

# Maturing the Korea-Australia Investment Relationship

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# Executive Summary

- **The Korea-Australia investment relationship is rapidly expanding.** Over the last decade, bilateral capital flows have averaged approximately \$1 billion per annum, and each country now features in the other's top-ten investment partners. For the first time, investment is a key component of their bilateral economic relationship.
- **Booming investment flows have been driven by economic complementarity and supportive policy environments.** Korean firms have participated in Australian mining and energy projects to secure resource supply for heavy industries; while Australian institutional investors have sought attractive opportunities in the Korean market. Favourable regulatory environments and the Korea-Australia Free Trade Agreement have helped crowd-in these investments.
- **However, the bilateral investment relationship remains very 'traditional'.** Investments are mostly concentrated in the resource and real estate sectors, and there are few 'direct' investments that build managerial and knowledge links between Australian and Korean firms. A range of mutually-beneficial investment opportunities have yet to be fully realised.
- **Maturing the Korea-Australia investment relationship is key for its next stage of growth.** Building on recent successes in the resource sector, bilateral investment now needs to move into a range of new industries, including infrastructure, finance, services and agriculture. This will ensure a more diversified investment relationship, which fully exploits the complementarities between the Australian and Korean economies.
- **To unlock these opportunities, governments and businesses in Australia and Korea will need to develop new investment strategies.** These need to raise awareness of each other's business environments, augment the investment capacity of SMEs, augment regulatory cooperation between the governments, and develop industry-specific plans for bilateral investment.

## Forewords

### FOREWORD FROM EMERITUS PROFESSOR TAEHO BARK, PRESIDENT OF THE GLOBAL COMMERCE INSTITUTE OF LEE & KO

In recent years, Korea has greatly increased its engagement with global and regional economic partners. Its trade activity has steadily expanded, while it has also moved to become a major outward investor into high-growth economies across Asia. The Korean government has reaffirmed its longstanding interest in economic cooperation. It has signed fifteen bilateral FTAs, including with the US, Canada, India, Australia, Singapore and China. It has also actively participated in new regional economic institutions, such as the recently established Asian Infrastructure Investment Bank and ongoing negotiations for the Regional Comprehensive Economic Partnership trade agreement.

Australia has been an integral part of Korea's efforts to build economic ties with regional partners. The two countries have a three decade long trade relationship, based on Australia's role as a reliable supplier of minerals and energy for Korean industry. The bilateral FTA completed between the two governments in 2014 promises to deepen these ties. But while trade has been a core component of their bilateral economic relationship, investment connections are a more recent development. With strong complementarity between the Korean and Australian economies in a range of emerging knowledge- and technology-based sectors, there is significant scope for mutual gains through the growth of investment relationships as well.

In this report, Jeffrey Wilson highlights the importance of investment for the next stage of growth in the Australia-Korea economic relationship. Building on strong foundations established in the resource sector, the two countries now have an historic opportunity to mature and broaden their investment ties. In a time of global and regional economic uncertainty, such relationships will be catalytic for the achievement of an integrated and dynamic Indo-Pacific region.



#### **Dr Bark Taeho,**

Professor Emeritus of the Graduate School of International Studies, Seoul National University and former Minister for Trade in the South Korean government (2011 – 2013) and President of the Global Commerce Institute of Lee & Ko

## Forewords

### FOREWORD FROM GORDON FLAKE, CHIEF EXECUTIVE OFFICER OF PERTH USASIA CENTRE

Having spent much of my career working on Korea, and now calling Perth home, I have a strong interest in the enhancement of Australia-Korea relations. The work of the Perth USAsia focuses on the Indo-Pacific, a region which contains many of the world's leading and emerging economies. Strong economic relations between countries are crucial to the stability and prosperity of the region. In this report, Jeffrey Wilson explores how investment is one of the most significant growth areas for the Korea-Australia relationship in future years.

Since the establishment of bilateral relations in the later 1960s, Korea and Australia have developed a robust trade relationship based on the complementarity of their economies. But strong investment ties linking the two countries have been a much more recent development. This report shows how Korea and Australia can build on their strong trade relationship to mature and grow investment ties connecting their two economies

Recent geopolitical shifts, increasing uncertainty within alliances, and challenges for the international trade system are fostering a reappraisal of foreign policies across the region. To ensure the stability of the Indo-Pacific, it is essential that governments build cooperative relationships to achieve common goals. Korea and Australia now face a unique opportunity to use investment to strengthen their economic, political and strategic partnership.

As Korea becomes increasingly engaged with developments in regional politics, it will need to understand and respond to the emerging Indo-Pacific concept. By enhancing their bilateral investment ties, Australia and Korea can work together to build common strategies and approach for the Indo-Pacific. Doing so will have profound impacts on Korea's security, prosperity and future economic growth.

By establishing a strong business and investment presence in their respective countries, Australia and Korea can elevate the quality of their long-standing economic partnership. This report catalogues the existing strengths, identifies new opportunities for growth, and recommends policy and corporate strategies required to achieve this goal. Government and business leaders in Korea and Australia will find considerable value within its pages.



**Professor Gordon Flake**  
CEO, Perth USAsia Centre

## Summary of recommendations

To develop a stronger, diversified and more mature investment relationship, governments and businesses in Korea and Australia should:

1. Increase awareness and expertise amongst the corporate sector regarding bilateral investment opportunities
2. Build the capacity of service-sector SMEs in both countries to be 'investment ready'
3. Advance and broaden existing mechanisms for regulatory cooperation between the Australian and Korean governments
4. Develop mechanisms for infrastructure collaboration on both a bilateral and regional basis
5. Establish a strategy for advancing the agricultural relationship, which leverages existing trade ties to develop new investment partnerships

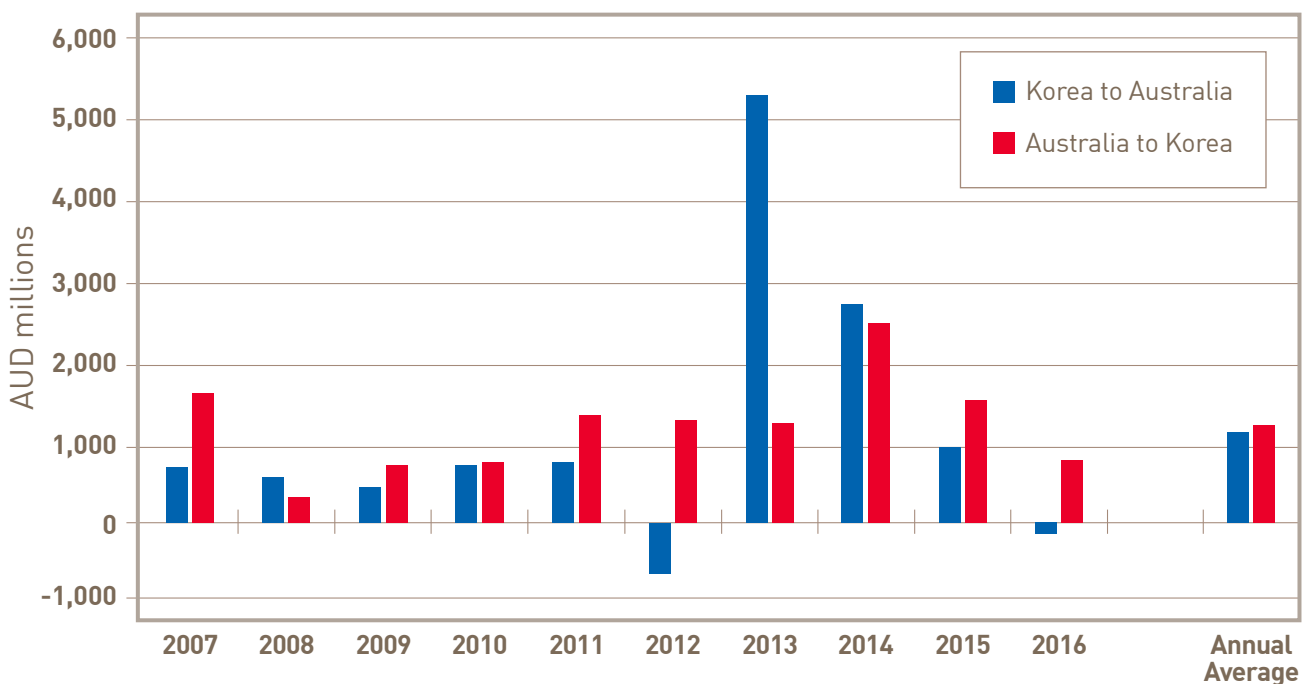


### 1. The contemporary Korea-Australia investment relationship

Investment ties have been a relatively recent addition to the Korea-Australia economic relationship. Economic ties were re-established by the governments' first bilateral trade agreement of 1965<sup>1</sup>, which was part of Australia's Cold War-era efforts to support the integration of Korea into the international economic system. The trade relationship that developed followed patterns of complementarity between the two economies: with Australia supplying Korea with agriculture, mineral and energy commodities; and Korea exporting manufactures and consumer goods. Bilateral trade relations have undergone two major expansions in subsequent years, both driven by natural resources. The first occurred between 1973 and 1981, when two-way trade grew nine-fold as expanding Korean heavy industry began seeking iron ore and coal supplies from Australia. The second was between 2004 and 2011, as surging mineral prices during the global resource boom drove bilateral trade to an all-time high of USD 31.4 billion<sup>2</sup>.

It was only during the more recent expansion of Korea-Australia trade that investment ties began to grow. As late as 2005, there was very little investment between the two economies: with Korean investment stocks in Australia of only \$900 million and Australian stocks in Korea of \$4.7 billion<sup>3</sup>. But during the mid-2000s investment began to surge. Over the last decade, bilateral capital flows have averaged \$1 billion per annum in each direction; with bumper years of Korean investment in Australia in 2013 and 2014 due to the launch of several high-value resource projects (Figure 1). This uptick in capital flows has seen bilateral investment stocks significantly increase, doubling in the five years to 2016 (Figure 2). For the first time in its five-decade history, investment now features prominently in the Korea-Australia economic relationship.

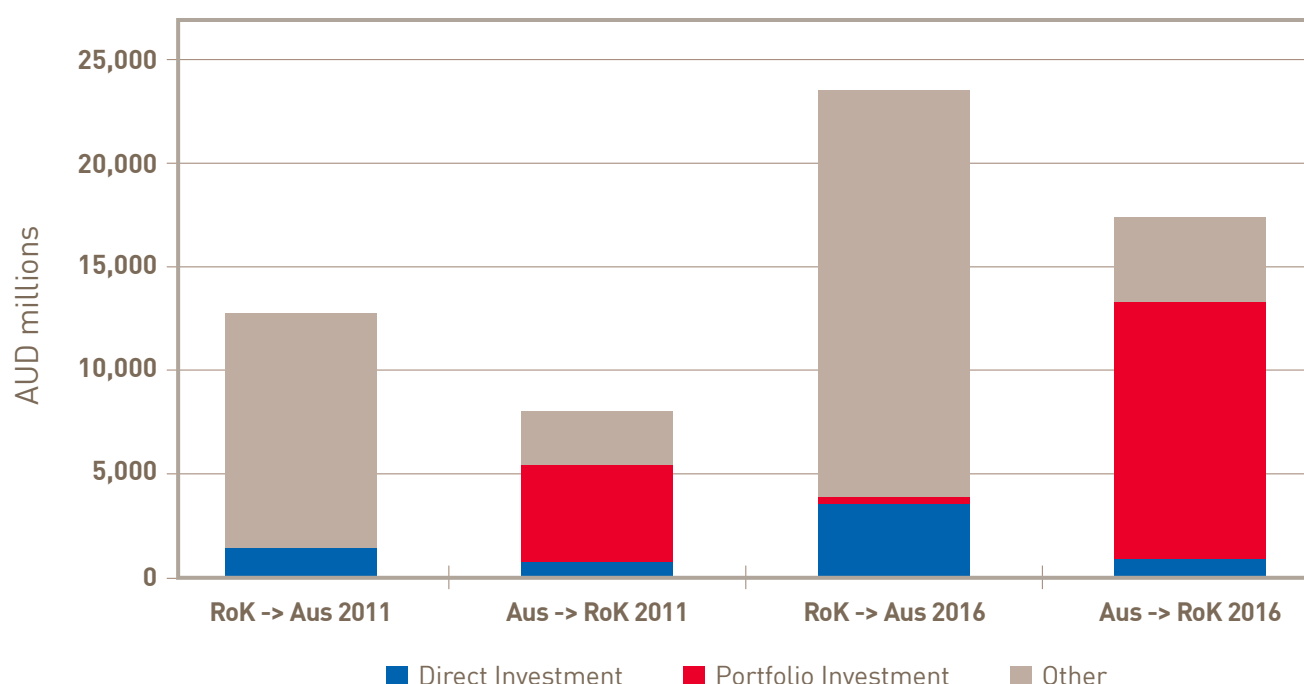
**Figure 1. Korea-Australia bilateral capital flows, 2007-16**



Source: ABS, *International Investment Position, Australia: Supplementary Statistics 2016* (Cat 5352.0)



**Figure 2. Korea-Australia bilateral investment stocks, 2011 and 2016**



Source: ABS, *International Investment Position, Australia: Supplementary Statistics 2016* (Cat 5352.0)

See note 4 for definitions.

Despite a rough symmetry in the volume of investment between Korea and Australia, the mode of entry by which each country invests is radically different. As Figure 2 shows, Australian companies favour portfolio investment - buying shares in Korean companies without seeking a management presence. These flows are principally driven by Australian institutional investors seeking positions in foreign equity markets. Korean investment predominantly falls into the 'other' category of the capital accounts, which represents inter-corporate debt financing extended to Australian firms. This mode of entry is common in mining and energy projects, where foreign partners offer debt-financing in exchange for 'offtake' sales contracts. Significantly, direct investment - where an investor buys over 10 percent of, and seeks managerial involvement in, a target firm - is only a small component of investment flows in either direction. This reveals that while capital flows between have grown considerably, the managerial connections between the two economies remain under-developed.

As a result of recent growth, the investment relationship between Korea and Australia has rapidly increased in importance. In the decade to 2016, Korea was the ninth largest source of capital inflows into the Australian economy, contributing \$11.7 billion (Table 1). Though Korea remains a long way behind established Australian partners such as the US, Japan and several EU economies, its presence in the top-10 is noteworthy given the relatively recent development of investment ties. From Korea's perspective Australia is also important, ranking sixth amongst destinations and accounting for 4 percent of all outbound flows. Significantly, Australia has leapfrogged comparable developed economies (including Canada, the UK and Singapore) in the Korean outbound ranking; and is not far behind Hong Kong, the regional investment hub of Northeast Asia. From a very low base a decade ago, the Korea-Australia investment relationship is now of strategic significance for both sides.

**Table 1. Australian and Korean investment flows, 2007-16**

	Australia Top-10 Sources			Korea Top-10 Destinations		
	Country	AUD billions	Shares	Country	USD billions	Shares
1 <sup>st</sup>	US	391.2	40.6%	US	60.4	21.9%
2 <sup>nd</sup>	Japan	126.8	13.2%	China	38.0	13.8%
3 <sup>rd</sup>	Belgium	120.8	12.5%	Hong Kong	15.6	5.6%
4 <sup>th</sup>	China	76.6	7.9%	Cayman Is.	13.3	4.8%
5 <sup>th</sup>	Singapore	38.6	4.0%	Vietnam	12.9	4.7%
6 <sup>th</sup>	Netherlands	34.8	3.6%	Australia	11.1	4.0%
7 <sup>th</sup>	Hong Kong	33.6	3.5%	Canada	9.1	3.3%
8 <sup>th</sup>	Luxembourg	16.0	1.7%	UK	9.0	3.3%
9 <sup>th</sup>	Korea	11.7	1.2%	Netherlands	8.4	3.0%
10 <sup>th</sup>	Virgin Is.	10.3	1.1%	Singapore	7.3	2.7%
Top-10		860.3	89.3%		185.1	67.0%
Others		103.4	10.7%		91.0	33.0%
<b>Total</b>		<b>963.6</b>			<b>276.1</b>	

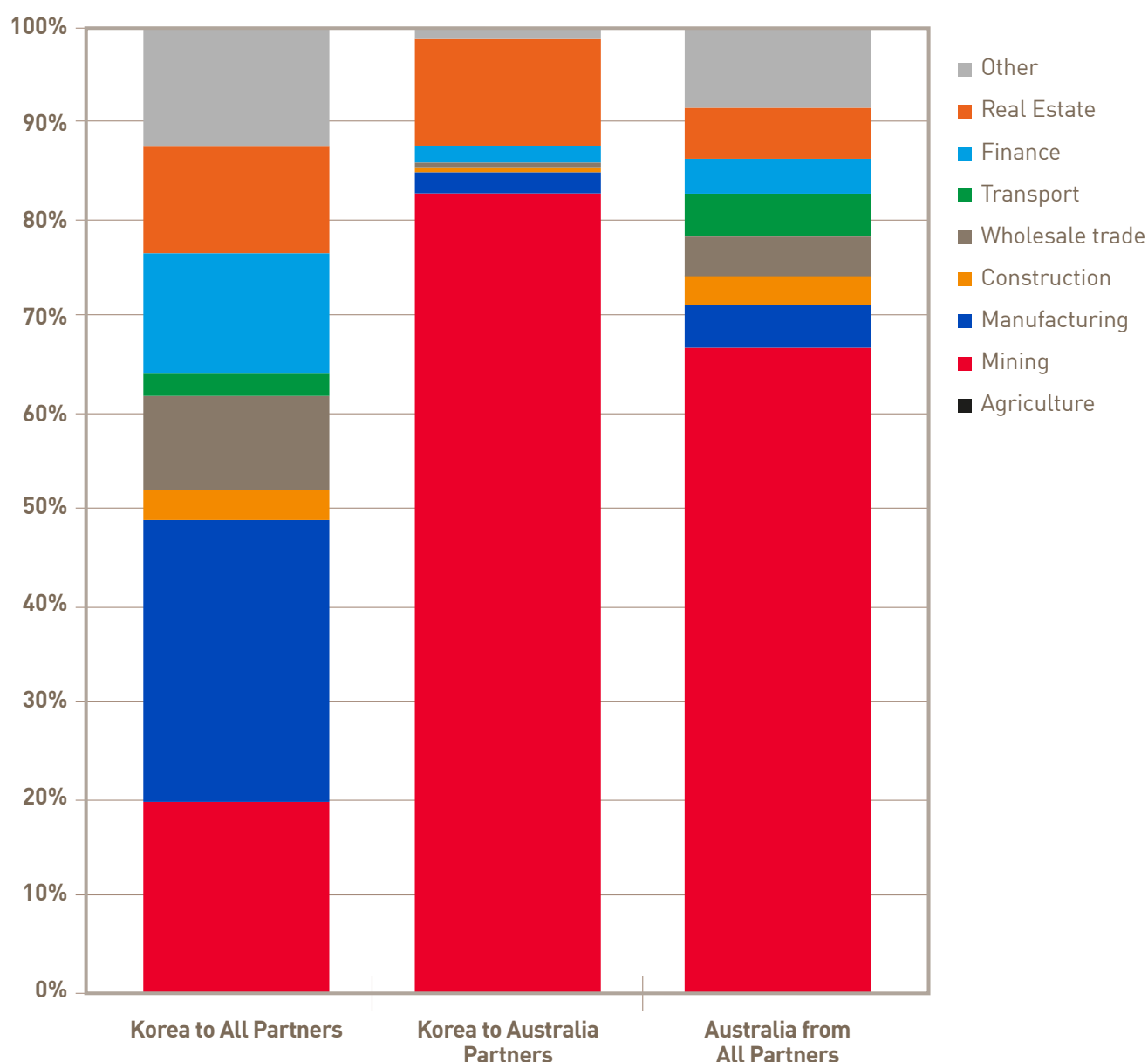
**Source:** ABS, *International Investment Position, Australia: Supplementary Statistics 2016* [Cat 5352.0]; KEXIM *Foreign Investment Statistics Database*, [http://211.171.208.92/odisas\\_eng.html](http://211.171.208.92/odisas_eng.html)

**There is a distinct sectoral bias to these investments.** As Figure 3 reveals, Korean investment in Australia is heavily weighted to the mining and energy sector, which accounted



for 83 percent of all capital flows during the last decade. Real estate contributed another 11 percent, with all other industries negligible. This sectoral pattern is very different from Korean outbound investment as a whole, which is dominated by manufacturing and a diverse range of service sectors. It is a similar pattern to what is typical for Australia, where the recent mining boom saw the resource sector account for two-thirds of capital inflows. However, this sectoral bias is relatively more exaggerated than for overall Australian investment inflows, and there is a notable absence of Korean investment in the construction, finance, wholesaling and transport sectors. The recent growth of the bilateral investment relationship is heavily reliant on the mining and energy sector.

**Figure 3. Composition of Korean investment flows to Australia, 2007-16**



**Source:** ABS, *International Investment Position, Australia: Supplementary Statistics* 2016 [Cat 5352.0]; KEXIM *Foreign Investment Statistics Database*, [http://211.171.208.92/odisas\\_eng.html](http://211.171.208.92/odisas_eng.html)

**Despite recent growth, the macroeconomic impact of Korean investment in Australia is limited.** The Australian economy is a net capital importer, which in recent years has depended on foreign sources for 11.2 percent of all investment (Table 2). The relatively modest volumes of Korean investment mean it is not a major contributor in terms of the aggregate supply of capital. The \$8.3 billion of net investment inflows from Korea accounted

for only 3.5 percent of all foreign investment between 2012 and 2016; and only 0.39 percent of all investment in the Australian economy. From the perspective of investment- and job-creation, Australia's relationships with the US, Japan, the EU and increasingly China remain an order of magnitude more important. While Korean investment now makes a material contribution in the resource sector, its macroeconomic impact for Australia remains minimal.

### Case studies

#### FINANCIAL SERVICES:

##### Macquarie Group



Many Australian financial institutions have adopted conservative attitudes towards Asian expansion. However, Macquarie Group saw major opportunities in rapidly growing Asian markets. Continuing a process of strategic realignment to Asia which had begun in the 1990s, it established a business presence in Tokyo and Seoul in 2000.

Korea offers Macquarie Group “an advanced, developed market with a healthy finance sector including a huge amount of equity and debt capital”.<sup>63</sup> Since opening its first Korean office with five staff, it has expanded its local presence to encompass many businesses outside of financial markets, several joint ventures and business alliances<sup>64</sup>. Its Korean portfolio includes an investment bank; property and financial advisory firms; real estate holdings; and infrastructure and investment management businesses. It wholly-owns Reclean Holdings, a renewable energy and environmental services company that is the largest food waste processor in Korea<sup>65</sup>. Macquarie Investment Management concluded the acquisition of ING Investment Management Korea from ING Group in December 2013, at the time making Macquarie Group the largest foreign asset owner in South Korea<sup>66</sup>.

Key for Macquarie Group’s success has been a recognition of the distinct opportunities in the Korean market, a diversified approach to investment, and expertise in public-private partnerships in infrastructure projects. This diversified strategy has helped Macquarie manage volatility within particular Korean sectors. Macquarie is reported to have the ‘lion’s share of all Australian investment in Korea’, with approximately \$25 billion under management as of January 2017.<sup>67</sup>

**Table 2. Net foreign investment inflows to Australia as share of total investment, by country, 2012-16**

	Net foreign investment inflows (AUD billions)	Share foreign investment in Australia	Share total investment in Australia
US	119.4	49.56%	5.56%
Japan	55.9	23.21%	2.60%
Belgium	111.0	46.10%	5.17%
China	60.1	24.97%	2.80%
Singapore	29.2	12.11%	1.36%
Korea	8.3	3.45%	0.39%
<b>All foreign investment</b>	<b>240.8</b>		11.22%
<b>All investment</b>	<b>2146.6</b>		

Source: ABS, *International Investment Position, Australia: Supplementary Statistics 2016* (Cat 5352.0); DFAT *International Investment Australia 2016* (Table 10).

## How well is the Korea-Australia investment relationship performing relative to expectations?

While all bilateral economic relationships are qualitatively different, a useful benchmark is Australia's investment ties with Japan. This is because of the close similarities between Australia's economic ties with the two Northeast Asian economies. Both are developed, industrialised and democratic countries, with similar economic and demographic structures. Both have similar trade relationships with Australia, initially founded on resources and agriculture during the 1970s before more recently moving into the service and technology sectors. Both are net capital exporters, whose corporate sectors have considerable experience investing abroad. These structural similarities mean the Japan-Australia investment relationship provides a relevant benchmark by which the strength of its Korea-Australia counterpart can be measured.

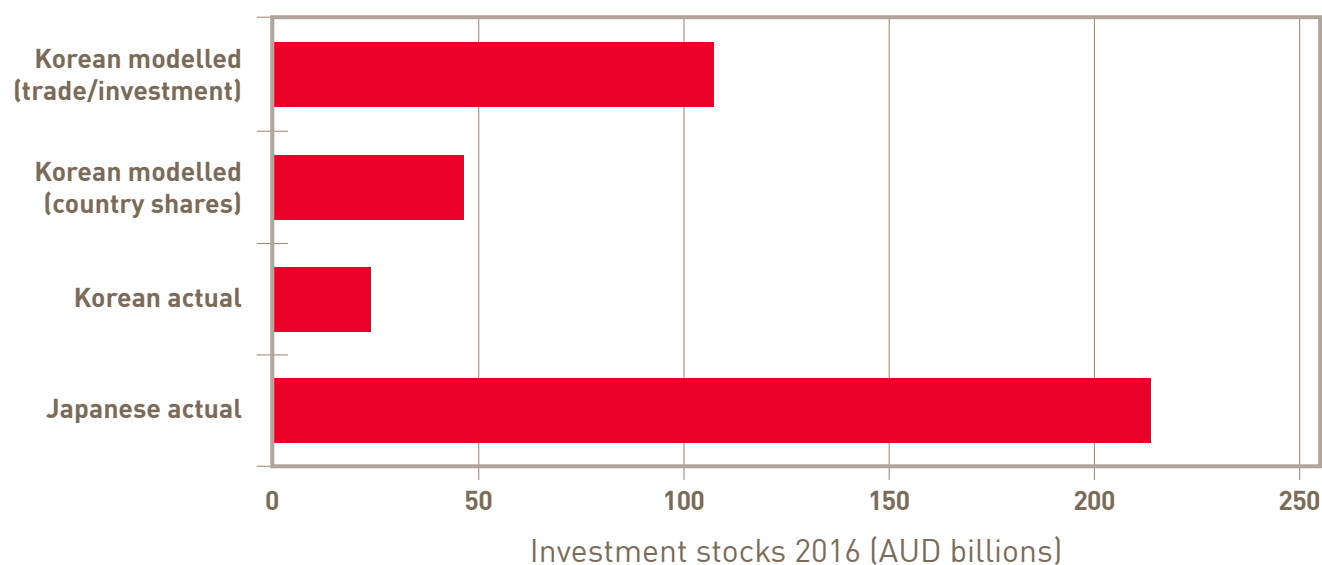
Figure 4 models the volume of Korean investment stocks in Australia if they were comparable with those from Japan. While current stocks of \$24 billion are only a tenth the Japanese level,

part of this difference is explained by the fact that the Japanese economy is 3.5 times larger than the Korean. But as the difference between these ratios suggest, Korean investment is still less than what might be expected. Australia ranks lower in Korea's outward investment than it does in Japan's; and if it received the same share of Korean investment abroad bilateral investment stocks would be twice as high. Similarly, the ratio between Australia's investment and trade volumes with Japan is 5.3, yet only 1.2 for Korea. Were the Japanese trade-to-investment ratio replicated for Korea, stocks would be four times higher. This modelling indicates that Australia's ability to attract Korean investment is underperforming relative to the potential implied by its investment relationship with Japan.

## What explains these unique features of the Korea-Australia investment relationship?

How have relevant policy frameworks shaped the recent size and form of investment ties? And how do these policy frameworks interact with contemporary market dynamics to enable and constrain investment?

**Figure 4. Benchmarking Japanese and Korean investment in Australia**



**Source:** Author's calculations, from ABS *International Investment Position, Australia: Supplementary Statistics 2016* (Cat 5352.0); UNCTADStat Database; KEXIM *Foreign Investment Statistics Database*; and JETRO *Japanese Trade and Investment Statistics Database*. See note 5 for methodology.

## 2. Policy frameworks for bilateral investment

**There is a strong and diverse set of policy frameworks governing the Korea-Australia economic relationship.** These exist at multiple scales, and include their domestic investment regimes, their bilateral trade arrangements, and joint participation in multilateral economic institutions at the regional and global levels. These frameworks are some of the most comprehensive and robust found in or between any countries, and provide a strong regulatory foundation upon which bilateral investment ties can be built.

**The first dimension is the domestic policy regimes of the Korean and Australian economies.** Both governments view international investment favourably, and maintain liberal policy setting designed to protect foreign investors and promote capital flows. The key features of their domestic investment environments are as follows<sup>6</sup>:

- **Transparent, rules-based investment regimes.** Both countries codify their foreign investment regulations in law – Korea's Foreign Investment Promotion Act and Australia's Foreign Acquisitions and Takeovers Act. These laws provide stable, transparent and legally-enforceable guidelines for how foreign investment will be managed by state agencies.
- **Korean negative-list approach to inward investment:** Korea applies 'negative-list approach' to assessing investment proposals (which presumes in favour of a foreign investment unless it falls into a defined list of restricted sectors). The majority of industries are open to foreign investment, with a limited number of restrictions applied only to sensitive sectors. Foreign investment is prohibited in sixty sectors (largely in the security and cultural spheres); while quantitative foreign ownership caps are imposed in another twenty-nine<sup>7</sup>.
- **Australian screening approach to inward investment:** The Australian government screens all foreign investment to ensure it passes a 'national interest' test. This screening is undertaken by the Foreign Investment Review Board (FIRB), a statutory body which makes recommendations to the Treasurer. Screening is required for six specified types of investment<sup>8</sup>, with all others receiving automatic approval. Caps on foreign ownership are also applied to airports, international airlines, shipping and Telstra. The overwhelming majority of foreign investment applications to the FIRB are approved.
- **Operational restrictions:** Neither government imposes performance requirements, trade balancing requirements, or limits on profit remittance, upon foreign investors.
- **Inward investment promotion:** The Korean government provides a number of incentives for foreign investors, including tax concessions, special economic zones, and access to a 'Foreign Investment Ombudsman' service. The Australian government does not offer inward investment incentives.
- **Outward investment policy:** Both governments maintain open capital accounts, and neither imposes any restriction on outward investment.
- **Support for outward investment:** Both governments provide technical support for small and medium enterprises engaged in outward foreign investment, via the Australian Trade and Investment Commission (Austrade) and the Korean Trade-Investment Promotion Agency (KOTRA).



**Table 3. 'Ease of Doing Business' performance of Korea and Australia, 2017**

Measure	Korea		Australia	
	Rank	DTF score	Rank	DTF score
Starting a Business	9	95.8	7	96.5
Dealing with Construction Permits	28	77.7	6	84.4
Getting Electricity	2	99.9	47	82.3
Registering Property	39	76.3	51	74.2
Getting Credit	55	65.0	6	90.0
Protecting Minority Investors	20	71.7	57	60.0
Paying Taxes	24	86.7	26	85.6
Trading across Borders	33	92.5	95	70.7
Enforcing Contracts	1	84.2	3	79.0
Resolving Insolvency	5	89.3	18	78.8
Overall Performance	<b>4</b>	<b>83.9</b>	<b>14</b>	<b>80.1</b>

Source: World Bank *Ease of Doing Business* database. See note 9 for definitions.

These policy regimes provide a liberal, transparent and rules-based approach to the management of foreign investment inflows and outflows; and compare favourably to those of many other economies in the Indo-Pacific region.

Korea and Australia also offer attractive business environments to investors. Both are consolidated democracies, with strong rule-of-law and effective economic institutions. This is reflected in their high rankings in the World Bank's *Ease of Doing Business* survey (Table 4), where Korea ranks fourth and Australia fourteenth out of 190 countries. Both countries score very well on most of the constituent metrics (with 'moderate' performance in a few areas such as property registration, customs procedures, minority investor protections and/or access to credit). Performance overall is well above the OECD average. These broader policy settings augment their attractiveness to investors, by reducing transaction costs and lowering regulatory burdens for operating a business. Australia and Korea offer some of the most business-supportive environments of any economy in Asia.

**The second dimension is the bilateral economic relationship, which was recently upgraded with the Korea-Australia Free Trade Agreement (KAFTA).** It is the first major economy-wide agreement between the two countries in over a generation<sup>10</sup>, and is designed to reflect the recent maturation of their economic relationship. By the standard of many FTAs, KAFTA was completed relatively quickly: negotiations commenced in 2009, were completed in 2013, and the agreement entered into force in December 2014. Both governments already have a wide suite of FTAs in place: Australia has ten bilateral agreements, Korea fifteen, and both have 'Plus One' plurilateral FTAs with the ASEAN bloc<sup>11</sup>.

However, KAFTA is marked out by being one of the highest-standard trade agreements either government has negotiated. In addition to significant provisions in the 'traditional' trade domain of market access, it also contains a range of 'WTO Plus' measures covering investment, services, finance, e-commerce and intellectual property (Table 4). These ambitious provisions reflect Korea and Australia's shared interest, as advanced economies, in institutionalising trade rules which reflect the needs of modern knowledge- and services-based industries. Few



### Case studies

#### BIOETECHNOLOGY:

##### Nutri Biotech



Korea has one of the fastest ageing populations in the world. As a result, there has been significant investment in biotechnology and pharmaceuticals from both the government and private sectors<sup>68</sup>. Given Australian capacity in biotechnology R&D<sup>69</sup>, Korean health food manufacturing company Nutri Biotech established its first Australian manufacturing facility in 2016. Its Victorian presence is the company's fourth global manufacturing facility, with others located in Korea, the US and China.

Nutri Biotech's Australian investment supported the development of a 26,000m<sup>2</sup> facility, responsible for the original development, design, manufacturing, marketing and delivery of approximately sixteen distinct product lines. The Victorian government expected the investment to create 150 new jobs, as well as make a significant contribution to the 47 percent of Australia's pharmaceutical exports<sup>70</sup> which are manufactured in the state. As the average age of populations continues to rise around the world, partnerships such as this will continue to grow in importance.

The expansion of Nutri Biotech into Australia implies the strategic advantage of Australia as a source of technological capability in newly-emerging sectors. The 2016 Scientific American Worldview Overall Scores<sup>71</sup> ranked Australia fifth in overall innovation in the biotechnology industry. Despite prioritising biotechnology R&D, Korea currently ranks twenty-fourth in overall innovation in the sector. With Korea having considerable manufacturing capacities in the pharmaceutical sector<sup>72</sup>, investments such as Nutri Biotech highlight the opportunities that Korea-Australia biotechnology partnerships offer.

contemporary FTAs amongst Asian countries, Trans-Pacific Partnership agreement<sup>12</sup>, contain with the exception of the recently completed such a range of high-standard provisions.

**Table 4. Major provisions of the Korea-Australia Free Trade Agreement**

Trade policy area		Provisions
Market access	Agriculture	Sugar, wine and seafood tariffs eliminated immediately; beef, wheat, dairy, lamb, pork and horticulture tariffs progressively eliminated over phase-in period between three and twenty years
	Industrial products	Tariffs on crude petroleum, natural gas, unwrought aluminium, automobile parts, white goods, steel products, electrical and electronic products, and pharmaceuticals eliminated either immediately or over phase-in period of between three and five years
	Services	National treatment (NT) and most-favoured-nation (MFN) protections; new access provisions in legal, financial, telecommunications, education; negative list approach to non-conforming measures (NCMs)
	Technical procedures	Provisions for information exchange, consultation and cooperation around technical barriers to trade (TBTs) and sanitary and phytosanitary (SPS) measures
Investment	Protections	National treatment (NT), most-favoured-nation (MFN), expropriation and transfers protections; negative list approach to excluded sectors
	Dispute Settlement	Access to Investor-State Dispute Settlement (ISDS) mechanism to enforce investment obligations, with modern public welfare safeguards
WTO-Plus Provisions	Movement of natural persons	Temporary access for business visitors (investors, managers and specialists) under specified circumstances
	Financial services	Rules for establishing commercial presence; 'cross-border' supply provisions; and negative-list approach to allowed financial services
	Intellectual Property	Builds on the TRIPS agreement, with protections for patents, trademarks, copyright and related rights, and enforcement.
	E-Commerce	Provisions to minimise regulatory burdens, online consumer protection and data protections
	Telecommunications	Rules governing infrastructure and spectrum access, technological neutrality, network unbundling and transparency provisions
	Others	Chapters governing competition, environmental, labour and government procurement regimes

**Source:** Author's compilation, from *Korea-Australia Free Trade Agreement 2014* and DFAT (2014) *Korea-Australia Free Trade Agreement Regulation Impact Statement*.

Beyond provisions which liberalise trade flows, KAFTA also contains three elements that aid bilateral investment flows. The first are its market access provisions, which are especially significant in the agriculture and services sectors. By increasing trade flows, these also augment investment by encouraging forms of vertical integration within regional value chains, particularly in the agricultural sector. The second are its investment rules, which guarantee national treatment (NT) and most-favoured-nation (MFN) protections, enforced through an Investor-State Dispute Settlement (ISDS) mechanism. These provide a greater degree of regulatory certainty for investors in both economies. The third are its WTO-Plus provisions, which reform 'behind-the-border' regulatory regimes across a range of modern sectors, including finance, e-commerce and knowledge-intensive industries. These reforms improve the domestic environment for foreign firms, allowing easier market entry and lowering the prospect of regulatory risk for long-term investment commitments.



**The third dimension is participation in multilateral economic organisations.** Australia and Korea are longstanding and active participants in the key institutions for economic cooperation:

- **At the global level,** both are members of the World Trade Organisation, International Monetary Fund, World Bank, Organisation for Economic Co-operation and Development, and G20.
- **At the regional level,** both are members of APEC, the East Asia Summit, and are formal dialogue partners of ASEAN. APEC is especially significant for investment, having adopted a set of 'Non-Binding Investment Principles' under which members commit to transparency, protection and dispute settlement arrangements for managing cross-border investments<sup>13</sup>.
- **In the investment sphere,** they are members of the World Bank's Multilateral Investment Guarantee Agency (which offers political risk insurance and investment guarantees); and are signatories to the New York Convention and ICSID Convention (which commit states to arbitral procedures for the settling of investment disputes).
- Both are members of the **region's two multilateral development banks** – the Asian Development Bank and Asian Infrastructure Investment Bank – which make loans to developmentally-significant projects across the region.

Via these shared institutions, Australia and Korea are deeply-interwoven in the international architecture for investment cooperation.

### Fourth, there are also prospective areas for these investment policy links to grow in future years:

- One is the **Regional Comprehensive Economic Partnership (RCEP)** trade agreement currently under negotiation. RCEP aims to integrate the six existing 'ASEAN Plus One' FTAs into a single agreement, and further improve market access in a number of protected merchandise and services trade lines. While RCEP offers a lower-standard approach to liberalisation than in KAFTA, it will include provisions designed to promote cross-border investment amongst members.
- Another is the **'TPP-11' agreement**, which in March 2018 was signed by the remaining eleven members of the Trans-Pacific Partnership (subsequent to US withdrawal)<sup>14</sup>. Like KAFTA, the TPP-11 eleven contains a wide range of WTO Plus provisions – which in many cases advance upon those in KAFTA – and will help 'regionalise' a high-standard approach to trade and investment rules in Asia. While Korea is not presently a TPP-11 member, the agreement includes an accession mechanism that allows additional members to join following entry-into-force. The Korean government is presently considering membership to the TPP-11 agreement<sup>15</sup>, and is considered to be one of the most likely candidates for accession.

The particular value of RCEP and the TPP stems from the fact they are *regional*, rather than bilateral, agreements. Multilateral trade agreements provide liberalising rules which facilitate the development of global value chains spread across multiple regional economies.

**Overall, the picture is one of a very supportive policy environment supporting investment flows between Korea and Australia.** Both countries maintain highly-favourable domestic investment and economic policy regimes by international comparison; are connected by a high-standard bilateral FTA with strong investment and WTO-Plus provisions; and are co-participants in the regional and global economic institutions which facilitate investment flows. The policy environment for Korea-Australia bilateral investment is amongst the strongest that either country has with any economic partner. Therefore, to understand the unique features of the contemporary investment relationship requires assessing the economic drivers that are shaping corporate investment decisions.

## 3. Economic drivers of Korea-Australia investment

**The principal driver behind the Korea-Australia economic relationship is the complementarity between the two economies.**

As a recently industrialised country, Korea has a range of globally-competitive manufacturing sectors, particularly in heavy industries such as construction, petrochemicals, shipbuilding, automobiles and engineering. However, as a comparatively resource-poor country, Korea needs to look abroad for the supply of raw materials for its heavy industrial sectors. As a leading natural resource producer, Australia has for several decades been one of the most important suppliers of mineral, energy and agricultural products to the Korean economy.

In 2016, Australia supplied 70 percent of Korea's iron ore, 44 percent of coal, 57 percent of sugar, 48 percent of beef, 39 percent of wool and 26 percent of wheat imports<sup>16</sup>. Korea supplies Australia with a range of manufactured products, principally in the automobile, petrochemical, engineering and electronic equipment fields<sup>17</sup>. Two-way trade in goods was worth \$20.2 billion in 2016, with Australia ranking as Korea's sixth largest export market, and Korea as Australia's third.

**Economic complementarity not only drives a robust bilateral resource trade, but also helps crowd-in investment flows.** Korea's lack of natural resources means its heavy industrial sectors are dependent on raw material imports, exposing them to heightened resource security risks. In the resource sector, these risks are often managed through quasi-vertical integration strategies<sup>18</sup>, where industrial firms take minority ownership stakes in important mineral and energy suppliers abroad. These strategies benefit both sides. They enable consumers to

financially sponsor the development of new resource projects, integrate corporate planning through managerial representation, and secure preferential access to supplies with 'offtake' arrangements. For resource firms, they provide access to project financing and the long-term security needed to successfully execute giant projects with multi-decade design lives. As a consequence, resource trade and investment relationships often develop simultaneously, as producing and consuming firms develop projects via joint ventures, long-term sales contracts and investment cross-holdings.

**This joint resource development model has been the foundation of the Korea-Australia investment relationship for many years.**

Korea's first major resource investment abroad occurred in 1979, when POSCO acquired a 20 percent stake in the Mt Thorley metallurgical coal project in New South Wales<sup>19</sup>. However, the volume of Korean resource investment increased considerably during the mid-2000s. Table 5 below provides a summary of some of the more significant projects. These investments were in part driven by the 'global resource boom', which saw international mineral and energy prices roughly quadruple between 2005 and 2013. This encouraged Korean industrial firms to more actively seek equity positions in key resource suppliers. Another contributing factor was resource security policies adopted by the Lee Myung-Bak administration (2008-13), which offered government subsidies for resource investments through the Korean EXIM Bank<sup>20</sup>. In the decade to 2016, Korean firms made USD 55 billion of resource investment abroad, of which 17 percent were located in Australia<sup>21</sup>.



**Table 5. Major Korean resource investments in Australia since 2005**

Year	Project	Commodity	Investor	Stake	Value (AUD millions)
2007	Cockatoo Coal	Coal	POSCO	20%	\$25
2008	Macarthur	Coal	POSCO	10%	\$440
2008	Murchison Metals	Iron Ore	POSCO	12%	\$26
2010	Australian Premium	Iron Ore	POSCO	25%	\$185
2010	Roy Hill	Iron Ore	POSCO	15%	\$1500
2011	Gladstone	LNG	KOGAS	15%	\$600
2012	Prelude	LNG	KOGAS	10%	\$1500
2018	Pilbara Minerals	Lithium	POSCO	5%	\$80

## Real estate has recently emerged as a new investment driver.

It is the second largest sector for Korean investment in Australia, accounting for 11 percent of bilateral flows in the decade to 2016. A noteworthy feature is that these are driven by Korean institutional investors, who are seeking large commercial opportunities with long-term tenants (particularly hotels, retail and office buildings) in mature real estate markets. Several major Korean institutional investors - including Mirae Asset Global Investment, SK Teacher's Pension Fund, FG Asset Management, and the National Pension Service - have made large commercial real estate acquisitions in Australia in the last five years<sup>22</sup>. These real estate investments align with their strategy of seeking stable, long-term returns from overseas assets in secure markets. The strength of Korean interest in Australian real estate is reflected by the fact that the FIRB approved \$2 billion of investment proposals in 2015-16, four times higher than five years prior<sup>23</sup>.

## A factor common to both the resources and real estate sectors is Australia's status as a 'reliable' business environment.

As noted prior, Australia offers an attractive political, legal and policy environment for foreign investors. But equally important is the stability of its domestic regulatory framework. Australia has maintained these liberal policy settings for many decades, making it a mature investment environment with minimal risk of adverse policy or institutional changes. This regulatory *stability* is especially

important for large projects with long-term time horizons. Resource projects have very long design-lives typically measured in decades rather than years; while institutional property investors seek long-term positions in fixed real estate assets. The stability of Australia's business environment gives Korean firms confidence their investments will be secure over the long-term.

## On the Korean side, an important driver is the recent growth of the funds management sector.

Korea is currently the most rapidly-ageing country in the OECD, due to its low birth-rate, growing life expectancy and minimal inward migration<sup>24</sup>. As the retirement-age population steadily grows, it is driving a huge expansion in the size of Korean pension and insurance funds. The National Pensions Service (NPS) Fund alone held assets under management of USD536 billion in 2017<sup>25</sup>, while the range of other private and state-owned pension and insurance funds are also growing rapidly<sup>26</sup>. While these funds have historically focussed on Korean equities, they are increasingly looking to overseas markets to diversify risk within their booming portfolios. For example, the NPS has indicated its overseas investments will rise to 40 percent by 2022<sup>27</sup>, up from only 8 percent in 2012<sup>28</sup>. As the Korean funds management sector seeks secure, long-term and relatively low-risk assets, Australia's stable business environment has seen it become an increasingly attractive site for Korean investment abroad.

### Case studies

#### NEW RESOURCE PARTNERSHIPS:



Over many years of involvement, POSCO has invested \$1.9 billion in Australia<sup>73</sup>. The Korean steel firm was founded in 1968 and established its Australian subsidiary POSCO Australia in 1981. POSCO has made significant investments in Australian commodities including iron ore, coal and most recently lithium. POSCO has had a long presence in Western Australia, investing in various iron ore projects and most recently acting as a significant investment partner in Roy Hill.

However, POSCO's most recent move to acquire a 4.5% stake in Pilbara minerals is a game changing investment. Pilbara Minerals is an emerging lithium and tantalum producer, which aims to tap into the global shift in energy technologies<sup>74</sup>. The company's Pilgangoora Lithium-Tantalum project is one of the world's leading lithium projects<sup>75</sup>. In February 2018, POSCO agreed to buy up 240000 t/y of lithium concentrate from Pilbara Minerals to help supply producers of electric vehicle batteries<sup>76</sup>. The partnership benefits POSCO by providing it with a stable source of supply which will assist the company in its battery manufacturing operations while diversifying Pilbara's production routes for lithium<sup>77</sup>.

POSCO's investment in Pilbara Minerals indicates the company's and South Korea's ability to recognise emerging markets and new investment opportunities. It represents a marriage between the conventional pattern of Korean investment in Australian resource projects with emerging opportunities in high-technology industrial value chains.

The KAFTA agreement of 2014 has provided a fillip for bilateral investment flows. As both the Korean and Australian governments already maintained comparatively open and secure investment regimes, the principal impact of KAFTA has not been via its investment provisions. Rather, it has come through its more trade-oriented elements. These include:

- **Market access-related investment effects**, where improved market access leads to increased bilateral trade flows, which in turn crowds-in additional investment. These increased trade flows, such as in liberalised agricultural sectors, may encourage Korean agribusinesses to acquire stakes in their Australian suppliers, following a similar joint development model to that seen in the resources sector.
- **WTO Plus-related investment effects**, where more open regulatory regimes encouraged additional investment. Improved regulatory provisions for financial services, e-commerce, telecommunications, intellectual property and movement of natural persons reduce transactions costs for firms, making bilateral investment more attractive. This will help Australian service business seeking to establish a commercial presence in Korea, particularly in the fintech<sup>29</sup> and biotechnology<sup>30</sup> sectors.

- **FTA signalling effects**, where the completion of a free trade agreement focuses greater attention to bilateral economic relations amongst key stakeholders. The signing of KAFTA in 2013 encouraged businesses in both countries to 'take a closer look' at investment opportunities in the other<sup>31</sup>. The agreement also includes a number of consultation mechanisms for ongoing intergovernmental discussions across its suite of WTO-Plus regulatory areas<sup>32</sup>.

To be sure, bilateral investment flows declined markedly in the two years following KAFTA's entry into force in late 2014 (**Figure 1**). However, this decline can be attributed to the fact that investment flows were abnormally high in previous years due to several very large resource investments made by POSCO and KOGAS (**Table 5**). With a reduction in mining and energy investment following the end of the resource boom, this decline thus reflects a 'return to trend' rather than secular decline in the Korea-Australia investment relationship. As the economic drivers outlined above grow in importance, an uptick in bilateral investment flows should be expected in coming years.



## 4. Opportunities and new areas for growth

The Korea-Australia investment relationship is on the cusp of a structural transformation. While the size of investment flows picked up sharply during this last decade, they remained relatively traditional in form: dominated by the resource sector, and characterised by arm's length modes of entry. However, the next stage of growth is likely to change this pattern. KAFTA's regulatory provisions will facilitate investment in a wider range of service sector areas; while the underlying economic drivers for investment are shifting into new industries. A more diversified, closely-integrated and mature bilateral investment relationship is likely to emerge. Several key areas for expected growth exemplify this trend.

**One is a transformation within resource sector investments.** Korea's dependence on mineral and energy imports, and Australia's strengths as a reliable supplier, mean natural resources will always play a key role in their investment relationship. With the end of the global resource boom in 2014, the investment driver for resource sectors that were important during the last decade – particularly coal, iron ore and natural gas – has declined considerably. However, a new set of resource sectors are well-positioned to become a new source of investment growth:

- Renewable energy and associated technologies. Korean industrial firms have significant technological capabilities in the renewables sector, particularly in terms of wind generation, fuel cells, lithium batteries and electric vehicles<sup>33</sup>. Australia has some of the world's best natural endowments of geothermal, solar and wind energy<sup>34</sup>; whose potential would benefit considerably from storage and battery technologies to manage asynchronous gaps between supply and demand. Korean expertise in storage technology – such as Hyundai Electric's 150MW lithium-ion storage system under construction in Ulsan<sup>35</sup> – could make a major contribution to the security of Australia's National Energy Market.
- Lithium and battery technologies. As the renewables sector grows in size and technological sophistication, global demand for lithium is expected to soar. Korean firms producing batteries, or using them in electrical, automotive and industrial products, will need to secure greatly-increased volumes of lithium abroad. Australia is currently the world's largest producer of lithium, and holds the third-largest proven reserves behind Chile and China<sup>36</sup>. Australia's reliable regulatory regime, alongside its technical capacity in the lithium mining and processing chain<sup>37</sup>, make it an ideal site for joint developments. POSCO's \$80 million investment and offtake partnership with Western Australia's Pilbara Minerals in early 2018 promises to be the first of many Australia-Korea lithium projects.

**An emerging area is agriculture, where the existing trade relationship can be leveraged to drive cross-border investment.** Agriculture is a key component of bilateral trade, with the USD 1.8 billion of trade accounting for 13.8 percent of Australia's exports to Korea in 2016<sup>38</sup>. Yet this trade has not led to corresponding investment flows. Agriculture accounted for only 0.14 percent of Korea investment in Australia during 2007-16; and the FIRB has approved only \$65 million of Korean agricultural investment proposals in the last five years<sup>39</sup>. Given the economic complementarity in agriculture between the two economies, it has hitherto been a missed opportunity for building more diversified investment ties.

New trade agreements involving Australia and Korea may change this in future. KAFTA provided duty free access for 84 percent of Australia's agricultural export on entry-into-force, which will rise to 98 percent upon full implementation<sup>40</sup>. Major market access gains were opened in beef, sugar, wheat, dairy and horticulture (Table 4). As KAFTA's agricultural provisions are progressively implemented, Korean companies will gain more exposure to –

and more investment interest in – the Australian agricultural sector. Diversified agricultural asset funds, rather than individual agribusiness, are a good match for the needs of the Korean funds management sector. The RCEP agreement, currently under negotiation, may also boost agricultural trade by streamlining rule-of-origin (ROO) procedures<sup>41</sup>. The TPP-11 also includes significant agricultural market access gains, and if Korea was to join the agreement could further contribute to bilateral agricultural trade.

**Another area of expected growth is financial services.** As their populations age, and their economies continue a long-standing structural shift towards services, financial services are expected to be a major growth sector in Korea and Australia. Ongoing expansion in assets under management – particularly by insurance and pension funds – is creating a need for asset managers in both countries to diversify their portfolios into foreign asset classes. The maturity, stability and regulatory strength of the Korean and Australian financial sectors makes them attractive partners for such investments. A more recent addition is the emergence of 'fintech' (financial technology). This emerging sector sits at the junction of two areas where Australia and Korea possess world-class capacity: combining

banking and financial services with information and communication technologies. Fintech is being rapidly adopted in both countries, with 37 percent of digitally-active Australians and 32 percent of Koreans using fintech products or services in 2017<sup>42</sup>.

The prospects for financial services investment are being augmented by a number of cooperative initiatives involving Korea and Australia. One is the *Asian Region Funds Passport* (ARFP) initiative, launched through APEC in 2013 by Australia, Korea, New Zealand and Singapore. The ARFP is intended to provide a multilateral framework for the cross-border marketing of managed funds<sup>43</sup>. A Memorandum of Cooperation to initiate the ARFP was signed in 2015, and a pilot project is commencing in 2018<sup>44</sup>. KAFTA's financial services provisions have similarly reduced barriers to these investments, by defining rules for the establishment of commercial presence and the 'cross-border' (i.e. without commercial presence) supply of services. KAFTA's negative list approach to financial services future-proofs these provisions, by ensuring that they will also apply to new products emerging from the fintech sector<sup>45</sup>.



### **Infrastructure will also provide a platform for deepening investment ties.**

While infrastructure presently only accounts for a tiny fraction of bilateral investment flows<sup>46</sup>, underlying economic complementarity between Australia and Korea suggest there is significant scope for growth. Korea has world-class capacity in engineering and construction (E&C), with its range of industrial conglomerates – including divisions of Hyundai, Samsung, GS, POSCO and Daelim – currently active in over 300 major infrastructure projects around the world<sup>47</sup>. Australian firms have considerable capacity in infrastructure financing, particularly in terms of developing public-private partnerships (PPPs) to manage complex infrastructure projects with long time-horizons<sup>48</sup>. Synergies between Korean E&C and Australian PPP capabilities could support two kinds of infrastructure investments:

- One is Korean involvement in Australian infrastructure projects. Here, Korean E&C firms could contribute as contractors, service providers, operators and/or equity partners to major infrastructure projects in Australia. As identified in the 2016 Australian Infrastructure Plan, the imperatives of population growth, trade expansion, urbanisation and sustainability are driving a wide range of new infrastructure projects<sup>49</sup>. Infrastructure Australia has identified some twelve specific projects and eighty-four broader initiatives which are national priorities in either the near-, medium- or long-term<sup>50</sup>. There are particular opportunities for Korean E&S firms in the Australian road and rail transport sectors.

- A second is Australian and Korean joint involvement in infrastructure projects in third countries in Asia. The Asian region is presently plagued by a range of 'infrastructure gaps', where better transport, energy and informational connections between economies are required. The Asian Development Bank has recently estimated that the region will need to make USD 1.5 trillion of infrastructure investments in every year from 2016 to 2030<sup>51</sup>. The available pool of financing for these projects has increased dramatically in recent years, particularly since the establishment of the Asian Infrastructure Investment Bank (AIIB) in 2015, of which Korea and Australia are both founding members<sup>52</sup>. There are significant opportunities for Korean E&C and Australian infrastructure financing firms to partner in the development of projects in the Southeast Asian region<sup>53</sup>.

### **Taken together, these prospective areas of growth point towards an opportunity to 'mature' the Korea-Australia investment relationship.**

Over the last decade, a solid foundation has been put in place in the resource sector, where bilateral trade in minerals and energy has acted as a platform for growing investment ties. The time is now right to build off this resource-driven base, and build a more diversified set of investment linkages that exploit the full range of complementarities between the Australian and Korean economies.

## 5. Recommendations for maturing investment relations

Developing a more mature and diversified investment relationship should be a strategic priority for both Korea and Australia. It would open new channels for the supply of capital, offering firms a wider range and volume of financing opportunities. It would provide a platform for deeper trade relations, by using the joint development model pioneered in the resource sectors and broadening to new industries. It would also contribute to the sharing of knowledge and technology, particularly through more direct forms of investment that develop managerial links between Australian and Korean firms. To achieve these goals, however, will require managing a number of policy, economic and institutional challenges.

**The first is raising awareness regarding bilateral investment opportunities.** Outside of the resource sector, corporate actors on both sides report relatively limited knowledge of the

other. This is partly the result of low overall levels of investment, especially the lack of direct investment links that build managerial ties and familiarity with local markets. But it is also reflected in the behaviour of governments. Table 6 below presents data on international visits by Australian state governments to Asia. These visits are an important form of Australian economic diplomacy and play a signalling role raising awareness amongst businesses regarding investment and trade opportunities. The data reveals that Korea is relatively under-represented in these efforts, with twenty visits between 2010 and 2016 accounting for only 10 percent of the total. This is similar to Indonesia and India, but far less than is made to leading investment partners in Asia such as China, Japan and Singapore. A comparable pattern is observed in Commonwealth government visits, with Korea accounting for only eleven of 248 parliamentary trips made to Asia in 2017<sup>54</sup>.

**Table 6. Official visits by Australian state governments to Asia, 2010-16**

	China	Indonesia	India	Japan	Korea	Singapore	Other Southeast Asia	Total
NSW	12	1	6	9	5	6	5	44
QLD	31	9	7	12	6	14	7	86
SA	8	0	1	0	1	2	2	14
WA	44	16	9	14	6	26	7	122
VIC	2	1	0	2	2	1	1	9
<b>Total</b>	<b>97</b>	<b>27</b>	<b>23</b>	<b>37</b>	<b>20</b>	<b>49</b>	<b>22</b>	<b>275</b>

**Source:** Compiled from media reports and state government travel disclosures. Notes: No data for Tasmania is available. SA data is for Premier only between 2013-15. WA data limited to Premier, Cabinet and Parliamentary Secretary level visits.



The solution is to augment ongoing efforts to improve knowledge and awareness of bilateral investment opportunities amongst Australian and Korea businesses. These are presently undertaken at the government level by Austrade, and the private sector through the Australia-Korea Business Council (AKBC) and Australian Chamber of Commerce in Korea (AustChamKorea). These organisations hold events, offer training and publish resources to assist businesses develop bilateral trade and investment relationships<sup>55</sup>. Austrade also provides services to Australian businesses through its network of advisers. Given the new opportunities currently available in the Korea-Australia investment space, the time is now right to upgrade and better resource these existing efforts. Australian state and federal governments should also ensure Korea is better represented in economic diplomacy initiatives, to reflect its importance as a trade and investment partner.

Effort should be focussed on building knowledge and contacts beyond traditional industries. There are longstanding and extensive investment ties - and a corresponding degree of mutual understanding - in the resource and real estate sectors. But very low levels of investment outside these sectors means that networks of personal contacts, professional familiarity and informational availability is poor for firms in prospective growth markets. Efforts to improve knowledge and awareness should therefore focus on sectors such as infrastructure, financial services, agriculture and resource-related manufacturing industries. Establishing a foundation of informational and inter-personal connections specific to these sectors will be essential if the investment relationship is to diversify and mature.

### **The second is developing capacity amongst small- and medium-enterprises (SMEs).**

Hitherto, the bulk of investment between Australia and Korea has been undertaken by large corporations in the resource sector. These are large internationalised businesses, with significant in-house capacity for managing complex cross-border transactions and operating in a diversity of regulatory environments. However, the sectors in which investment is likely to develop next are instead characterised by the presences of SMEs. This is particularly relevant to the fintech, agriculture and professional service industries, where new knowledge- and technology-intensive activities are more likely to be provided by startups and small businesses. The firms lack the capacity of their larger counterparts to develop international investment ties, due to their more limited pools of human and financial resources. If the Korea-Australia investment relationship is to move into these sectors, SMEs will need to play a far more active role.

There are no easy fixes for building the international capacity of SMEs. While these challenges have long been recognised, to some extent their size poses an inherent limit to what capabilities they can reasonably expect to develop in-house. Therefore, the best solutions will find ways to 'network' SMEs so they can draw on a wider range of external resources and capabilities. One strategy is to encourage SMEs to participate in consortia, in which firms cooperate as a group to share knowledge and spread risks<sup>56</sup>. Such consortia allow SMEs to acquire local market knowledge, so they can be better informed when deciding on legal issues, potential investment opportunities, and investment risk assessments. Another is to develop formal partnerships with the 'platform' businesses that manage complex value chains, to improve access for Australian and Korean SMEs<sup>57</sup>. The development of stronger Korea expertise in the Australian commercial consultancy sector (and vice versa) would provide a deeper 'ecosystem' of knowledge and expertise on which SMEs could draw.

### Case studies

#### INFRASTRUCTURE AND MANUFACTURING:

##### Railconnect NSW



The inter-city railway system connecting Sydney to growing regional centres in the South Coast, Blue Mountains, Central Coast and Newcastle requires modernisation. In 2016, the NSW government awarded a \$2.3 billion contract for the manufacturing and maintenance of a next generation inter-city rail fleet to the Railconnect consortium. Railconnect is a three-country joint venture, comprised of UGL Limited (Australia) performing maintenance services, Mitsubishi Electric (Japan) providing technology systems, and Hyundai Rotem (Korea) undertaking design and manufacturing of rolling-stock<sup>78</sup>.

The Railconnect consortium promises a modern, value-for-money upgrade for the Sydney inter-city rail network. Railconnect's bid to develop the 500+ carriage fleet was assessed as 25 percent cheaper<sup>79</sup> than its competitors during the tendering process. This includes the development of a new maintenance facility at Kangy Angy on the NSW Central Coast, employing more than 200 staff.<sup>80</sup> The inter-city fleet will offer more comfortable seating with 2x2 seating rows, mobile phone charging docks, increased accessibility and room for luggage, prams and wheelchairs, among other new features aimed at increasing passenger comfort, safety and security.<sup>81</sup>

Incorporating three different countries into this joint venture both enhances business relations between the countries and utilises the competitive advantage of each industry; Japan's technological skills, South Korea's design and manufacturing expertise and Australian local market expertise. The consortium is on track to deliver the first carriages in 2019 as planned.

### **A third is advancing regulatory cooperation between the Australian and Korean governments.**

In many new service sectors, the paramount barriers to trade and investment are not tariffs, but differences between national regulatory frameworks. These so-called 'behind the border' issues impose transaction costs, lower transparency, and raise regulatory risks for international investments. They are especially pronounced in areas where professional accreditation is required (including branches of healthcare, legal consulting and engineering services) or there are significant public-interest regulatory systems (such as the finance and agriculture sectors). They are also particularly onerous for SMEs, who have limited resources to manage compliance with multiple regulatory requirements. Regulatory harmonisation can play a major role in providing the regulatory groundwork to make cross-border investment attractive.

Fortunately, there has been much recent progress in this space. The KAFTA agreement included bilateral regulatory reforms in the areas of financial services, intellectual property, e-commerce and technical barriers to trade. The Asian Regional Funds Passport initiative promises to do the same, on a regional rather than bilateral basis, to facilitate cross-border acquisitions between managed investment funds. However, more work could be done on regulatory cooperation, particularly with a focus on the sectors expected to drive growth in the investment relationship. KAFTA provides an ideal instrument to advance bilateral regulatory cooperation. It contains five 'built-in' review mechanisms, and a further fifteen sectorally-based implementation committees which can be activated at the agreement of the parties<sup>58</sup>. Advancing cooperation through these KAFTA mechanisms will ensure the best possible regulatory environment for bilateral investment flows.

### **A fourth is developing mechanisms for infrastructure partnerships.**

There are significant governmental and private sector opportunities for Australia and Korea to cooperate on infrastructure projects. It is an area of complementarity between the two economies, with Korean strengths in E&C well-matched with Australian expertise in project design and financing. These capabilities could be combined in joint ventures for infrastructure projects in Australia, particularly in the road, rail and port transport sectors. As Asian governments increasingly up their infrastructure spend in coming years, there are also opportunities for Korean and Australian firms to partner in consortia developing infrastructure projects in third countries. With both governments active members of the two multilateral development banks which finance infrastructure projects in Asia<sup>59</sup>, they are well-placed to take advantage of such opportunities.

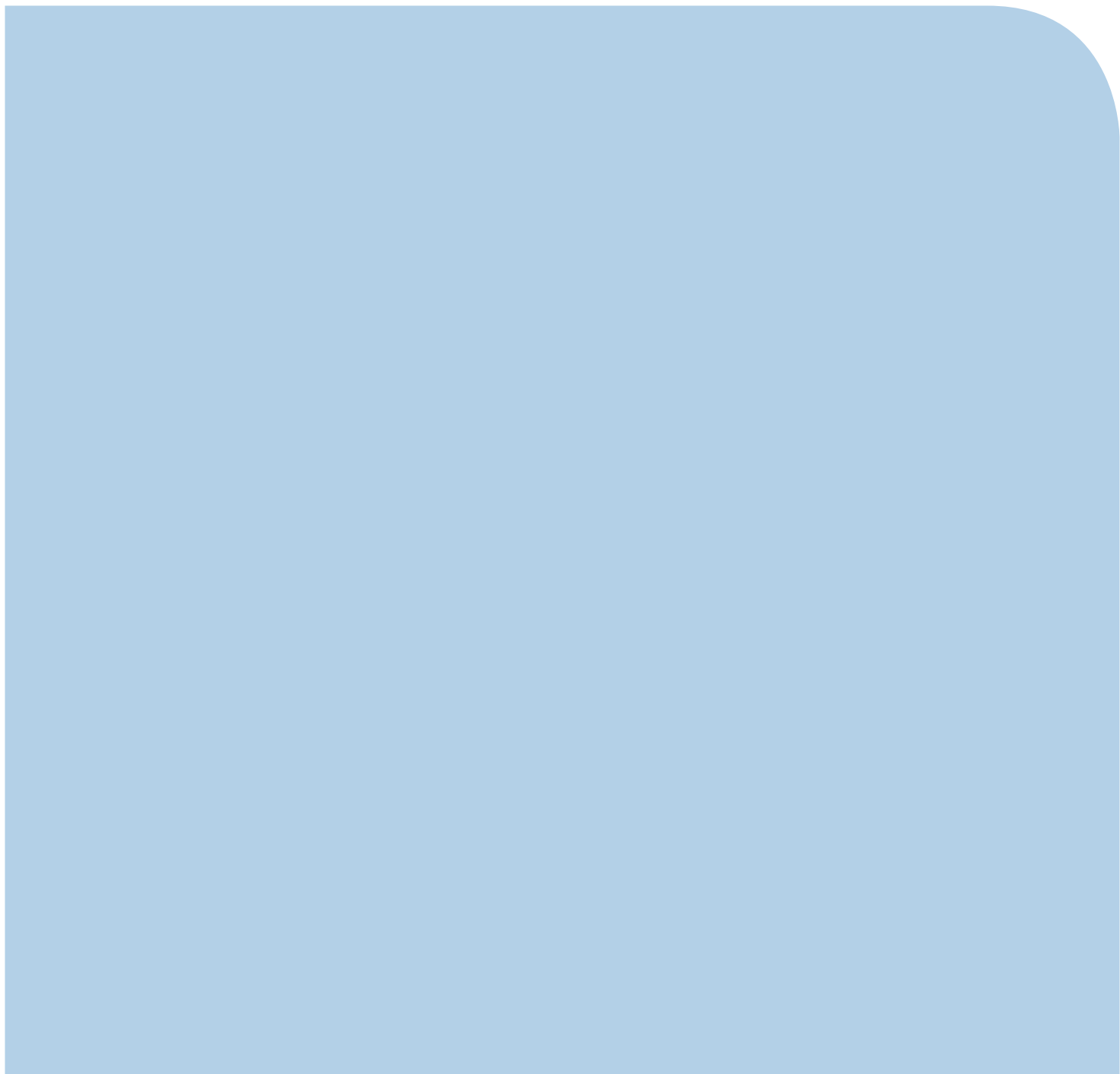
However, there is scope for bilateral infrastructure cooperation to augment these efforts. Infrastructure projects are by their nature large, complex, and have long time-horizons in the order of decades rather than years. They therefore intersect with a very wide range of regulatory domains, including transport, competition, environmental, trade, professional services and urban planning policies. Cross-border infrastructure also requires inter-governmental cooperation to harmonise such policies and provide a secure regulatory footing for private sector investment. A dedicated infrastructure cooperation mechanism – potentially via an inter-governmental MoU and/or committee with KAFTA's review mechanisms<sup>60</sup> – would enable bilateral coordination on these regulatory issues. Such a mechanism would significantly augment the prospect for Korean investment in Australian infrastructure projects. It would also help Australia and Korea develop shared understandings which could be articulated into regional infrastructure planning efforts.

### The fifth are new strategies for building an agriculture investment relationship.

Agriculture is one of the principal domains of economic complementarity between Australia and Korea; and as KAFTA and other FTAs progressively lower agricultural tariff barriers there are many emerging opportunities for trade-related investments to follow. Unfortunately, there is a very limited agricultural investment base upon which to build. In the decade to 2016, Korean firms made only USD 15 million worth of agricultural investment in Australia; and since KAFTA's entry into force in December 2014 no Korean agricultural investment applications have been made to the FIRB<sup>61</sup>. A salient factor here is a lack of experience amongst Korean investors – particularly large SOEs and managed investment funds – in the agribusiness sector. In the last decade, agriculture accounted for only 0.44 percent of Korea's total outward investment<sup>62</sup>.

For this reason, KAFTA's tariff reforms are unlikely to drive bilateral agricultural investment on their own. Rather, Australia will need to (a) work to raise understanding of the agricultural sector amongst Korean businesses; and (b) offer investment opportunities compatible with their specific requirements. For the former, Australian efforts to develop an agricultural relationship with Korea should move beyond a focus on export promotion, to market Australia as both a *trade* and *investment* partner for Korean agribusinesses. For the latter, it will be necessary to market larger investment vehicles that combine a range of agricultural assets (such as consolidated investment funds), which are viable opportunities for Korean institutional investors. Together, these efforts can foster the development of vertically-integrated agricultural value chains between Australia and Korea, similar to those pioneered in the mining and energy sectors.





## Endnotes

- <sup>1</sup> Trade Agreement Between the Government of the Commonwealth of Australia and the Government of the Republic of Korea 1965, *Australian Treaty Series* [No. ATS 18].
- <sup>2</sup> Author's calculations, from UNComtrade Database, <https://comtrade.un.org/data/>
- <sup>3</sup> Author's calculations, from ABS, *International Investment Position, Australia: Supplementary Statistics 2016* (Cat 5352.0).
- <sup>4</sup> Portfolio investments are those where the investor acquires an equity stake of less than 10 percent; direct investments are those above this threshold. 'Other' investments are principally composed of financial derivatives and inter-corporate debt.
- <sup>5</sup> "Country shares" models if Australia attracted the same proportion of Korea's foreign investment as it does of Japan's foreign investment. "Trade/investment" models if the ratio between Australia's two-way trade and investment with Japan were the same for Korea.
- <sup>6</sup> This summary is based on the following independent policy reviews: World Trade Organization (2016), *Trade Policy Review: Republic of Korea 2016*, Geneva: WTO; World Trade Organization (2015), *Trade Policy Review: Australia 2015*, Geneva: WTO; and US State Department (2017), *Investment Climate Statements 2017*, available at <https://www.state.gov/investmentclimatestatements/>.
- <sup>7</sup> Korean sectors with foreign ownership caps are: beef, wholesale meat distribution, shipping, air transport, electricity transmission and inland and coastal shipping (<50 percent); electricity generation and publishing (<30 percent); and telecommunication services (varies by subsector, but generally <49 percent).
- <sup>8</sup> The FIRB screens: acquisitions of over 20% of any businesses valued over \$260 million (with higher monetary threshold of \$1134 million for FTA partners); over 10% of an agribusiness valued over \$57 million; over 5% of a media business of any value; residential real estate; commercial and residential land; and any investment by a foreign government entity.
- <sup>9</sup> 'Rank' ordinally measures performance relative to the 190 countries in the World Bank *Ease of Doing Business* survey. 'Distance to Frontier' (DTF) cardinally measures performance relative to identified best practice, where 0 indicates lowest and 100 indicates best performance.
- <sup>10</sup> Prior to KAFTA, the last economy-wide agreement between the Korean and Australian governments was the *Agreement on the Development of Trade and Economic Relations*, signed in 1975.
- <sup>11</sup> Author's summary, from Asian Development Bank Free Trade Agreements Database, <https://aric.adb.org/database/fta>
- <sup>12</sup> See Mireya Solís and Jeffrey D. Wilson (2017), 'From APEC to Mega-Regionals: The Evolution of the Asia-Pacific Trade Architecture', *The Pacific Review* 30(6): 923–37.
- <sup>13</sup> Asia-Pacific Economic Cooperation (2011), *APEC Non-Binding Investment Principles* (2011 Update), <https://www.apec.org/Achievements/Group/Committee-on-Trade-and-Investment-2/Investment-Experts-Group-2>
- <sup>14</sup> A description of the TPP-11 – formally known as the 'Comprehensive and Progressive Agreement for the TPP' – is available at DFAT (2018), 'TPP-11', <http://dfat.gov.au/trade/agreements/not-yet-in-force/tpp-11/Pages/trans-pacific-partnership-agreement-tpp.aspx>
- <sup>15</sup> *Nikkei Asian Review* (2018), 'Seoul to decide on new TPP membership by June', 13 March.
- <sup>16</sup> Author's calculations, from UNCTADStat Database, <http://unctadstat.unctad.org/EN/>
- <sup>17</sup> DFTA (2018), *Republic of Korea: Country Fact Sheet January 2018*, <http://dfat.gov.au/trade/resources/Documents/rkor.pdf>
- <sup>18</sup> For a review of quasi-vertical integration in global resource industries, see Terutomo Ozawa (1979), *Multinationalism, Japanese Style: The Political Economy of Outward Dependency*, Princeton: Princeton University Press; and Jeffrey D. Wilson (2013), *Governing Global Production: Resource Networks in the Asia-Pacific Steel Industry*, Basingstoke: Palgrave Macmillan.
- <sup>19</sup> William T. Hogan (2001), *The POSCO Strategy: A Blueprint for World Steel's Future*, Lanham, CO: Lexington Books, p. 83.
- <sup>20</sup> Jeffrey D. Wilson (2014), 'Northeast Asian resource security strategies and international resource politics in Asia', *Asian Studies Review*, 38(1): 15–32.
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