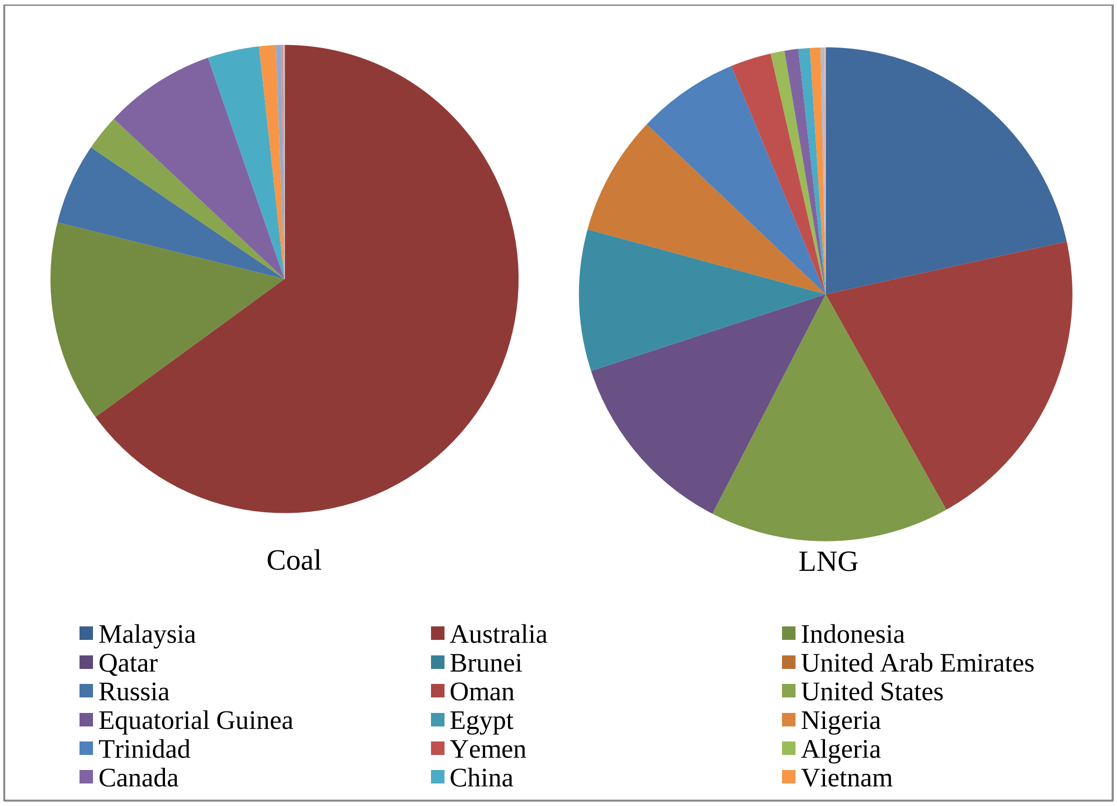
Table 1.1 Australia's ten leading goods exports to Japan by value, 2010

Rank	Commodity	A$000
	Total exports to Japan	**43,575,661**
1	Coal	14,835,418
2	Iron ore & concentrates	8,598,753
3	Natural gas*	7,752,134
4	Beef	1,721,764
5	Aluminium	1,558,697
6	Copper ores & concentrates	1,101,177
7	Crude petroleum	933,783
8	Wood in chips or particles	790,688
9	Liquefied propane & butane	647,347
10	Cheese & curd	373,253

Source: DFAT STARS Database, based on ABS Catalogue 5368.0.
*DFAT estimate based on partner country data.

Australian exports provide significant shares of strategic imports for Japan, particularly in energy and resources (see Appendix One for a list of Australia's top 50 merchandise exports to Japan). Japan is only 4 per cent energy self sufficient, and is the largest importer of both coal and liquefied natural gas (LNG) in the world.[3] Australia was Japan's largest source of coal in 2010; indeed, imports from Australia were larger than those from all other countries combined (see Figure 1.2). Over the same period, Australia was Japan's second-largest supplier of LNG. In minerals, Australia provided 65 per cent of Japan's iron ore in 2009-10, 22 per cent of Japan's uranium, and was the third-largest supplier of copper ores. Japan was also Australia's largest buyer of unwrought aluminium, silver and platinum.

Figure 1.2 Japan's coal and LNG imports by country value, 2010



Source: Japan Ministry of Finance trade database

As well as contributing to Japan's energy and resource needs, Australia has proven itself a safe and reliable provider of food and food products to Japan. Beef and bovine exports were worth $2.02 billion in 2009-10, consisting mainly of chilled and frozen beef ($1.83 billion), bovine offal ($176.2 million) and live cattle ($17.4 million).[4] That year, Japan accounted for 42 per cent of the value of Australia's global beef

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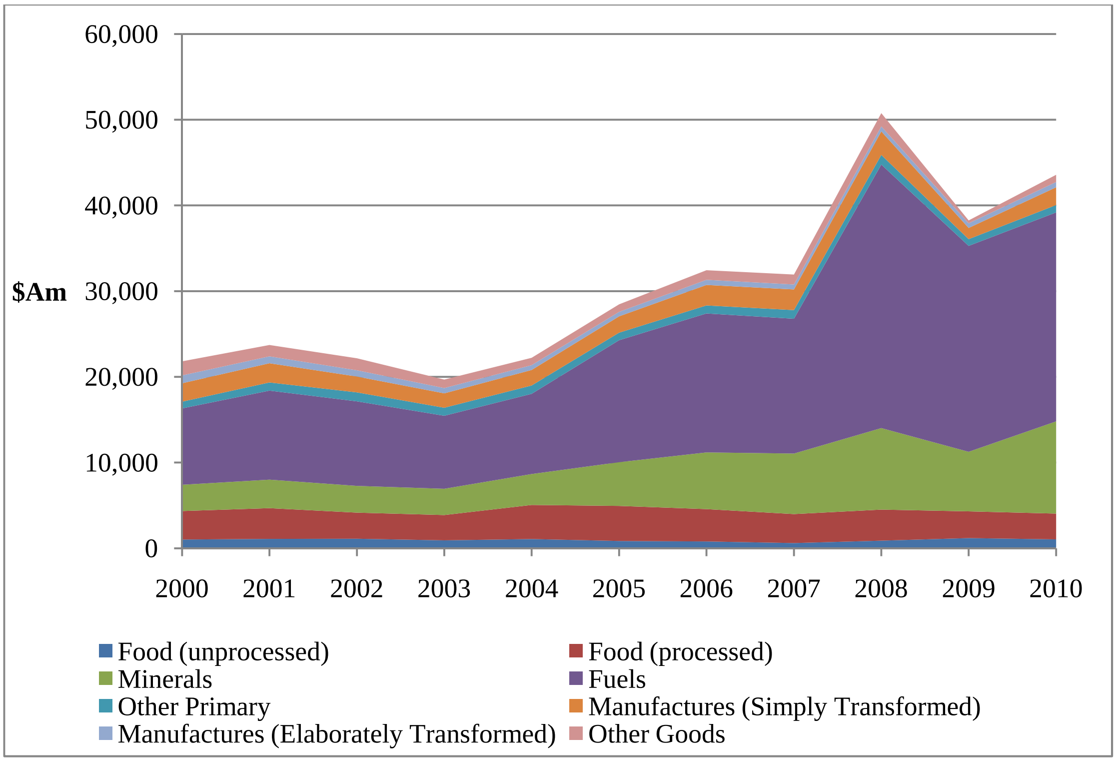
[3] Japanese Ministry of Economy, Trade and Industry, *Promoting independent development and diversifying sources*, Japanese Ministry of Economy, Trade and Industry, 2011; and United States Energy Information Administration, *Japan Country Analysis Brief*, United States Energy Information Administration, Washington D.C., updated March 2011.

[4] Japanese Department of Agriculture, Forestry and Fisheries and Japanese Ministry of Finance Trade statistics. The live cattle figure includes a small number of live water buffaloes.

exports, and Australia secured a 75.6 per cent share of Japan's beef import market – supplying 43 per cent of the entire Japanese beef market. Much of this market share has been gained since September 2001, when an outbreak of bovine spongiform encephalopathy (BSE) in Japan precipitated major herd reductions and a significant deflation of consumer confidence. Two years later, in December 2003, Japan imposed import restrictions on US and Canadian beef in response to BSE outbreaks in those countries. In the face of these developments, and drawing on Australia's strong record of food safety, Australian exporters were able to fill Japan's supply shortage.

The value of Australia's goods exports to Japan continue to grow in absolute terms, despite over a decade of limited economic growth in Japan. Since 2000, Australian merchandise exports to Japan have more than doubled, outpacing growth in other established markets such as the United States and New Zealand.

Figure 1.3 Australia's merchandise exports to Japan by broad sector



Source: DFAT STARS database. The graph includes DFAT estimates for confidential items, including salt, LNG and nickel.[5]

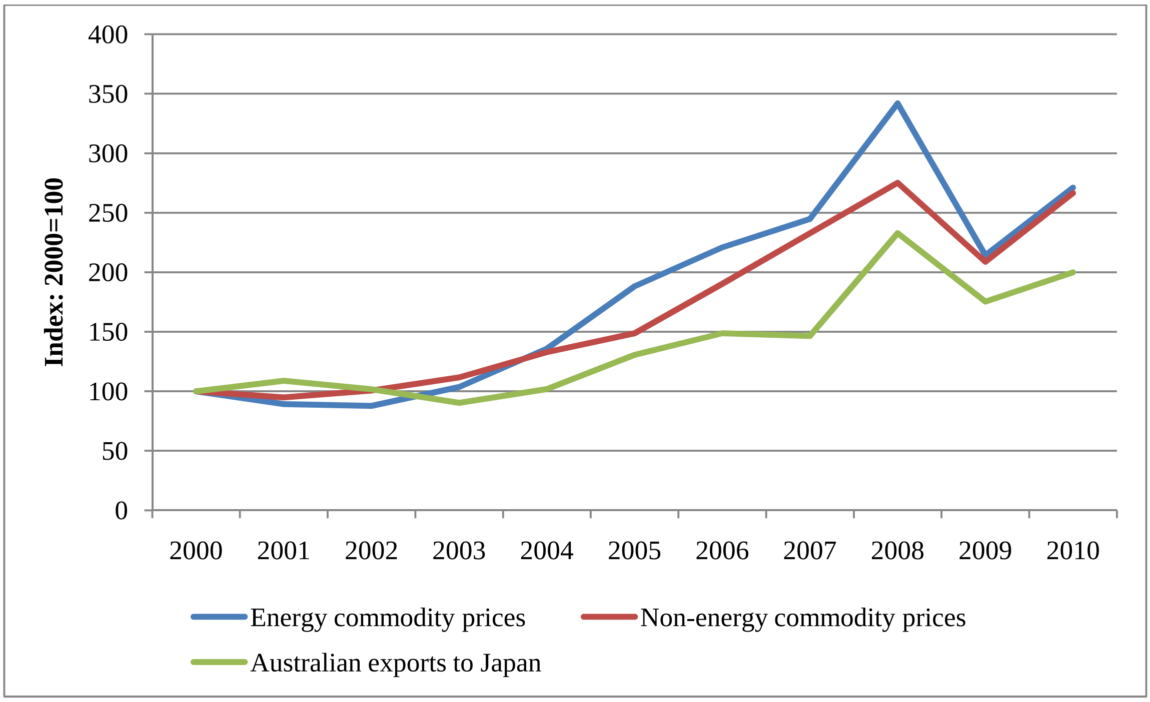
Figure 1.3 provides an overview of the changes in the composition of Australian exports over the past decade. Fuels – including coal and natural gas – and minerals have lead the growth, increasing three-fold and four fold on 2000 levels respectively.

[5] Confidentiality provisions of Commonwealth legislation constrain the publication by the Australian Bureau of Statistics (ABS) of some trade activity. Data here are derived from the Japanese Ministry of Finance. Further information on how DFAT statistics are formulated can be found in the DFAT publication *Confidentiality in Australian Merchandise Statistics*, May 2009, available at: http://www.dfat.gov.au/publications/stats-pubs/confidentiality-in-australian-merchandise-export-statistics.pdf

In 2010, resources and energy comprised 85 per cent of the value of Australia's total exports to Japan. The notable fluctuation in the last four years of export statistics can largely be explained by annual variations in commodity prices, as Figure 1.4 makes clear.

Food exports have remained largely constant since 2000, with manufactures declining slightly. However, these figures do not fully reflect the level of contact between Australian and Japanese firms in these industries. An increasing amount of Australian exports are going to firms in regional countries where Japanese companies are prominent investors, including China, with their output being sold on to Japan and other countries. This trend is explored in more depth in Box 1.1.

Figure 1.4 Commodity prices and the value of Australian exports to Japan, 2000-2010



Source: DFAT STARS database, World Bank *Prospects* commodity database

1.1.2 Japanese merchandise exports to Australia

On the other side of the ledger, Australia has been a large importer of Japanese products throughout the post-war period (see Appendix Two for a list of Australia's top 50 merchandise imports from Japan). Japan was Australia's third-largest source of merchandise imports in 2010, after China and the United States, worth $18.2 billion. Growth in Australian imports from Japan outpaced those from the United States and the United Kingdom over the past ten years. The propensity of Australians to buy Japanese goods is also high compared to Japan's other developed trading partners. Growth in per-capita purchases has also been relatively rapid in recent times (Table 1.2).

Table 1.2 Value of Japan's exports per capita in importing country 2002 and 2007 (US$ p.a.)[6]

	2002	2007
Australia	435.0	716.9
New Zealand	455.3	687.4
United States	432.6	494.8
United Kingdom	215.0	256.5
China	41.6	101.4

Sources: UN data on the DFAT STARS database; IMF World Economic Outlook database.

The connection is particularly strong in the automotive sector, which dominates Japanese exports to Australia. Many more passenger motor vehicles are imported into Australia from Japan than from any other country, and Japanese firms are major investors in the industries of other key countries supplying these products to Australia, including Thailand (our fourth-largest source in 2010). Japan is also the largest exporter of motorcycles, rubber tyres and vehicle parts to Australia, and the second-largest source of imported vehicles for transporting goods (after Thailand, where Japanese investment again plays a major role in production) and other motor vehicles. Despite its relatively small population, Australia is the third-largest market for new passenger motor vehicles manufactured in Japan.

Australia has long had a sizable trade surplus (exports of goods and services minus imports) with Japan. Over the past decade, Australia's trade surplus with Japan has consistently been our largest with any country. It was again in 2010 – at $25.3 billion – contributing substantially to Australia's record trade surplus of $16.8 billion.[7]

[6] Differing exchange rates can strongly influence these types of comparisons.
[7] See DFAT, 2011, *Trade in Primary and Manufactured Products Australia 2010*, Department of Foreign Affairs and Trade, Canberra.

Box 1.1 Third markets and the Australia-Japan trade

Sophisticated economies such as Japan are increasingly specialising in design, engineering, management and high value-added components. Japanese corporations are seeking to take advantage of lower-cost production in other Asian economies, particularly China – moving from a made-in-Japan model to a made-by-Japan model.

In doing so, Japanese companies have created supply chains across the region. A product may be designed in Japan, from components made in Japan, China and elsewhere, then assembled in China before finally being re-exported to Japan, Australia or other countries. These regional production networks result in extensive trade and investment flows, as semi-finished (or intermediate) goods exported and re-exported across borders. While difficult to measure, the World Trade Organization has pointed out that both China and Japan are increasing their trade in intermediate goods.[8]

As well as exporting energy and resources to Japan, Australia is exporting inputs directly into these supply chains, including in China. ANU Emeritus Professor Peter Drysdale cites the example of Australian exports of wool: 'Japan used to be our main export market for wool. Now the largest market is China, where imports are processed not only by Japan-invested but also Chinese enterprises for home consumption in China but also, significantly, for export to the still large Japanese market for woollen clothing.'[9]

In this way, Japan's multinationals are playing a role in Australia's increasing trade with China and the rest of Asia. The opportunities for Australia and Japan from this trend are explored in Chapter four.

1.2 Australia's services trade with Japan

Australia's bilateral services trade with Japan in 2010 was worth $4.3 billion, made up of $2.08 billion in services exports and $2.2 billion in services imports. Japan ranks as Australia's seventh-largest two-way services trading partner, behind the United States, the United Kingdom, China, New Zealand, Singapore and India. Japan is our fifth-largest source of services imports and seventh-largest services export destination. Tourism, transport and education services make up the bulk of both Australia's services exports and imports.

[8] World Trade Organisation & IDE-JETRO, 2011, *Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks*, Geneva, pp 78-91

[9] Peter Drysdale, 2009, *Australia and Japan: A New Economic Partnership in Asia*, report prepared for Austrade, Canberra, p 3

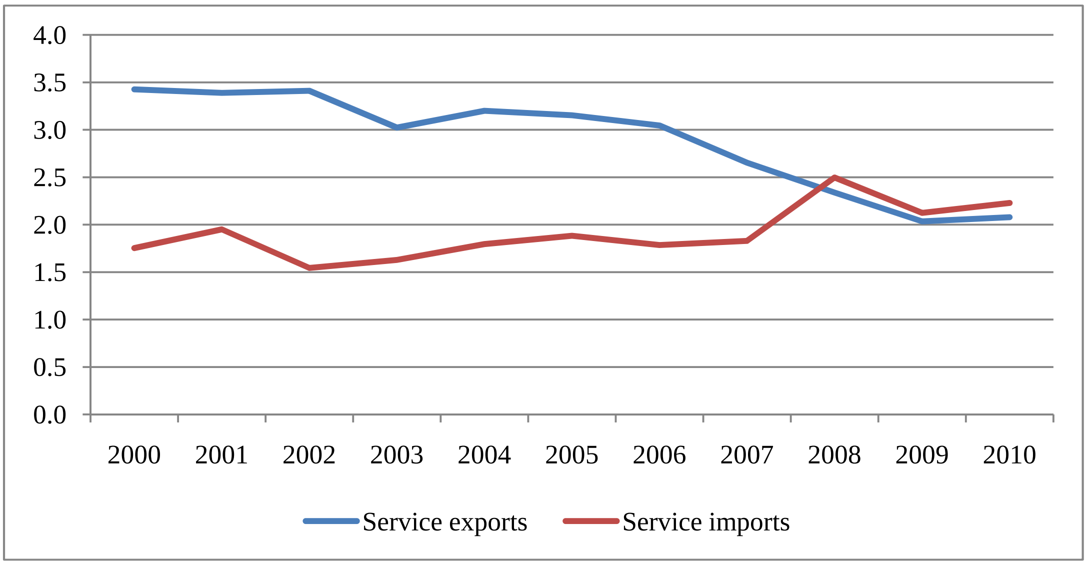
Table 1.3 Australia's services trade with Japan, 2010

Services item	Exports (A$m)	Imports (A$m)	Total (A$m)
Travel services (includes business, personal and education-related travel)	1,214	539	1,753
Transport services	578	1,002	1,580
Other business services	150	323	473
Charges for the use of intellectual property	30	279	309
Financial services	24	22	46
Insurance & pension services	23	10	33
Telecom. computer & information services	23	20	43
Personal, cultural & recreational services	18		18
Government services	10	30	40
Construction services	9		9
Other	-	4	4
Total	2,079	2,229	4,308

Source: DFAT STARS database

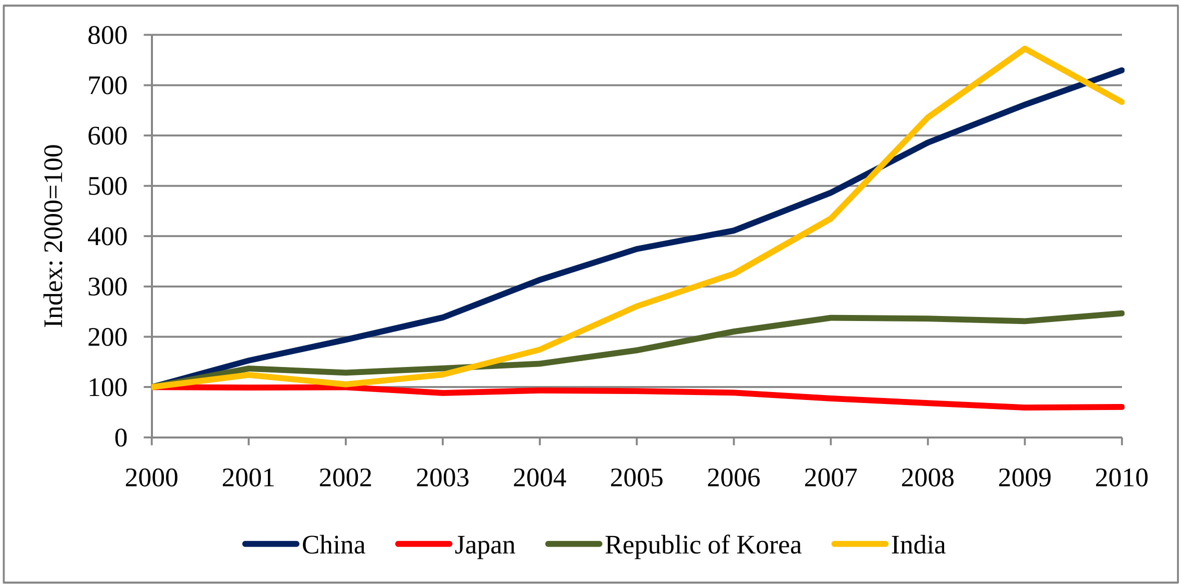
Australia's services exports to Japan have shown a steady downward trend over the last ten years, falling from a $3.4 billion in 2000 to $2.08 billion in 2010. Services imports have grown slightly. This has occurred at a time when Australia's services exports to other major trade partners in Asia have grown significantly.

Figure 1.5 Australia's services trade with Japan since 2000 (A$ billion)



Source: DFAT STARS database.

Figure 1.6 Australia's services exports, selected Asian countries, 2000-2010



Source: DFAT STARS database.

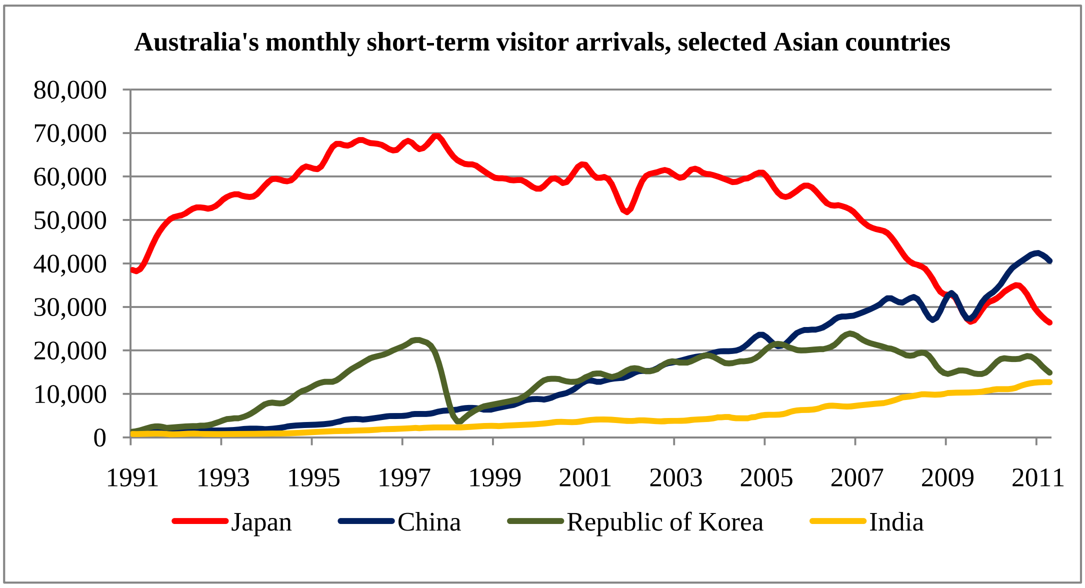
A significant part of the decline in Australia's overall services exports to Japan is explained by the steady decline in Japanese tourism since the mid-1990s. This trend reflects changing economic circumstances and consumer behaviour in Japan, as well as competition from other tourism markets. The total inbound economic value of Japanese tourism to Australia fell to $1.2 billion in 2010 from a peak of $2.2 billion in 2000[10]. Prior to the 11 March earthquake there had been a 5 per cent increase in visitor numbers in the year ending in April 2011. Following the disaster, however, visitor numbers have dropped again, as Japanese travellers defer overseas trips, and the outlook remains unclear.

Japanese student numbers in Australia have also declined in recent years, from over 14,000 in 2002 to 9,200 in 2010. Japan is now Australia's twelfth-largest source of international students, down from seventh in 2007. Australian Education International attributes this trend in part to increasing opportunities for Japanese students to enter domestic universities as Japan's youth population declines, and in part due to the increased relative cost of studying abroad. There is also a potential emerging cultural trend for young Japanese to be less inclined than in the past to study overseas. Japan's population of 18-year-olds has decreased by an annual average of 2.85 per cent since 1992, and by 2020 the 18-year-old population is forecast to decline to 1.16 million.[11]

Another factor in Australia's declining services exports to Japan has been the difficulties Australian firms encounter in entering Japan's services market (see 2.3).

[10] Tourism Research Australia.
[11] Australian Education International, *Market Data Snapshot: Japan*, Australian Education International, Canberra, 2009

Figure 1.7 Australia’s monthly short-term visitor arrivals, selected Asian countries



Source: ABS Data Catalogue 3401.0

Box 1.2 Analysis: Australia-Japan services trade

The relatively low absolute value of Australia-Japan services trade in comparison with overall bilateral trade is consistent with worldwide trade patterns, in which services tend to be significantly less traded than merchandise goods. But it is also reflective of two factors specific to Australia and Japan. First, Australia is not a big exporter of services. Services make up approximately 80 per cent of Australian GDP, and 85 per cent of total employment, but only 18.4 per cent of Australia's exports to the world. Australia's bilateral services trade with Japan is below this average, making up 6.9 per cent of total two-way trade.

Second, Japan is not a big importer of services. Japan's services sector accounts for about 80 per cent of Japan's economy, and 78 per cent of employment, but trade in services equates to only around 5.5 per cent of Japan's GDP, compared to an average of 11.4 per cent among OECD members.[12] The WTO considers that Japan's services sector "has been protected from foreign competition… in large part through restrictive internal regulations, such as licensing, restrictions on foreign investment, and generally the high cost of doing business in Japan".[13] Section 2.3 contains a description of some of Japan's barriers to services trade.

Nevertheless, a number of Australian services firms are entering the Japanese market with globally competitive management techniques and professional services. For example, in 2009, Toll Holdings acquired Footwork Express, a Japanese logistics firm with over 5,000 employees. In 2010, Blake Dawson became the first Australian law firm to open an office in Japan to provide legal services to Japanese corporations investing in Australia.

There is clearly scope to increase bilateral services trade, including in business and financial services, construction, logistics, education, tourism, and other services. Opportunities for increasing Australia's services trade with Japan are discussed in Section 4.3.

1.3 Australia-Japan investment

1.3.1 Japanese investment in Australia

Japan has been Australia's third-largest foreign investor for many years, after the United States and the United Kingdom. The total stock of Japanese investment in Australia at the end of 2010 was worth $117.6 billion, almost twice as large as the

[12] World Bank data at http://data.worldbank.org

[13] World Trade Organization, *Trade Policy Review of Japan*, Report by the Secretariat, World Trade Organization, Geneva, 2011, p 85.

sum of investment from China (including Hong Kong) at approximately $61 billion.[14] Japan is one of Australia's fastest-growing sources of foreign investment. Total investment grew by $15 billion (14.7 per cent) in 2010, and has more than doubled since 2001. Over 40 per cent ($49 billion) of the stock of Japanese investment in Australia is foreign direct investment (FDI).

Under Australia's foreign investment policy, Japanese investors receive treatment as equally favourable as that afforded to other foreign investors.[15] Generally, investments by Japanese companies only require notification to the Foreign Investment Review Board (FIRB) if they involve an interest of 15 per cent or more in an Australian business valued at above $231 million.[16] Foreign investment arrangements are being discussed in Australia's Free Trade Agreement negotiations with Japan.

Table 1.4 Total stock of foreign investment in Australia – top 10 sources ($Am)

	2009	2010	Rank in 2010	2009 to 2010 % change	% share of total stock in 2010
Total	**1,907**	**1,968**	**NA**	**3.2**	**100.0**
United States	515	550	1	6.8	27.9
United Kingdom	499	473	2	-5.3	24.0
Japan	103	118	3	14.7	6.0
Singapore	41	44	4	6.5	2.2
Netherlands	43	42	5	-2.3	2.1
Hong Kong (SAR of China)	43	41	6	-5.6	2.1
Germany	38	41	7	6.6	2.1
Switzerland	32	41	8	26.4	2.1
New Zealand	32	34	9	6.6	1.7
France	23	24	10	3.9	1.2
China	17	20	12	17.4	1.0

Source: ABS catalogue 5352.0

Japanese investment has been crucial in the development of many of Australia's key export industries and, consequently, central to Australia's own prosperity. Since the early 1960s, long-term contracts from Japanese users of minerals and energy, and investment by Japanese trading houses, have enabled the development of mines and gas fields for export markets, both in Japan and third countries. One well-known

[14] Investment is difficult to measure accurately for a number of reasons, including the difficulty in verifying the source country and accurately capturing foreign companies' borrowings and reinvested earnings. Data here is drawn from the Australian Bureau of Statistics and the Japanese Ministry of Finance and the Bank of Japan databases.
[15] Except for United States investors, who are subject to higher thresholds as negotiated under the Australia-United States FTA.
[16] Some thresholds are lower for investments in real estate and media, and investments by foreign governments. See http://www.firb.gov.au

example is the one-sixth interest of Japan Australia LNG (MIMI) Pty Ltd (jointly owned by Mitsubishi and Mitsui) in the North West Shelf gas fields.

Over time, Japan's FDI into Australia has diversified beyond the traditional resources sector, making a significant contribution to the development of Australia's manufacturing, agriculture and tourism sectors. Since 2004, Toyota Australia has invested more than $800 million in its Australian manufacturing facilities in order to launch new models and increase production capacity. In 2009, the Nippon Paper Grouped acquired Paper Australia for $600 million, and Sekisui House, one of Japan's largest homebuilders, completed a $190 million joint venture with Payce Consolidated to construct 4,500 sustainable homes in Homebush Bay, NSW and Ripley Valley QLD. Japanese companies have also made a number of substantial investments in Australia's food sector. Recent examples include the Asahi Group's 2011 announcement that it would buy a stake in P&N Beverages Australia for approximately $188 million, following its earlier purchase of Schweppes Australia for $1.19 billion in April 2009. Japanese beverage maker Kirin acquired Dairy Farmers for $910 million in December 2008 and Lion Nathan for $3.5 billion in June 2009. An earlier wave of Japanese investment in Australia's tourism industry played an important role in establishing Australia as a major holiday destination, including for Japanese holiday-makers.

Over half of Japanese investment approved by FIRB in 2009-10 was in Australia's manufacturing sector. A further one-third of FIRB-approved Japanese investment was in Australia's mineral exploration and development.[17] Around six per cent was in real estate.

Table 1.5 FIRB-approved Japanese investment in Australia by industry sector, 2009-10

Industry Sector	Value (A$m)	%
Agriculture, forestry & fishing	150	2.5
Finance & insurance	350	5.8
Manufacturing	3,149	52.2
Mineral exploration & development	2,011	33.4
Real estate	368	6.1
Services	-	0.0
Total	6,028	100.0

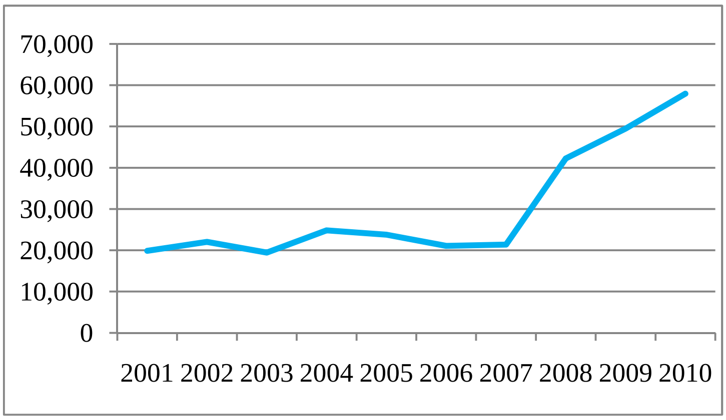
Source: Foreign Investment Review Board, Annual Report 2009-10

In addition to FDI, portfolio investment from Japan is also growing. The concurrence of Australia's need for external capital to finance economic development and Japanese savers' desire to find higher returns than are available domestically has

[17] Statistics relate only to those proposed investments that fall within the scope of the Foreign Acquisitions and Takeovers Act 1975 and Australia's Foreign Investment Policy, and therefore are not a measure of actual or total foreign investment.

resulted in a significant expansion of Japanese portfolio investment by both Japanese mutual funds and personal investors. At the end of 2010, the stock of Japanese portfolio investment in Australia was $56.7 billion. The stock was $19.9 billion in 2001, equating to an annual average growth rate of over 12 per cent since then. Japanese funding was particularly important to Australian banks and corporations during the 2008-09 financial crisis, when other offshore sources of funds tightened significantly. Bonds issued in Japan represented 13 per cent of total Australian bond issuance overseas in 2008, up from levels of around 4 per cent during the previous seven years.

Figure 1.8 Japanese portfolio investment in Australia (A$m)



Source: ABS catalogue 5352.0

1.3.2 Australian investment in Japan

Japan is Australia's seventh-largest destination for foreign investment, with a total stock worth $29 billion at the end of 2010. Portfolio investment made up over two-thirds ($20.4 billion) of this. The stock of direct investment was worth approximately $520 million[18]. Australia was Japan's fifteenth-largest source of FDI, with just under 0.5 per cent of Japan's total FDI stock.[19] Notwithstanding the relatively low base, Australia's FDI stock in Japan has grown by 80 per cent since 2000.

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[18] A number of other investment components are not released in the ABS' investment data, so the total of direct and portfolio investment sum to less than the total stock of Australian investment in Japan.
[19] Based on data from the Japanese External Trade Organisation (JETRO).

Table 1.6 Total Australian investment abroad – top 10 destinations (A$ billion)

	2009	2010	Rank in 2010	2009 to 2010 % change	% share of total stock in 2010
Total	**1,132**	**1,186**	**NA**	**4.8**	**100**
United States	403	410	1	1.7	34.6
United Kingdom	179	192	2	7.7	16.2
New Zealand	80	74	3	-7.2	6.2
Canada	37	39	4	6.6	3.3
Germany	38	37	5	-1.1	3.1
France	28	29	6	5.7	2.5
Japan	32	29	7	-7.9	2.5
Singapore	26	25	8	15.7	2.1
Netherlands	26	25	9	-6.9	2.1
Hong Kong (SAR of China)	28	23	10	-16.9	2.0
China	6	12	15	87.7	1.0

Source: ABS catalogue 5352.0

The comparatively small stock of Australian FDI is consistent with the low levels of direct investment from all sources into Japan. FDI into Japan remains substantially lower than Japan's outward FDI, and is low overall compared with other developed economies[20] (see section 5.3.4 for more details on investment barriers in Japan).

1.4 Emerging trends

The Japanese economy has for some years been characterized by low growth rates and weak domestic demand, resulting in a heavy dependence on exports (which made up 15.2 per cent of Japan's GDP in 2010) and external sources of corporate profit.

Structural rigidities in a range of sectors and severe demographic problems will hamper Japan's economic growth going forward. Japan's working-age population has been declining since 1996, and is forecast to continue falling by an annual average of approximately one percent in the period 2011 to 2015[21]. As a result, Japan is seeking new ways to engage with key trading partners in Asia and beyond, and is re-considering its approach to a range of bilateral and multilateral trade agreements (see section 1.4.2) as it seeks to improve its competitiveness and responds to the increasing global competition for resources and energy. The strong yen and need to find alternative markets for growth will add momentum to outwards FDI from Japan in the medium term.

1.4.1 11 March earthquake and tsunami

On 11 March 2011, Japan was struck by a 9.0 magnitude earthquake, the fourth-largest recorded since 1900. The Great East Japan Earthquake and resulting tsunami devastated significant stretches of the Pacific coast of Tohoku (north east) area of

[20] World Trade Organisation, *op. cit.*, p 18
[21] Economist Intelligence Unit, *Japan economy: Demographic profile*, London, 2011

Japan's main island Honshu, with over 22,000 people killed or unaccounted for. Nuclear reactors located at the Fukushima Daiichi nuclear-power plant were severely damaged, resulting in radiation leaks in the immediate vicinity of the plants and ongoing restrictions to Japan's energy-supply capacity.

The disasters caused significant damage to Japan's energy infrastructure, with flow-on effects for global manufacturing and energy markets. The Japanese Government has responded by announcing the construction of new non-nuclear power stations and greater use of gas. It has also announced a review of Japan's Basic Energy Plan, giving renewable energy an increased role in Japan's future energy mix, alongside nuclear power and fossil fuels. Japan's response will have implications for Australia as a global resources and energy supplier, for future Japanese investment in Australia, and for Australia's partnership with Japan on low-emission and renewable-energy technologies.

Other industries affected by the disaster include agriculture and manufacturers of specialised electronic parts and equipment. Major disruptions occurred to supply chains throughout Japan in processed food, automobiles and manufactured products as specialised inputs and components were unable to be supplied from Tohoku. Minor damage was recorded in Tokyo (located over 250 kilometres from the earthquake's epicentre). Infrastructure and production facilities in other regions of Japan were unaffected.

Japan's economy is now technically in recession, with GDP declining by 0.9 per cent in the first quarter of 2011. Though negative GDP growth was always likely, given the large impact of the earthquake and tsunami on the economy, the scale of the drop was larger than most analysts had predicted. Negative growth is likely to continue in the second-quarter.

While the Japanese economy is likely to remain weak in the near-term, it has the capacity to bounce back. The tsunami-affected prefectures account for a relatively small share of Japan's GDP, and reconstruction efforts are eventually expected to drive a pick-up in economic growth. Further supplementary budget packages should provide further impetus to growth.

The disaster will affect the Australian economy in the short term primarily through lower coal and iron ore exports, because of damage to coal-fired power stations and steel-making plants. Treasury estimates a fall of around $2 billion in export earnings in 2010-11.

1.4.2 Japan's new approach to trade liberalisation

In November 2010, the Japanese Government launched an ambitious new policy on trade liberalisation and domestic economic reforms called the 'Basic Policy on Comprehensive Economic Partnerships'. The Basic Policy is the trade-policy platform of the Japanese Government's June 2010 'New Growth Strategy' to revitalise Japan's economy after nearly 20 years of low growth.

The Basic Policy's core elements include a commitment to promote high-level economic partnerships with major trading partners, specifying that Japan will 'subject all goods to negotiations for trade liberalisation'. It emphasises bilateral Free Trade Agreements (FTAs), and makes special mention of Japan's intention to increase efforts to conclude negotiations with Australia. It also recognises the need to reform Japan's agricultural sector and commits to initiating 'bold policies' to increase productivity.

Australia has welcomed the Japanese Government's moves towards trade liberalisation and economic reforms, including in agriculture. Trade Minister Dr Craig Emerson described the Basic Policy as "a profoundly important change in Japanese thinking, heralding a new commitment to opening up Japan to more trade, more economic engagement in the region and associated domestic economic reform."[22]

The Japanese Government has delayed progress on some elements of the Basic Policy to focus on handling the aftermath of the 11 March earthquake. A scheduled round of Australia-Japan FTA negotiations in April was postponed and Japan has delayed its announcement, originally due in June, on whether it will seek to join Trans-Pacific Partnership negotiations. Notwithstanding the tremendous challenges the earthquake has brought, Australia will continue to encourage Japan to pursue trade liberalisation and economic reforms as soon as it is able.

[22] "Emerson welcomes fresh start on Japan-Australia trade negotiations", Minister for Trade media release, 23 November 2010, available at http://www.trademinister.gov.au/releases/2010/ce_mr_101123.html

Chapter Two
Trade and Investment Barriers in Japan

Though Japan is a large trading nation it maintains a significant number of barriers to trade and investment, especially in sectors considered sensitive, such as agriculture. This chapter describes barriers and impediments to trade with and investment in Japan by Australian businesses.

2.1 Tariff barriers

2.1.1 Applied tariffs

Japan's average most-favoured-nation (MFN) applied tariff is 5.8 per cent. Tariffs are imposed on around 59 per cent of Japan's 8,826 tariff lines. Around 24 per cent of tariff lines have rates greater than zero, but less than or equal to 5 per cent; around 21 per cent have rates greater than 5 per cent, but less than or equal to 10 per cent; and 14 per cent have tariff rates above 10 per cent. In value terms, approximately 8 per cent of Australia's exports to Japan face tariffs (in 2009).

Japan's average MFN-applied tariff for agriculture is 15.7 per cent[23]. The rates vary considerably among different products, ranging from zero per cent for cut flowers up to a maximum tariff of 458 per cent for certain vegetables, such as broad beans. Most of Japan's tariff peaks are hidden behind specific tariffs (i.e. tariffs based on a unit), rather than ad valorem (or percentage) tariffs. For example, the specific tariff on racehorses is 3.4 million Yen (approximately $40,000) per head[24]. This converts to an applied tariff of 349.1 per cent. Specific tariffs cover 17.4 per cent of Japan's agriculture tariff lines. When converted to percentages, the simple average for these specific tariffs is 57.8 per cent.

Japan imposes tariffs on 78 per cent of its 2,393 agriculture tariff lines. This translates to tariffs being applied to 54 per cent of the total value of Japan's agriculture imports from Australia. Tariffs on Australia's major agriculture exports to Japan include up to 50 per cent for beef, up to 78.7 per cent for wheat, up to 218.6 per cent for raw sugar, up to 40 per cent for cheese, up to 66.1 per cent for milk powders, 16 per cent for oranges, and 15 per cent for wine. [25]

Japan's tariffs on non-agricultural products are low, with an average MFN-applied tariff of 3.5 per cent. The majority of Australia's non-agricultural exports to Japan (99 per cent by value in 2009) face zero tariff rates. Tariffs on significant Australian non-agricultural exports to Japan include 11.7 per cent, or 44 yen/kg for nickel, 6.3 per cent for ferro-manganese, 3.2 per cent for coke and semi-coke of coal, and

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[23] World Trade Organization, *op. cit.*
[24] Assuming a modest racehorse valuation of $11,460.
[25] Japan uses specific tariffs (i.e. XX yen/kg) for wheat, raw sugar and certain milk powders. Conversion into percentages will vary each year. The figures for wheat, sugar and milk powders do not take into account duties other than tariffs which are collected by the Japanese government under state trading.

3.3 per cent for aluminium hydroxide. Japan has higher tariffs in the area of leather, rubber, footwear and travel goods (average applied tariff of 14.5 per cent).[26]

2.1.2 Duties other than tariffs

Many of Australia's key agricultural exports to Japan, including wheat, barley, sugar and certain dairy products, attract duties other than tariffs. This is because Japan classifies these products as state-traded items, and duties such as mark-ups, surcharges and levies are applied through Japan's state trading system.

State traded items must first be sold to the Japanese government (or its agents), which then extracts a duty before selling the product onto Japanese end-users. In this way, the Japanese government can strictly control import volumes while extracting a rent (or revenue) from the transaction process.

The non-transparent nature of the state-trading system conceals the fact that in many instances, non-tariff duties are actually much higher than applied tariffs. So while some trade might appear *tariff free*, it is not necessarily *duty free*.

For example, most state-traded wheat, barley and sugar are actually tariff free, although mark-ups and surcharges can be as high as 271.6 per cent (in the case of certain types of raw sugar). State-traded dairy products such as butter and milk powders attract both a tariff and a mark-up: the total duty for butter is a combination of a tariff (35 per cent) and a mark-up (up to 164.2 per cent); for skim milk powder the total duty consists of a tariff (25 per cent) and a mark-up (up to 160.0 per cent).

In addition to the high level and non-transparent nature of the many mark-ups and surcharges which are applied, Japan's state-trading system also obstructs the direct interaction between sellers and buyers. This prevents many Australian exporters from strengthening their commercial relationships with Japanese customers.

2.2 Non-tariff barriers

In addition to tariffs, Japan manages imports through the use of complex safeguards and tariff-rate quotas (where a specified quantity of imports may occur in quota at a reduced or zero tariff) and safeguards.

2.2.1 Tariff-rate quotas

Japan operates 18 tariff-rate quotas covering 175 tariff lines, of which most pertain to dairy products and cereals. Methods for quota administration differ among products, and even within product groups. Quotas often involve *inter alia* a combination of tariffs, additional duties collected by state-trading enterprises, import licensing, end-use restrictions, and restrictive-eligibility criteria for quota applicants.

Australian exporters have described Japan's import-quota system as rigid, highly complex and opaque. For example, in the case of wheat, Japan operates two import systems, differentiating wheat class and shipment method. Under both systems, the

[26] World Trade Organization, *op. cit.*

Japanese Ministry for Agriculture, Forestry and Fisheries (MAFF) purchases wheat through tender processes, applies a mark-up and resells the wheat to a Japanese end-user. Operation and timing of the tenders are different for each system. The methodology for calculating the mark-up is not made public and tender volumes are based on MAFF projections. Australian exporters have highlighted the difficulty this system creates in forming commercial relationships with Japanese customers. Forward planning is also difficult as exporters have to make decisions based on times dictated by MAFF.

Quota administration for dairy products is equally complicated. Japan has a general-use quota administered by a state trading enterprise (STE) covering seven designated products: skim-milk powder and solids, whole-milk powder and solids, buttermilk powder and solids, condensed milk, whey, butter and butter oil, and dairy spreads. Under this quota, importers first pay a tariff before selling the product to the STE. The STE levies a mark-up, before reselling the product back to the importer. Additional conditions apply to specific products. MAFF administers a general-use or pooled quota and a number of other product-specific quotas to supplement the STE's general-use quota. Under MAFF's product-specific quotas, imports can only be used for specific purposes, for example skim-milk powder for school lunches; butter for in-flight meals; or cheese for processing[27] together with a minimum amount of domestic product. Tellingly in 2008, a country as wealthy as Japan experienced butter supply shortages because of the rigidity of its dairy import system.

2.2.2 Import quotas for fisheries products

The Japanese government directly controls the import volumes of certain fisheries products – including those of interest to Australia - through the administration of import quotas and licences. These quotas apply *inter alia* to yellowtail, herring, cod, mackerel, sardines, horse mackerel, cod roes, scallops, cuttlefish and squid. In-quota tariffs range from 3.5 to 15 per cent. Trade outside the quota is strictly prohibited.

For each quota, the government sets the overall import quota quantity at a level that limits the quantity of imported product to an amount deemed necessary to fill the expected gap between domestic demand and domestic production in the year concerned.[28]

Quotas are divided into sub-quotas, which have specific qualifying criteria and end-use restrictions. The sub-quota allocated on a first-come-first-served basis accounts for a very small proportion (in some cases, as small as 0.3%) of the total quota, which is otherwise unavailable. In this way, new exporters are prevented from accessing key sectors of Japan's fisheries market.

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[27] Cheese for processing is not technically a tariff-rate quota. Since it predates the Uruguay Round, it is actually a "quantitative restriction", but for ease of reference, the Japanese government calls it a tariff-rate quota.

[28] See subparagraph 6.II of Sub-Section I.A of "Marine Products", in Japan's *Replies to Questionnaire on Import Licensing Procedures*(WTO) (G/LIC/N/3/JPN/7 of 1 April 2009).

2.2.3 Gate-price system for pork

Japan's gate price system for pork strongly resembles a variable levy. If pork imports, priced at entry into Japan, are valued at or above a set price (called the gate-price), they are subject to a simple tariff of 4.3 percent. If their value is lower than the gate-price, the importer must pay the difference between the import value and the gate-price as a duty. The 4.3 per cent tariff is also applied. The sum of these duties is called a differential tariff.

Depending on the declared average import price, the percentage equivalent of the differential tariff can be as high as 658.6%. As a result, Japan's gate-price system places disproportionately high tariffs on lower-valued pork cuts.

2.2.4 Safeguards for beef and pork

Japan maintains its right to 'snap-back' the applied 38.5 per cent tariff on beef to 50 per cent for a specified period, if cumulative quarterly imports in the current year are more than 117 per cent of the volume in the same period of the previous year. This mechanism is similar to an emergency safeguard and has been invoked on three occasions, most recently from August 2003 to March 2004. In practice, exporters and importers manage trade in order to ensure the snap-back provision is not triggered. In this sense, the snap-back provision continues to restrict trade.

Japan also reserves the right to implement a gate-price safeguard for pork, which allows it to increase the tariff for pork by up to 24.4 per cent, if imports in any quarter are more than 119 per cent of the average level of imports in the corresponding quarter in the previous three years. Japan has invoked this safeguard on seven different occasions, from 1995 to 1997 and from 2001 to 2004. This safeguard causes increased market volatility and other distortions, which particularly disadvantage smaller-scale pork exporters such as Australia.

2.2.5 Other special agricultural safeguards

WTO members may restrict imports of a product temporarily, that is, take safeguard action by increasing tariffs, if a surge of imports injures or threatens to injure its domestic industry. But in the case of special agricultural safeguards it is not necessary to demonstrate injury to the domestic industry.

Japan has reserved the right to use special safeguards on 119 agricultural products, compared to only ten agricultural products for Australia. Japan has undertaken a number of special safeguard actions in recent years, both with price-based and volume-based triggers. Products commonly affected include rice, barley, starches, milk, butter, yoghurt, flour and some food preparations. In 2010, Japan took special safeguard action on yoghurt, maize starch, milk and cream.

2.2.6 Other barriers

WTO members have complained that Japan's sanitary and phytosanitary (SPS) regime, that is, its quarantine regime, has resulted in some regulations that are more stringent than internationally established guidelines and risk-assessment procedures.

One notable example is Japan's positive-list system for maximum residue limits (MRL) for pesticides, veterinary medicines and feed additives.

Australia has a good record of MRL compliance and is working closely with Japan to minimise unnecessary trade barriers resulting from Japan's comprehensive positive MRL list.

Another example is Japan's lengthy approval system for food additives. Although Japan refers to international standards on food additives, only additives which have been approved by the Japanese government may be used in food and beverages sold in Japan. New additives must be approved not only for their function (preservative, antioxidant, etc.), but also the types of foods and beverages in which they will be used, together with the maximum tolerances allowable. The approval process for new additives is quite lengthy, lasting up to five years, and this in turn can cause disruptions for some Australian exporters.

Australia also works closely with Japan to advance each party's phytosanitary market-access requests for the export of horticultural goods to the other party. Products for which Australia does not yet have phytosanitary access into Japan include table grapes, mandarins, non-seed potatoes and summerfruit (apricots, nectarines, peaches and plums). Market access for agricultural commodities facing SPS barriers is not negotiated through the Australia-Japan FTA, but rather directly between Australia's Department of Agriculture, Forestry and Fisheries and its Japanese counterpart.

2.3 Services barriers

Japan has made a high level of services commitments on market access in the WTO. However, Japan maintains a number of barriers to access by foreign services providers and foreign investment, and therefore has made only a moderate range of commitments on national treatment in the WTO. Services barriers of particular interest to Australia are outlined below.

2.3.1 Legal services

Japan maintains restrictions on the ability of foreign lawyers to provide international legal services in Japan. Only lawyers who have passed the Japanese Bar Examination and are qualified as *bengoshi* (Japanese lawyers) may practise Japanese law. Foreign lawyers qualified under Japanese law may provide legal advice on international-law issues and may form joint enterprises and share profits with Japanese lawyers. Registered foreign lawyers are able to provide legal advisory services on the laws of their home jurisdiction, but are required to be resident in Japan for 180 days per year to maintain their registration. Registration processes can be cumbersome. Foreign lawyers cannot form a legal professional corporation in the same manner as Japanese lawyers and are prevented from opening branch offices in Japan.

2.3.2 Financial services

The financial services sector in Japan is largely open to foreign participation. Japan has shown progress in this sector, including through promoting competition and improving the regulatory environment. However, many barriers remain. Under Japan's Banking Law, deposit insurance does not apply to branches of foreign banks not incorporated in Japan. Financial services providers are subject to licensing requirements and restrictions on foreign investment.

Non-resident companies (companies without a commercial presence in Japan) experience barriers to accessing Japanese financial-advice and funds-management markets. In particular, non-resident companies cannot, except in very limited circumstances, access Japan's sizable Government Pension Investment Funds (GPIF) market. As of September 2010, the total value of GPIF-market investments was 117.6 trillion yen (approximately A$1.4 trillion).

2.3.3 Education

Foreign education institutions are able to open and provide education services in Japan. However, strict regulation and administrative requirements discourage foreign universities from opening campuses in Japan. Japanese education institutions are entitled to benefits not available to foreign institutions, including tax concessions. Japan has some limitations on the recognition of foreign academic education qualifications, impeding the movement of students. The Government of Japan intends to increase the number of foreign students studying in Japan from 120,000 in 2008 to 300,000 by 2020.

2.3.4 Telecommunications

Since Japan opened its telecommunication services market in 1985, significant progress has been made in deregulating telecommunications services and promoting competition in this sector. However, Japan maintains a number of restrictions on communication and broadcasting services. Japan's formal WTO commitments on telecommunications services are relatively broad, but both the policy and regulatory functions for telecommunications remain the responsibility of Japan's Ministry of Internal Affairs and Communications, rather than an independent regulator. There is a relative lack of competition in Japan's domestic market, as interconnection rates are fixed by the dominant government-owned carrier, NTT. Foreign investment in NTT is limited to 33 per cent.

2.3.5 Infrastructure

Despite recent amendments to Japan's Public Finance Initiative Law that allow private firms to collect fees for the use of infrastructure and expand the scope of facilities which can be built and operated by the private sector, there remain a number of restrictions upon foreign interests participating in public infrastructure projects in

Japan. In addition to not allowing the private sector to participate in certain sectors – such as toll roads – the Japanese government is yet to resolve legislative inconsistencies that effectively preclude private sector participation in sectors such as hospitals.

Foreign companies experience difficulties in accessing information regarding upcoming projects, which is generally held by prefectural governments, rather than at a central location, and is often only available in Japanese. Accessing distribution networks in Japan is also difficult for foreign companies due to the often interlocking relationships between businesses in the supply chain.

2.4 Investment barriers

Japan's inward stock of FDI was only three per cent of GDP in 2007, the lowest in the OECD. Foreign-controlled affiliates accounted for only 3.1 per cent of Japan's total turnover in manufacturing, and 1.4 per cent in services, both the lowest in the OECD.

Language barriers and the high cost of doing business in Japan are sometimes cited as deterrents to inwards foreign direct investment, but Japan's foreign investment regime also plays a role. According to the OECD's FDI restrictiveness index, Japan is the fourth-most restrictive country in the OECD.[29] It has the strongest restrictions on foreign equity investments in the OECD, although other types of restrictions, such as on the appointment of foreign managers, are lower. By sector, Japan's FDI restrictions are greatest in agriculture and forestry, fishing and mining, and lowest in electricity, construction and retail and wholesale distribution.

Japan requires prior notification for inward FDI in industries including agriculture, forestry and fisheries, petroleum, leather and leather products, and air and maritime transport. In addition, some other sectors require prior notification on the grounds of public order and national security. These include aircraft, arms, explosives, nuclear power, electric utilities, gas utilities, water, heat generation, space, security, biological preparations, rail transport, passenger transport, telecommunications (accompanying certain network facilities), television and cable television, and broadcasting sectors.

In November 2010, the Japanese Government announced an "Inward Investment Promotion Program" which aims to facilitate increased FDI. Planned measures include a reduction in the effective corporate tax rate, the promotion of bilateral investment protocols under Free Trade Agreements with major countries and the abolition of excessive regulations.[30]

[29] OECD, *Economic Survey of Japan*, 2011 pp.87, 89.
[30] Japanese Ministry of Economy, Trade and Industry

Figure 2.1 OECD Restrictiveness Index scores by sector, selected countries

(closed = 1, open =0)

Sector	OECD	Non-OECD	Japan	Republic of Korea	India	Australia
Agriculture & Forestry	0.128	0.227	1.000	0.375	0.451	0.100
Fishing	0.320	0.333	1.000	0.500	0	0.100
Mining	0.122	0.209	1.000	0.000	0.525	0.100
Manufacturing	0.030	0.059	0.070	0.000	0.026	0.100
Electricity	0.123	0.125	0.000	0.417	0	0.100
Construction	0.055	0.055	0.000	0.000	0	0.100
Distribution	0.029	0.12	0.000	0.000	0.42	0.100
Hotels & restaurants	0.030	0.077	0.000	0.000	0	0.100
Transport	0.227	0.289	0.550	0.500	0.174	0.243
Media	0.180	0.316	0.000	0.400	0.6	0.210
Telecom	0.092	0.174	0.300	0.500	0.425	0.300
Financial Services	0.053	0.132	0.000	0.020	0.248	0.150
Business Services	0.067	0.167	0.000	0.000	0.5	0.128
Real Estate	0.283	0.277	0.100	0.000	0	0.300
Total FDI Index	0.095	0.157	0.241	0.142	0.220	0.138

Source: OECD FDI Restrictiveness Update 2010

Chapter Three
Other Trade Issues

3.1 Government support and managed trade

Japanese agriculture policy is characterised by high government support. Japan's total support estimates for agriculture in the period 2006-08 were equivalent to 1.1 per cent of Japan's GDP[31], which is especially notable given that agriculture's contribution to GDP was only 1.2 per cent that year. Direct government support to Japanese agricultural producers on average accounted for 47 per cent of farmers' incomes over the period 2007-09. Support measures (apart from high tariffs, import quotas, tariff-rate quotas and safeguards) include subsidies (e.g. buckwheat barley, rice), income support (e.g. meat, wheat, potatoes, sugar beet) and price support through direct market intervention (e.g. beef, pork). The OECD estimates that 90 per cent of the Japanese Government's direct support to agricultural producers is of the most distorting type: payments linked to output and variable input use.

State trading enterprises, such as Japan's Agriculture Livestock Industries Corporation, manage imports of rice, wheat, barley, milk products, and other products. Japanese authorities maintain that the aims of state trading are to stabilise the supply and price of commodities and protect consumer interests. However, the prices of these commodities tend to be higher than – and often well above – world prices.

Japan's agriculture policy is also driven by factors such as promoting food self-sufficiency that do little to improve domestic productivity. These types of measures can be viewed as indirect non-tariff barriers to trade given their intention of limiting the importation of goods that might have otherwise occurred in a free market. This is another reason why, despite being the world's largest net importer of food products, consumer prices in Japan are considerably higher than the OECD average.

3.2 Anti-dumping

Dumping has not been a significant issue in Australia's trade relationship with Japan. Since 1995 Australia has initiated seven anti-dumping investigations against Japan and imposed five anti-dumping measures. Only one of these remains current: duties on polyvinyl chloride homopolymer resin from Japan. These duties were originally imposed in 1992 and have been extended a number of times following continuation inquiries by customs. They are due to expire on 22 December 2012. Japan made a statement at the World Trade Organization's 2011 Trade Policy Review of Australia which criticised the length of time that this measure has been in place. The four other cases of Japanese products subject to duties were: hot rolled plate steels (imposed on 2 April 2004, expired 2 April 2009); and three measures on various grades of A1, A2 and A3 paper (imposed 1998, expired 2003).

[31] World Trade Organisation, *op. cit.*, p 77

Japan is an infrequent user of anti-dumping measures. Since 1995 it has initiated one anti-dumping investigation against Australia, and imposed one measure, which is still current. The measure applies duties to electrolytic manganese dioxide from Australia.

3.3 Intellectual property

Intellectual property (IP) laws in Australia and Japan provide a high standard of protection that meets WTO standards. The Australian and Japanese Governments are exploring new commitments beyond our existing obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights, including measures to enhance cooperation on intellectual property. Box 5.1 provides further information.

3.4 Impact of Japan's other Free Trade Agreements

Japan has concluded 13 Free Trade Agreements (FTAs[32]), is currently negotiating three, including with Australia, and has commenced feasibility or joint studies into a trilateral Japan-China-Korea agreement, a Japan-Canada FTA, a Japan-Mongolia agreement and, most recently, a Japan-EU FTA (see Box 3.1).

Japan's FTAs to date do not pose a significant threat to Australian exports in the Japanese market. They are not with economies that are major competitors of Australia in the main sectors in which Australia exports to Japan. However, Japan's FTA with Chile gives Chile preferential access for wine, salmon and some horticulture products. Japan's FTA with Peru gives Peru preferential access for ingots of non-ferrous metals such as copper, zinc and lead. Potential agreements with the EU and China (through a Japan-Korea-China FTA) could have an impact on Australia's exports to Japan in some areas.

In 2010, the simple average applied tariff under Japan's FTAs ranges from 2.9 to 3.4 per cent, lower than Japan's average applied-MFN tariff of 5.8 per cent. However, the percentage of duty-free tariff lines in Japan's FTAs ranges from 81.2 to 82.3 per cent, implying that duty-free trade was not achieved in approximately 18 per cent of tariff lines. Australia is seeking a more ambitious outcome in its FTA negotiations with Japan.

Japan's FTAs to date have consistently excluded a number of products, including agricultural products, such as: rice; wheat and barley; sugar; dairy products; fish and fish products; petroleum oils (other than crude oil); leather, leather products, and footwear; and laminated wood. The WTO's 2011 Trade Policy Review of Japan records that:

> In the Committee on Regional Trade Agreements, some Members raised concerns about Japan's FTAs. These included disproportionate liberalization between

[32] The Japanese Government more commonly refers to preferential trade agreements as 'Economic Partnership Agreements' rather 'Free Trade Agreements', on the basis that its EPAs are broad in scope and encompass the free movement of labour, capital and services, in addition to goods. Another factor is that Japan's EPAs to date have included exclusions.

agricultural and non-agricultural products, and Japan's longer implementation periods compared with some developing-country FTA partners (such as Brunei and the Philippines).[33]

In services and investment, a number of Japan’s FTAs contain commitments that go beyond Japan’s obligations under the General Agreement on Trade in Services (GATS) in areas of interest to Australia. For example, in the Japan-Singapore FTA, Japan made further commitments on professional services, construction services, computer services, distribution services, telecommunication services, financial services and transport services. Japan’s FTAs have contributed to structural reform, leading to enhanced transparency and greater liberalisation of services and investment. The liberalisation of Japan’s services sector has also played an important role in increasing the efficiency of Japan’s other industries, including its manufacturing industries.

In its 2011 Economic Survey of Japan, the OECD stated that “to make EPAs more effective in expanding trade, Japan should negotiate agreements with its major trading partners and aim at removing all barriers to trade rather than just reducing tariff rates, which are already low in general”.[34] This view is consistent with Australia’s approach to its FTA negotiations with Japan. Australia would be Japan’s first FTA partner among its top six trade partners (China, the United States, Australia, Saudi Arabia, the United Arab Emirates and the Republic of Korea), and its first with a major developed economy. Australia is seeking a comprehensive, high-quality agreement covering trade in goods (agricultural and non-agricultural), services and investment. Such an agreement would have a real impact in expanding trade and investment between Australia and Japan.

[33] World Trade Organization, *op. cit.*

[34] *Ibid*.

Box 3.1: Japan's Trade Agreements

Completed Economic Partnership Agreements (EPAs)
Japan-India Economic Partnership Agreement (February 2011)
Japan-Peru Economic Partnership Agreement (November 2010)
Japan-Vietnam Economic Partnership Agreement (October 2009)
Japan-Switzerland Economic Partnership Agreement (July 2009)
Japan-Brunei Economic Partnership Agreement (December 2008)
Japan-Philippines Economic Partnership Agreement (November 2008)
Japan-Indonesia Economic Partnership Agreement (July 2008)
Japan-ASEAN Comprehensive Economic Partnership Agreement (April 2008)
Japan-Thailand Economic Partnership Agreement (October 2007)
Japan-Chile Economic Partnership Agreement (September 2007)
Japan-Malaysia Economic Partnership Agreement (July 2006)
Japan-Mexico Economic Partnership Agreement (March 2005)
Japan-Singapore Economic Partnership Agreement (November 2002)

Under Negotiation
Japan-Australia Economic Partnership Agreement
Japan-Republic of Korea Economic Partnership Agreement
China-Japan-Republic of Korea trilateral investment agreement

Feasibility Studies
China-Japan-Republic of Korea trilateral economic partnership agreement
Japan-Mongolia Economic Partnership Agreement
Japan-Canada Economic Partnership Agreement
Japan-European Union Economic Partnership Agreement

Chapter Four
Opportunities for Deepening Commercial Links with Japan

4.1 Supporting Japan's reconstruction

In addition to the enormous human suffering caused by the 11 March disaster, it also caused significant damage to parts of Japan's infrastructure. As a close friend and partner, Australia provided extensive support to Japan in the immediate aftermath of the disasters, including the deployment of a 72-person urban search and rescue team, the use of C17 aircraft to support relief operations, and a $10 million donation. Australia stands ready to continue to support Japan in its immense task of recovery and rebuilding in the aftermath of the 11 March disaster.

4.1.1 Reconstruction

Reconstruction activities in northern Honshu are now under way, with temporary housing an immediate priority. Many contracts for reconstruction will not be available for Australian companies to bid on directly, as tenders announced so far require all applications to include a Japanese builder. However, opportunities are likely to emerge for Australian exporters in supplying specialist inputs to Japanese building and construction companies, including sustainable design and products, logistics, engineering, water and waste management services.

4.1.2 Energy

Alternative energy solutions are now a priority for the Japanese Government due to reduced energy capacity as a result of the damaged Fukushima nuclear reactors, and the potential for future nuclear accidents. Clean-energy technologies are commanding urgent attention by both government and business in Japan.

Following the earthquake, the Japanese Government announced it will enforce energy-usage restrictions in Eastern Japan of up to 15 per cent over the coming summer months (July and August) to decrease consumption to match reduced energy supply. Demand for energy efficient products, technologies and consulting services will increase substantially, creating immediate opportunities for Australian businesses with expertise in these areas.

Moreover, the Japanese Government has established a renewable-energy-usage target of 20 per cent of total energy consumption by 2020, which will create additional pressure to source alternative forms of renewable energy. LNG as well as biomass for co-firing offer immediate short-term opportunities, and Australia will continue to play a major role in supplying Japan's LNG needs - most major Japanese utilities have existing linkages to LNG projects in Australia. The same utilities have been conducting extensive testing on biomass for co-firing with coal in traditional coal-fired power stations, and recent events, together with renewable-energy, are expected to drive many of these utilities to include biomass in their forward plans.

Medium or long term opportunities for renewables from Australia include incorporation of clean energy solutions into the rebuilding program for the entire Tohoku area. Several think tanks have been commissioned by the Japanese Government to submit plans to integrate renewables into the reconstruction process.

4.1.3 Diversification of Supply Chains

Food shortages in Tokyo and the surrounding areas following 11 March 2011 highlighted the vulnerability of Japanese food supply chains. This could potentially have two consequences:

First, Japanese food companies accelerate and diversify their investment off-shore, to countries including Australia, to ensure that food production and delivery is not interrupted in times of natural disasters.

Secondly, Japanese manufacturers, facing similar disruptions to their supply chains, seek to identify and establish alternative suppliers. Panasonic, for example, is conducting an audit of all external suppliers to ensure that its supply chains are sound. Some other Japanese firms appear to be accelerating their relocation of production offshore.

These developments highlight further the need for Japanese firms to boost the global skill sets of their workforces to enable them to manage and lead offshore operations and participate effectively in global markets. In many cases this is through specialised external training and education programmes, presenting potential opportunities for Australia.

These disruptions have increased the demand for supply-chain management advisory services as Japanese food and other manufacturers review and restructure their contingency supply chain planning, including diversification of suppliers in the production and delivery processes.

4.2 Public Private Partnerships (PPP)

The Australian Government supports the work of the Australia-Japan Business Cooperation Committee (AJBCC) and its Japanese counterpart (the Japan-Australia Business Cooperation Council, the JABCC) to promote the public-private partnership model of infrastructure financing in Japan and in third countries. This initiative was prompted by growing recognition of the complementary strengths of Australian and Japanese companies in finance, construction, and infrastructure management, as well as Japanese institutional investors' seeking safe investments with good returns.

The two business councils have undertaken numerous missions from Australia to Japan and vice versa, as well as joint missions to India and Indonesia. DFAT, Austrade and Infrastructure Australia have been closely involved in this work.

In February 2011 the Australian and Japanese Trade Ministers agreed to launch a new dialogue promoting bilateral public-private infrastructure cooperation. The first round was held on 7 March in Tokyo with senior officials from DFAT, Austrade and Infrastructure Australia present. Attendees from government, industry and business councils on both sides discussed opportunities for cooperation in infrastructure investment and development, and identified ways that Australia and Japan can work to take advantage of each other's respective comparative advantages.

The enormous reconstruction required as a result of the 11 March disasters appears to have accelerated the Japanese Government's plans to revise the Private Finance Initiative (PFI) law in Japan. On 24 May 2011, the Japanese Diet passed into law amendments to PFI legislation, which includes an initial JPY712 million ($8.4 million) of funds allocated in the 2011 Japanese budget for development of PFI projects under a new 'concession system' (operational rights transfer).

At this stage, these amendments appear to open the way for a relaxation of PFI restrictions allowing for the adoption of PFI models closer to the Australian PPP model of build, operate and transfer, in which the private sector builds, owns and operates an asset before transferring it back to the government after a certain period. This contrasts with the Japanese PFI model of build and transfer, which leverages construction rather than operation.

Australian firms have extensive experience in PPP infrastructure projects, a fact already recognised by the Japanese. For Australia, these PFI amendments create opportunities for Australian advisory and financial services firms to provide insight and direction in PPP financial structuring, provision and execution. There is also an existing nationwide need in Japan to replace, upgrade and repair retiring infrastructure, which will lead to further PPP infrastructure opportunities beyond the reconstruction of the Tohoku region. Partnering with Japanese counterparts on infrastructure projects in third markets in the region will generate opportunities for Australian firms in Japan itself, as well as in these third countries.

While the Japanese market may open for Australian PPP expertise, available rates of return will be an important determinant of the pace of take-up by companies. It is unclear at this stage whether payment for the use of infrastructure will provide the investment returns that Australian investment banks and PPP professionals are accustomed to with project work in Australia.

4.3 Services

There are significant opportunities for Australian and Japanese firms to increase the bilateral trade in services. For some time, academics have pointed to the scope for Australian services firms to apply domestically-acquired expertise to increase exports to Japan in sectors such as government services, legal and accounting services, medical and aged care services, real-estate and property services, vocational training, recreational, music and performing arts and hospitality services[35]. There are a number

[35] See, for example, de Brouwer and Warren, *Strengthening Australia-Japan Economic Relations*, report prepared for the Department of Foreign Affairs and Trade, Canberra, 2001

services of which Australia's exports to the world are greater than might be expected given the size of our economy and share of global services trade, but the share of our services going to Japan is lower. These include including travel, insurance, financial services, personal and computer services.

In financial services, for example, as long as returns on investment in equities and bonds in Japan remain below those available in Australia, demand for Australian investment products from Japanese mutual funds and retail investors is likely to continue to grow. Reforms to the Japanese pension system, to make it more responsive to the needs of the country's ageing population, could make it easier for more Japanese funds to be invested offshore.

The Australian Government is pursuing increased access and recognition for Australian professional service providers in Japan via bilateral FTA negotiations (see section 5.3). The Australia-Japan FTA Feasibility Study, concluded in December 2006, assessed that increasing business mobility and recognition of professional qualifications would increase services trade and economic growth in both countries.

4.3.1 Education

Japan's international competiveness is increasingly determined by its ability to develop a globally literate workforce capable of developing and expanding overseas markets for Japanese products and services. Japan today faces a contracting domestic market and mounting competition from neighbouring countries, which has seen Japan's international competiveness drop from number one in 1990 to number 26 in 2011, according to the IMD annual competitiveness survey[36].

As a result, Japanese companies are increasingly looking to extend their overseas operations, in particular seeing the emerging economies of Asia as not just cheaper production locations, but as attractive markets to penetrate. However, at the same time, there is widespread realisation that Japan's education and training systems are largely failing to supply the quality of human resources capable of negotiating these challenges. As a result, companies are investing significant resources to develop globalised human capital; people with competencies that broadly encompass:

- English language ability with real world applicability;
- Cross-cultural understanding, diversity in thinking, and an ability to adapt to different environments; and
- Global leadership skills to lead the development and expansion of overseas markets, and to transfer that know-how to local staff.

The 11 March disaster has dealt a heavy blow to Japanese universities' internationalisation goals. Many international students returned to their home countries, often at the insistence of their home institutions and in some cases, home

[36] IMD World Competitiveness Yearbook, 2011.

governments. This comes at a time when the rapidly aging demographics of Japan were putting its universities under considerable pressure, and leading them to seek growth and sustainability through increased international student numbers.

There will be opportunities for Australian education providers to both partner with Japanese corporations and to offer programmes directly to individual students focusing on global skills such as language, cross-cultural communications and global leadership. To this end, Austrade is promoting these opportunities through its Global Human Capital initiative (see Austrade's Roles and Priorities section).

4.4 Food and agriculture

Japan represents the largest market for Australian food and agricultural exports, accounting for 15 per cent of all exports in 2009. Japan is one of the largest net importers of food (by value) globally. Within Japan, concerns around food safety and traceability have increased substantially due to a rising number of food product scares in recent years. Food safety is now recognised by Japan's largest food retailers and suppliers as a critical supply chain management issue. Australia's reputation as a reliable supplier of high-quality food products provides an opportunity for Australian food exporters to leverage these safety concerns to expand market share, and encourage Japanese partner firms to deepen strategic procurement and investment into Australia.

4.5 Rare earths

In recent times, Japan has shown an increased interest in investments in Australia's rare earths sector, as it seeks to secure a stable and diversified supply of these raw materials. Rare earths are a critical input into many of Japan's high-tech manufactured products.

In November 2010, Australian company Lynas signed an agreement with Japanese company Sojitz providing funds of up to US$250 million to accelerate Lynas' rare earths project in Mount Weld, Western Australia, and to secure additional supply of rare earths products for the Japanese market. The Australian Government has welcomed Japan's interest in investing in Australia's rare-earths sector, and has emphasised that Australia stands ready to be a secure, reliable supplier of rare earths.

4.6 Online retailing

The combination of a long period of high income levels and increased penetration of internet usage in Japan has led to an increase in e-retailing, catalogue sales and TV shopping. At a time when overall retail sales are generally weak, on-line retailing has been growing in Japan. Firms such as Rakuten, who offer a range of online services covering retailing, banking, insurance, credit cards, travel and securities, are revolutionising the way Japanese consumers shop. Since the earthquake, Japanese consumers' online retail activity has actually increased, with internet shopping seen as the most effective way to purchase goods at the best price. The rapid growth of this new channel to consumers offers new opportunities to Australian suppliers.

Chapter Five
The Role of Government in Ensuring Opportunities are Identified, Developed and Utilised

5.1 Bilateral engagement on trade and policy issues

The Government consistently engages Japan on trade and economic policy issues at the highest level. Since 1957, when then-Prime Minister Sir Robert Menzies visited Japan (the first Australian prime minister to do so), there have been 23 prime-ministerial visits to Japan. The most recent of these was Prime Minister Julia Gillard's visit in April 2011. Prime Minister Gillard and Prime Minister Naoto Kan agreed that trade and investment liberalisation would be vital to the continuing health of the global and regional economy and to economic growth in both countries. Taking into account the current circumstances in Japan and their implications, the Prime Ministers also confirmed that the two countries would conduct further negotiations leading to a conclusion of a comprehensive and mutually beneficial bilateral FTA/EPA.[37]

Prime Ministerial-level engagement is complemented by regular meetings between Australian and Japanese Trade Ministers. In an effort to provide a consistent opportunity for strategic and structured bilateral discussions on the full range of trade and economic policy issues, then-Trade Minister Simon Crean and then-Japanese Minister of Economy, Trade and Industry, Masayuki Naoshima, established the Japan and Australia Trade and Economic Ministerial Dialogue on 27 October 2009.[38] Trade Minister Craig Emerson and Japan's Minister for Economy, Trade and Industry, Banri Kaieda, held a second dialogue in February 2011.[39] Dialogues have included discussion of Australia’s continuing role as a safe, secure and reliable supplier to Japan of food, energy and mineral resources; trade in financial and other services; and bilateral investment in the fields of resources and energy, manufacturing, agriculture, infrastructure and tourism.

Individual Commonwealth departments have established further mechanisms for ensuring effective trade and economic engagement. The Department of Resources, Energy and Tourism represents the Australian Government at the High-Level Group (HLG) on Energy and Minerals Consultations. The HLG provides a framework to explore trade and investment opportunities in energy and mineral resources, including infrastructure development. The 34th High-Level Group meeting was held in Australia in March 2011, as was the third Australia-Japan Coal Technology Workshop. A Geoscience Australia Minerals Investment Seminar was held in Japan

[37] The Japan-Australia Joint Communiqué of 21 April 2011 is available at http://www.pm.gov.au/press-office/japan-australia-joint-communique-tokyo
[38] The Joint Statement for the first dialogue can be found at: http://www.dfat.gov.au/geo/japan/trade_dialogue.html
[39] “Press Conference with Banri Kaieda, Japanese Minister for Economy, Industry and Trade”, Minister for Trade media release, 11 February 2011, available at http://trademinister.gov.au/transcripts/2011/ce_tr_110211_press_conference.html

in 2010. The Government of Japan is also represented on the Australia-based Global Carbon Capture and Storage Institute by its Ministry for Economy, Trade and Industry (other secondees include the Japan Bank of International Cooperation and the Chiyoda Corporation).

The Department of the Treasury holds annual bilateral consultations with Japan's Ministry of Finance to (last held on 31 May 2011), usually at the Executive Director level. The dialogue allows for discussions of economic conditions and collaborative work in international forums.

The Department of Innovation, Industry, Science and Research (DIISR) engages with engages with Japan on a broad range of science and technology issues through a biennial Australia-Japan Joint Science and Technology Committee Meeting. The overarching goals of this regular process of bilateral consultation are to exchange information on recent research and innovation policy developments in each country and assist in developing closer links between Australian and Japanese researchers and research institutions. The next biennial meeting is scheduled to be held in Tokyo in FY2011-12.

The Department of Agriculture, Fisheries, and Forestry (DAFF) and its Japanese counterpart, the Ministry of Agriculture, Forestry and Fisheries of Japan (MAFF) hold regular bilateral talks on beef, dairy, plant quarantine and animal health issues.

In March 2011, senior officials from DFAT, Austrade and the Department of Transport participated in an inaugural Australia-Japan government-private sector bilateral dialogue on infrastructure in Tokyo. Participants discussed opportunities for cooperation in infrastructure investment and development, including in third countries, and identified barriers to firms in both Australia and Japan.

5.2 Austrade's role and priorities

Austrade is the Australian Government's trade and investment development agency. Austrade assists Australian companies to succeed in international business, attract productive foreign direct investment into Australia and promote Australia's education sector internationally.

Austrade provides coverage in Japan with 46 staff in four locations - Tokyo, Osaka, Fukuoka and Sapporo. Osaka and Fukuoka operate as Consulates-General, while Sapporo is a Consulate. The central region of Japan is covered remotely from Osaka, with one staff member in Nagoya.

In 2009-10, Austrade Japan provided marketing services to 1,150 Australian businesses, which contributed to securing export deals valued at $628 million. Austrade also generated 112 new Japanese investment leads, predominantly in the clean energy sector.

Austrade's priorities in Japan are focused on developing initiatives and opportunities that will deliver the greatest value add for Australian business.

These trade and investment initiatives are aimed at a broad level within Japan's market and include:

- building better brand awareness of Australian capability (e.g. Taste of Tomorrow Food Safety);
- breaking down barriers to market entry (e.g. PPP Infrastructure);
- developing new market sectors for Australia (e.g. Online Retail);
- expanding market share; and,
- creating new pathways to market.

Austrade's resources are focused on those sectors and potential opportunities where it assesses that our involvement can materially reduce the time, cost and risk for Australian exporters and investors.

Austrade's approach is predicated on viewing Japan's challenges as opportunities for renewed or new engagement with Australia, and are primarily driven by Japan's need for:

- minerals and energy security;
- food security;
- responses to its ageing population and declining productivity;
- technological leadership as a competitive edge; and,
- new markets in growing economies.

Priority sectors that match Australia's international competitiveness with Japanese market demand include clean energy and agribusiness, food and beverage, services, education, technology, and creative and consumer. Six national marketing teams based on these priority sectors have been formed across all four Austrade posts.

Currently, Austrade's major market initiatives in Japan include:

- **Taste of Tomorrow Food Safety**. The objective of this initiative is to raise the profile of Australia's food safety, reliability and integrity with major Japanese food suppliers and retailers to strengthen supply chain linkages and increase market share for Australian products. Austrade hosted a high level forum in Australia in February 2010 to facilitate consultations between key Australian industry and government stakeholders, and major Japanese food suppliers to discuss food safety protocols, supply chain issues and crisis management strategies. A second forum is planned for late 2011.

- **PPP Infrastructure**. This initiative is positioning Australia as a sophisticated provider of infrastructure and related services utilising the PPP financing model, through the identification of pilot projects in Japan that Australian firms can participate in. Austrade is working closely with key stakeholders such as the Australia-Japan Business Cooperation Committee (AJBCC) and Infrastructure Australia.
- **Australia and Japan in Asia**. Austrade is facilitating collaboration between Australian and Japanese businesses in third-country markets in Asia, as Japanese corporates continue to expand their operations throughout the region to seek growth markets outside Japan. In particular, PPP infrastructure projects are likely to provide opportunities for Australia-Japan collaboration. Austrade has provided assistance to two major trade missions led by the AJBCC and JABCC that visited India in July 2010 and Indonesia in May 2011 to identify potential projects for joint collaboration.
- **Growth and Diversification of Japanese FDI**. This initiative is facilitating the further diversification of Japanese FDI into Australia, particularly in green building, water and the environment, supporting the Australian Government's clean energy priorities. Increased FDI in these areas will lead to greater technology transfer and R&D collaboration with Australian partners to create new business models.
- **Global Human Capital Development**. This initiative is positioning Australia as a preferred supplier of high-end educational services and programs for global human capital development. Austrade is assisting Australian educational institutions and providers create tailored solutions for Japanese corporates and educational institutions to develop more globally competent human resource management capabilities.
- **Online Retail**. Austrade is assisting Australian businesses to take advantage of the boom in on-line sales and new value for money paradigm in Japanese retailing to provide a new pathway to market for small-medium sized exporters, by supporting the development of an on-line product testing laboratory, providing instant feedback to Australian suppliers and enhanced access to Japanese consumers.
- **Women in Business**. This initiative is leveraging Japan's need to incorporate more women in its workforce to boost productivity. Austrade is introducing Australian services and products to Japan aiming to support women in business.

In light of the 11 March earthquake Austrade is also conducting further research to identify opportunities for Australian advisory firms to provide supply chain advisory services to Japan based around contingency planning. Austrade's education team visited universities in Tohoku in June to gauge their needs and goals, and determine how the Australian education sector can provide support. This builds on the Prime Minister's announcement of a post-disaster education package which focuses on support for institutions in affected areas. Specifically, these measures include $500,000 for 100 students for two-way exchange between institutions in the affected areas and their Australian counterparts for this year and next, and 10 Endeavour Awards for Japan, on an on-going basis. For 2012 only, these will be directed to affected institutions.

5.3 Negotiation of a Free Trade Agreement

On 12 April 2011, the Australian Government released a new Trade Policy Statement, *Trading our way to more jobs and prosperity*. This Statement positions trade policy as a central element of the Government's broader economic reform agenda, with Australia’s commitment to trade liberalisation contributing to growing prosperity and to more and better jobs. The Statement makes clear that the Government's trade negotiating agenda ‘will steer a middle course of championing and protecting the multilateral system while seeking to negotiate high-quality, truly liberalising sectoral, bilateral and regional trade deals that do not detract from but support the multilateral system’.

In concluding FTAs, the Government is seeking to ensure that Australian businesses can compete on level terms, particularly in markets where our trading partners have provided preferential treatment to our competitors. Australian FTAs also aim to deliver substantial commercial and wider economic benefits to Australia more quickly than would be possible through the multilateral process. Our FTAs are designed to promote stronger trade and commercial ties, open up opportunities for Australian exporters and investors and secure Australia’s competitiveness with key trading partners.

An FTA with Japan is identified as a priority in the Government’s Trade Policy Statement. Japan is a crucial market for Australia, it is our second-largest trading partner and our second-largest export market, with exports worth more than $45.6 billion in 2010. As pointed out in Chapter Two, Japan has substantial tariff and non-tariff barriers, the reduction and elimination of which would bring considerable benefits to Australian business.

A joint Australia-Japan feasibility study on the pros and cons of a Free Trade Agreement was completed in December 2006[40]. This study concluded that a WTO-consistent FTA would bring about significant benefits to Australia and Japan. The study noted, *inter alia*, that an FTA would:

- deliver major economic gains for both countries[41];

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[40] Australia-Japan Senior Officials’ Joint Consultative Committee Study Group, *Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility or Pros and Cons of a Free Trade Agreement*, Final Report, 2006

[41] The study group noted that econometric modelling undertaken jointly by the two governments, concluded that the estimated magnitude of the macroeconomic gains varied between the two econometric studies undertaken, ranging from 0.66 per cent to 1.79 per cent for Australia’s GDP in 2020, and between 0.03 per cent and 0.13 per cent for Japan’s GDP in 2020. In net present value terms

- address discrimination resulting from each country's FTAs with others;
- promote ongoing economic reform and increase productivity in both countries;
- create new opportunities in respective services sectors, including by improving business mobility;
- tie Japan more closely to the largest contributor to Japan's energy supply and its third-largest supplier of minerals and resources;
- ensure Japan has reliable supplies of key minerals and energy into the future;
- help Japan realise its food security objectives;
- provide Australia with enhanced export opportunities to the world's third-largest economy and its largest market for minerals, energy and food;
- promote greater Japanese investment in Australia which would integrate Australia more closely with the Japanese market.

The Australian and Japanese Prime Ministers agreed in December 2006 to begin negotiations on a bilateral FTA, on the basis of the joint feasibility study. Following this announcement, the Australian Government called for submissions from the public outlining their interests and concerns in an FTA and commenced a program of public consultations in all states and territories. The call for submissions has remained open during the negotiations. To date DFAT has received over 60 submissions on the FTA, the majority from peak industry organisations and companies involved in the areas of agriculture (20 submissions), manufacturing (8 submissions) and services (21 submissions). The most common themes in the submissions were:

- the potential for increased agricultural sales to Japan if market access is improved, particularly for big ticket export items such as beef, dairy, sugar, wheat, barley and wine;
- the need to protect current Australian tariff settings in manufacturing; and
- the desire for increased access and recognition for Australian professional service providers.

Subsequent consultations with industry have raised the issue of gaining parity with the concessions Japan granted in its FTA with Chile, especially in relation to wine, fisheries products and horticulture.

Australia-Japan FTA negotiations formally commenced in April 2007 and twelve negotiating rounds have been held in total (the last in Tokyo, 7-10 February 2011). Progress in the important area of agricultural market access received a boost in November 2010 with the release of Japan's Basic Policy on Comprehensive Economic Partnerships, with specific reference made to Australia.

(in 2006) over 20 years, the lower end of the range of Australia's GDP gains would equate to $A39 billion (around ¥3.3 trillion), while Japan's would be $A27 billion (around ¥2.3 trillion).

However, the events on 11 March 2011, have, understandably, led to delays in our FTA negotiations and the 13th FTA negotiating round, scheduled for April, was postponed. The longer-term impact of the disaster on the FTA remains unclear. Nevertheless, recent developments in Japan have been positive, with the Japanese cabinet adopting on 17 May a set of new “Policy Guidelines: Towards Japan’s Revitalisation” for Japan’s recovery from the earthquake, tsunami and nuclear incident. This statement clarifies that cabinet discussions on trade liberalisation will continue, but that the new basic policy on agricultural structural reform (originally planned for June 2011) and an accompanying action plan (originally planned for October 2011), both foreshadowed in the November Basic Policy on Comprehensive Economic Partnerships, will be delayed.

Prime Minister Kan and Prime Minister Gillard, during her recent visit to Japan, confirmed that Japan was committed to the conclusion of the FTA and that negotiations should resume at the earliest possible date. Japan is yet to specify when this might be, but both sides are continuing to work intersessionally to push specific areas of the FTA forward. While the disaster has temporarily delayed progress in the FTA negotiation, successful conclusion of the FTA would provide a significant and long-term boost to the future economic relationship between Australia and Japan.

5.4 Cooperation in regional and international organisations

5.4.1 The World Trade Organization

In addition to being in Australia’s broader trade interests, an ambitious, comprehensive outcome in the Doha Round would enhance Australia’s economic relationship with Japan by liberalising trade in agriculture, manufacturing and services. In April 2011, the Prime Ministers of Australia and Japan released a joint statement which called for ‘a successful conclusion of the WTO Doha Round negotiations as promptly as possible’. Such a result would create a new wave of global trade liberalisation, which would also produce new trade opportunities for Japan and Australia – the world’s third and thirteenth largest economies respectively.

As a large economy, heavily reliant on exports, Japan has a crucial stake in the Doha Round, and Australia recognises the constructive and active role that Japan has been playing. Australia welcomes Japan’s efforts to introduce new ideas on non-agriculture market access (NAMA) sectoral liberalisation and also welcomes Japan’s strong support for an ambitious services package as part of the Doha Round outcome. Australia and Japan work closely together with other services demandeurs to progress services issues in the WTO. As one of its major suppliers of food and agricultural products we also work closely with Japan on agricultural issues in the WTO. We have consistently called on Japan to address its significant tariff and non-tariff barriers on food and agricultural products, as well as the high levels of support it provides to Japanese farmers.

Beyond the Doha Round, Australia and Japan have a continuing shared interest in a strong, open and rules-based multilateral trading system. Some trade issues, such as domestic subsidies, are most effectively dealt with in the multilateral trading system, rather than bilaterally. The WTO also offers the best currently available dispute settlement system for trade disputes. Australia values Japan's strong support of the WTO, including its technical assistance and capacity building initiatives, particularly at the regional level.

5.4.2 Trans-Pacific Partnership Agreement

The Trans-Pacific Partnership Agreement (TPP) provides a platform for genuine trade liberalisation and deeper regional economic integration in the Asia Pacific region. Australia has welcomed Japan's possible interest in joining the TPP negotiations, and supports the expansion of TPP membership over time to countries that can sign up to the high level of ambition of the agreement.

Box 5.1 Intellectual property: Japan-Australia cooperation at the WTO, in FTA negotiations and on anti-counterfeiting

The Australian Government addresses intellectual property (IP) protection and enforcement through a strong commitment to a rules-based trading system under the WTO. Japan, like Australia, has implemented obligations in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) which establishes minimum levels of IP protection and enforcement that each government has to give to the IP of fellow WTO members. This means that Australian IP stakeholders are assured certain minimum levels of protection and enforcement when exporting their IP to Japan.

The Australian Government has sought to enhance the WTO system by seeking additional commitments on IP protection and enforcement through FTAs. Discussions on IP commitments are well-advanced in Australia-Japan FTA negotiations. As IP laws in Australia and Japan provide a high standard of IP protection, negotiators are exploring commitments beyond our existing TRIPS obligations, including measures to enhance cooperation on intellectual property. Such commitments in an FTA would have the added benefit of promoting high standards in the region and enhancing existing, ongoing bilateral and multilateral cooperation between Australia and Japan IP offices.

Australia has also worked closely with Japan in successfully concluding a treaty with 35 other countries to establish a new international agreement dedicated to improving IP enforcement and reducing the trade in counterfeit material – the Anti-Counterfeiting Trade Agreement (ACTA). Japan played a leading role in driving the ACTA initiative.

The Government's work in the WTO, the Australia-Japan FTA and with respect to ACTA will create a more secure trading environment for Australia's innovative and creative industries by strengthening the protection and enforcement of IP rights in Japan.

5.4.3 Regional trade diplomacy

Australia and Japan cooperate closely in a number of regional trade and economic forums, including the Asia-Pacific Economic Cooperation (APEC) and the East Asia Summit (EAS).

Japan, along with Australia, is a founding member of APEC, the pre-eminent trade and economic forum in the Asia-Pacific region. Australia and Japan work together across the broad spectrum of APEC issues, including trade and investment facilitation, structural reform and emergency preparedness. Australia played a major role in assisting Japan to deliver progress on several key APEC issues during its host year in 2010. At Japan's invitation, we collaborated closely on the drafting of the Bogor

Goals assessment report, a key document mapping APEC's progress towards free and open trade and investment by 2020. Australia also took the lead in pushing the need for domestic structural reform as a central element of Japan's APEC growth strategy, and helped establish the concept of a 'seamless regional economy' as APEC's long-term vision.

Japan and Australia are both key drivers of APEC's structural reform agenda and Japan strongly supports Australia's $3 million Structural Reform Initiative announced by Prime Minister Gillard at the 2010 Yokohama Summit. In order to meet the Asia-Pacific's considerable infrastructure needs, Australia and Japan also cooperate in APEC to facilitate the growth of sustainable infrastructure development in the region, including through public-private partnerships.

Australia and Japan are also leading work under APEC's Supply-Chain Connectivity Framework, endorsed by APEC Leaders in November 2010, which aims to deliver a 10 per cent improvement in the reliability, timeliness and cost of regional supply chains by 2015. Australia is leading work on addressing inadequate transport logistics infrastructure and inconsistent logistics standards, while Japan is leading work to tackle inefficiencies in customs clearance procedures.

On emergency preparedness, Australia and Japan are working together to enhance the resilience of communities, businesses, trade and economic growth from disruptions caused by natural disasters.

Australia and Japan have worked together to support the analytical arm of APEC - the Policy Support Unit (PSU) - with Japan now making substantive financial contributions to the PSU to sustain this important aspect of APEC's work.

Australia strongly supports work on a possible Comprehensive Economic Partnership in East Asia (CEPEA), including a possible future EAS-wide FTA covering all 10 members of ASEAN, and ASEAN's +1 FTA partners (currently Australia, New Zealand, Japan, the Republic of Korea, China and India).

Australia continues to work with our EAS partners, including Japan, on CEPEA and regional economic integration issues. We have been participating in four officials-level ASEAN Plus Working Groups, which were set up to consider the recommendations of studies on CEPEA and the East Asia Free Trade Agreement (EAFTA – a possible agreement covering only ASEAN, Japan, China and the Republic of Korea) in parallel. ASEAN's FTA partners, including Australia and Japan, have been participating in all of the four ASEAN Plus Working Groups (Rules of Origin, Tariff Nomenclature, Economic Cooperation and Customs Procedure).

5.5 Export Credit Agencies

The Export Finance and Insurance Corporation (EFIC) is Australia's export credit agency and provides export credit, guarantee and insurance services to viable Australian exporters and companies investing overseas where the private market is unwilling or unable to provide support. EFIC has strong links with its counterparts in Japan: the Japan Bank for International Cooperation (JBIC) which is mandated to provide finance and guarantee support; and the Nippon Export and Investment Insurance (NEXI) of Japan which is mandated to provide investment and export credit insurances.[421] These agencies pursue a broad mandate which extends to the provision of untied financial support, that is, support for procurement of goods and/or services from Japan as well as to secure strategic supplies back to Japan.

As well as regular links through multilateral fora such as the Organisation of Economic Cooperation and Development (OECD), the Asian EXIM Banks (AEB) Forum and the Berne Union, EFIC has signed a bilateral Risk Participation Agreement-with NEXI which can facilitate the financing of projects involving multi-sourcing of capital goods and/or services from Australia and Japan into a third country. This agreement may also support Japanese ECAs participation in financing export-related projects domiciled in Australia.

The strategic goals of Japan's ECAs include supporting the acquisition of strategically important natural resources and regional infrastructure investment in the region. JBIC has supported significant loan and/or equity investments by a number of Japanese firms in Australian resource projects, examples of which include the Pluto LNG Project (Western Australia), the Gorgon Project (Western Australia), Sojitz Coal Resources (Queensland) and may also support the proposed Ichthys Project (Western Australia and Northern Territory). The amount of debt needed for these projects exceeds the capacity of the commercial bank market, and accordingly significant contributions are sought from ECAs. The continued demand for large-scale project financing in Australia and the Asia-Pacific region, combined with Japan's strategy to acquire natural resources and build regional infrastructure makes it likely that Japanese ECA financing is likely to continue to grow, with significant benefits for trade and investment in Australia and the region.

[42] EFIC provides finance and guarantee support, as well as medium and long-term insurance, within a single organisation.

Appendix One Australia's top 50 merchandise exports to Japan, 2010

Rank	Commodity	A$000
	All Commodities	**43,575,661**
1	Coal	14,835,418
2	Iron ore & concentrates	8,598,753
3	Natural gas*	7,752,134
4	Beef, f.c.f.	1,721,764
5	Aluminium	1,558,697
6	Copper ores & concentrates	1,101,177
7	Crude petroleum	933,783
8	Wood in chips or particles	790,688
9	Liquefied propane & butane	647,347
10	Cheese & curd	373,253
11	Animal feed	338,618
12	Wheat	299,272
13	Nickel ores & concentrates*	281,406
14	Meat (excl beef), f.c.f.	262,217
15	Nickel*	227,984
16	Barley	202,874
17	Sugar, molassis and honey*	190,811
18	Zinc ores & concentrates	182,760
19	Pearls & gems*	168,064
20	Lead ores & concentrates	157,777
21	Fish, f.c.f.	150,053
22	Sodium Chloride (Salt)*	140,352
23	Refined petroleum	135,410
24	Oil-seeds & oleaginous fruits, soft	123,603
25	Medicaments (incl veterinary)	116,587
26	Silver & platinum	114,242
27	Precious metal ores & conc (excl gold)	106,578
28	Manganese ores & concentrates	104,358
29	Cereal preparations	90,913
30	Starches, inulin & wheat gluten	90,443
31	Crustaceans, f.c.f.	83,290
32	Medical instruments (incl veterinary)	79,733
33	Inorganic chemical elements	79,295
34	Edible products & preparations, nes	77,766
35	Other non-ferrous metals	71,769
36	Coke & semi-coke	59,105
37	Fruit & nuts	57,023
38	Alcoholic beverages	47,133
39	Non-ferrous waste & scrap	43,860
40	Measuring & analysing instruments	41,169
41	Cotton	38,706
42	Milk, cream, whey & yoghurt	36,131
43	Chocolate & preparations of cocoa	35,930

44	Fruit juices	27,833
45	Meat, prepared or preserved	27,575
46	Vegetables, f.c.f.	24,509
47	Vehicle parts & accessories	24,319
48	Aluminium ores & conc (incl alumina)	24,042
49	Pharm products (excl medicaments)	22,463
50	Transmission shafts & parts	22,425

Source: DFAT STARS Database, based on ABS Catalogue 5368.0.

*DFAT estimate based on partner country data. Partner country data has been adjusted from a cif basis to a fob basis. Note: f.c.f. = fresh, chilled or frozen, nes = not elsewhere specified.

Appendix Two Australia's top 50 merchandise imports from Japan, 2010

Rank	Commodity	$A'000
	All commodities	**18,192,512**
1	Passenger motor vehicles	7,087,873
2	Goods vehicles	1,399,354
3	Refined petroleum	1,131,501
4	Civil engineering equipment & parts	670,008
5	Rubber tyres, treads & tubes	587,985
6	Vehicle parts & accessories	483,308
7	Office machines	478,221
8	Telecom equipment & parts	319,738
9	Tubes & pipes of iron or steel	310,179
10	Motorcycles & cycles	287,599
11	Electrical machinery & parts, nes	265,864
12	Internal combustion piston engines	254,057
13	Heating & cooling equipment & parts	238,238
14	Mechanical handling equip & parts	233,199
15	Pumps (excl liquid pumps) & parts	189,323
16	Monitors, projectors & TVs	165,352
17	Musical instruments & parts	163,784
18	Electronic integrated circuits	156,507
19	Measuring & analysing instruments	129,690
20	Road motor vehicles, nes	124,952
21	Transmission shafts & parts	110,539
22	Flat-rolled alloy steel	105,097
23	Photo & cinematographic supplies	98,370
24	Rotating electric plant & parts	96,008
25	Specialised machinery & parts	91,672
26	Pigments, paints & varnishes	90,463
27	Electric power machinery & parts	88,108
28	Electrical circuits equipment	87,662
29	Rubber articles, nes	83,415
30	Paper & paperboard	82,706

31	Medical instruments (incl veterinary)	80,680
32	Coated flat-rolled iron & steel	78,007
33	Optical goods, nes	77,294
34	Computers	74,448
35	Medicaments (incl veterinary)	66,478
36	Other primary plastics	60,458
37	Pumps for liquids & parts	57,570
38	Ball or roller bearings	57,237
39	Medical electrodiagnostic apparatus	54,804
40	Uncoated flat-rolled iron & steel	53,407
41	Non-electrical machinery & parts	52,687
42	Rails of iron or steel	52,508
43	Tractors	51,030
44	Plastic plates, sheets & film	49,370
45	Pharm products (excl medicaments)	48,212
46	Taps, cocks & valves	47,568
47	Organo-inorganic compounds	41,108
48	Steam & other vapour turbines	38,634
49	Machine tools for removing metal	38,275
50	Lime, cement & construction materials	37,726

Source: DFAT STARS Database, based on ABS Catalogue 5368.0

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