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**New Evidence of Asian Economic Integration:  
Prospects and Challenges of a Trilateral FTA between  
China, Japan and South Korea**

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## Abstract

Free Trade Agreements (FTAs) as a powerful trade policy instrument increasingly play an important role in Asian economic growth. Asian countries have sought to deepen their economic integration to achieve sustainable economic development by applying FTAs ever since the Asian Financial Crisis in 1997. The emerging trilateral FTA negotiation between China, Japan and South Korea (CJK) provides new evidence of ongoing Asian economic integration. In this paper, by analyzing recent FTA developments in Asia as well as prospects and challenges of the FTA-CJK negotiation, we find that the FTA-CJK will expand the intra-regional trade volume and stimulate economic growth in all three countries. However, given the tremendous differences in economic structure and development stage between the three countries as well as political economy considerations, the establishment of the FTA-CJK will not be a smooth process. Pragmatic and practical strategies during the FTA-CJK negotiation are needed to create a win-win-win situation.

## Key-words

Asia, economic integration, FTAs, FTA-CJK



## 1. Introduction

On May 15<sup>th</sup>, 2012, the three largest economies in East Asia, the People's Republic of China (hereafter, China), Japan and South Korea, officially agreed to launch negotiations for a Free Trade Agreement (FTA) by the end of that year. The emerging FTA talks between China, Japan and South Korea (hereafter, FTA-CJK) highlights the rapid development of economic integration mainly driven by FTAs in Asia. Given the economic size of the three countries and their respective shares in the global trade system, it also implies that there will be a significant impact across the world. In particular, the recent sluggish recovery of the US economy and the spreading of the crisis throughout Europe underline the significance of the forthcoming FTA-CJK for the global economy.

Undoubtedly, the FTA-CJK will significantly impact on the economic development and trade volume of the three countries. But exactly how much the FTA-CJK is to impact on the three countries' output and trade volume once the FTA-CJK is in effect needs to be empirically assessed. Lee *et al.* (2005: 27-43), applying computable general equilibrium (CGE) model, find that the macroeconomic effects of the FTA-CJK would be 5.15 per cent of GDP growth for South Korea, 1.54 per cent for China and 1.21 per cent for Japan. A similar model is employed by Yoon *et al.* (2009: 9-17). They find that corresponding effects on the GDP growth would be 2.53 per cent for South Korea, 0.99 per cent for Japan and 0.60 per cent for China. Considering the increasingly different performance in economic development and the fluctuation of trade volumes in the three countries as well as the uncertain global economy of the last few years, it is meaningful to analyze the prospects and challenges of the FTA-CJK for the three countries. In this article, we are not interested in assessing the potential macroeconomic impact of the FTA-CJK on the GDP or trade volume of the three countries, which has already been done quite well by official feasibility studies of the three governments and other scholars. Instead, here we discuss the recent FTA developments in East Asia as well as the prospects for and challenges of the FTA-CJK negotiation. Such an analysis provides us with a profound understanding of the forthcoming FTA-CJK as new evidence of deepening Asian economic integration.

The structure of this paper is as follows. Section two introduces the development of FTAs in Asia, followed by section three, which contains background information on the



trilateral FTA-CJK and policy analyses for China, Japan and South Korea. The prospects for and challenges of the FTA-CJK negotiation are discussed in section four and five respectively, while section six concludes.

## 2. The Development of FTAs in Asia

The Asian economy, mainly driven by foreign trade and foreign direct investment (FDI), has achieved a remarkable economic growth over the past several decades. FTAs played a unique role in boosting Asian countries' exports and motivating Asian economic integration during this process, especially for East Asian countries, which are also called the "*world factory*". Along with innovation and technological progress, removing tangible and intangible foreign trade barriers through bilateral and multilateral FTAs has significantly improved Asia's intra-regional and international trade with the rest of world. It appears that the past success in economic growth has encouraged Asian policymakers to deepen regional economic integration by adopting cooperative and mutually beneficial economic policies. FTAs, regarded as powerful trade policy instruments, increasingly play an important role in promoting Asian countries' participation in global supply chains and production networks (Kawai and Wignaraja, 2010: 3-5).

The creation of the EU Single Market in 1957 and the North American Free Trade Agreement (NAFTA) in 1994 also positively motivated Asian countries to adopt FTAs as trade policy instruments to expand their trade shares, thereby improving their international competitiveness in the global market. Asian FTAs initially started with the Asia-Pacific Trade Agreement (APTA)<sup>1</sup> in 1975. The ASEAN Free Trade Area (AFTA), regarded as a cornerstone of Asian FTA expansion, was signed by the member nations of the Association of Southeast Asian Nations (ASEAN) in Singapore in 1992. The Asian financial crisis in 1997 appeared to accelerate the process of creating a more deeply integrated Asia when Asian countries realized that economic integration and policy cooperation were critical for Asian economies, which had remained relatively vulnerable to the fluctuation of the global economy. The recent global financial crisis of 2007-2008, followed by the still ongoing European debt crisis and the euro crisis, which significantly reduced the demand for Asia's production, reinforced Asia's commitment to strengthening



its degree of economic integration. By January 2012, there were, in Asia, 99 FTAs signed and in effect and 27 FTAs signed but not yet in effect (see Table 1). 64 FTAs are still being negotiated by Asian countries. In addition, the number of proposed FTAs has increased rapidly since 2003: an additional 60 FTAs have been proposed or studied in Asia. From Table 1, we can see that the number of Asian FTAs has dramatically increased, from two FTAs in 1980 to more than 100 FTAs in effect in 2011. This indicates the increasing importance of FTAs for Asian countries to maintain economic growth, particularly for those outward-oriented economies such as China, Japan, South Korea, Taiwan and ASEAN countries.

Table 1: Asian FTAs by status (cumulative), 1975-2012

Year	Proposed <sup>1</sup>	Under Negotiation		Concluded		Total
		Framework Agreement Signed/Under Negotiation <sup>2a</sup>	Under Negotiation <sup>2b</sup>	Signed but not yet In Effect <sup>3a</sup>	Signed and In Effect <sup>3b</sup>	
1975	0	0	0	1	0	1
1976	0	0	0	0	1	1
1980	0	0	0	1	1	2
1981	0	0	0	0	2	2
1982	0	0	0	1	2	3
1983	0	0	0	1	3	4
1989	1	0	0	1	3	5
1991	1	0	0	2	5	8
1992	1	0	0	6	5	12
1993	1	0	0	5	9	15
1994	1	0	0	8	11	20
1995	1	0	0	15	14	30
1996	1	0	0	18	19	38
1997	2	0	0	20	20	42
1998	2	0	0	19	23	44
1999	4	0	1	19	24	48
2000	3	0	6	19	25	53
2001	2	0	8	18	28	56
2002	8	2	8	19	31	68
2003	18	4	9	25	36	92
2004	32	14	15	27	43	131
2005	44	18	28	27	51	168
2006	49	18	37	23	64	191
2007	47	18	42	26	70	203
2008	47	16	42	25	80	210
2009	54	16	45	25	86	226
2010	57	17	48	26	92	240
2011	60	17	48	26	99	250
2012	60	16	48	27	99	250

Source: Asia Regional Integration Center, Asian Development Bank, until January 2012.

Notes:

1. Proposed - parties are considering a free trade agreement, have established joint study groups or joint task force, and are conducting feasibility studies to determine the desirability of entering into an FTA.

2a. Framework Agreement Signed/Under Negotiation - parties initially negotiate the contents of a framework agreement (FA), which serves as a framework for future negotiations.

2b. Under Negotiation - parties begin negotiations without a framework agreement (FA).



3a. Signed but not yet in Effect - parties have signed the agreement after negotiations have been completed. Some FTAs require legislative or executive ratification.

3b. Signed and on Effect - when the provisions of an FTA become effective, e.g. when tariff cuts begin.

This rapid increase of FTAs in Asia, however, also raises questions which are called Noodle Bowl Effects (or “Spaghetti Bowl effects”, by Bhagwati, 1995). Different FTAs contain different Rules of Origin (ROOs)<sup>11</sup>, a fact which results in the increasing complexity and costly use of FTAs. Crisscrossing FTAs among Asian countries have not only increased the administrative costs of managing FTAs and transaction costs for enterprises, but they also impair the effectiveness of FTAs. Therefore, having too many bilateral FTAs in Asia poses challenges to overall Asian trade liberalization. The majority of existing FTAs in Asia are bilateral or small-scale FTAs, from which less developed Asian countries are believed to be excluded. Thus, Asian countries need wider, region-wide FTAs rather than excessively overlapping bilateral and plurilateral FTAs. On the other hand, analyzing enterprise-level data from five Asian countries, Kawai and Wignaraja (2009: 10-22) find that the noodle bowl effects of overlapping FTAs in Asia are not severely harmful to Asian countries’ business activities. But they also point out that cooperative policies are needed to address the increasing complexity of noodle bowl effects, given the fact that more of the proposed FTAs (incl. those under negotiation) in Asia are bilateral and plurilateral rather than region-wide. Although there are some challenges to the development of Asian FTAs, the successful past experience proves that FTAs, as trade policy instruments, do make significant contributions to Asia’s economic growth. Undoubtedly, from a pragmatic perspective, Asian countries still need FTAs to strengthen their international competitiveness and promote their shares in the global trade system.

### **3. Background of the Forthcoming Trilateral FTA between China, Japan and South Korea**

By signing the Trilateral Agreement for the Promotion, Facilitation and Protection of Investment at the Fifth Trilateral Summit Meeting on May 15<sup>th</sup>, 2012, the three economic giants in East Asia – China, Japan and South Korea – have displayed their efforts in the area of economic cooperation to achieve sustainable economic growth against the background of the uncertainty of the global economy. The leaders of the three countries



also agreed to officially launch the FTA-CJK negotiation by 2012, after a decade of discussions and preparations. This provides new evidence showing that Asian countries are seeking to deepen their economic integration by applying FTAs as a trade policy tool. The population of the three countries, as a whole, accounts for 21.82 per cent of the world's total population (see Table 2). The total GDP of the three countries, which was US\$ 14.3 trillion in 2011, accounts for 20.43 per cent of the world's total GDP. In addition, and even more strikingly, the share of goods exported and imported by the three countries in the world's total exports and imports is 18.20 and 43.62 per cent, respectively, in 2011. This indicates the tremendous potential of the FTA-CJK to further improve their shares in the international trade system.

Table 2: General information on China, Japan and South Korea

	Population			GDP			Goods exported			Goods imported		
	CJK	World	% of world	CJK	World	% of world	CJK	World	% of world	CJK	World	% of world
1982	1166,4	4606,8	25,32	1396,2	67,5	12,47	178,4	1817,2	9,82	379,5	1797,2	21,12
1983	1182,5	4688,8	25,22	1531,1	71,9	13,38	188,2	1772,7	10,62	388,1	1758,4	22,07
1984	1197,2	4770,4	25,10	1645,3	70,3	13,85	218,4	1891,0	11,55	427,5	1874,5	22,81
1985	1212,6	4853,9	24,98	1787,8	75,4	14,33	225,8	1901,7	11,87	427,1	1891,4	22,58
1986	1229,5	4940,2	24,89	2460,2	89,3	16,67	265,6	2076,4	12,79	449,8	2062,7	21,81
1987	1247,7	5028,7	24,81	2895,6	89,9	17,27	306,8	2450,5	12,52	562,9	2419,7	23,26
1988	1266,2	5117,9	24,74	3512,4	90,1	18,73	362,0	2813,4	12,87	702,7	2766,7	25,40
1989	1284,1	5206,6	24,66	3591,5	99,2	18,25	375,8	3032,8	12,39	815,1	3003,5	27,14
1990	1301,6	5296,2	24,58	3724,4	116,7	16,95	397,9	3471,2	11,46	917,4	3424,5	26,79
1991	1318,0	5383,0	24,48	4224,5	124,1	18,32	438,3	3559,3	12,31	1037,4	3520,9	29,47
1992	1332,9	5465,6	24,39	4605,3	130,3	18,68	480,1	3808,9	12,60	1053,8	3745,9	28,13
1993	1347,0	5548,9	24,28	5217,6	128,9	20,87	512,3	3774,2	13,57	1099,9	3682,3	29,87
1994	1361,2	5631,1	24,17	5833,0	135,2	21,73	583,5	4273,5	13,65	1317,7	4149,9	31,75
1995	1375,4	5714,7	24,07	6579,1	147,4	22,09	682,0	5154,9	13,23	1701,2	4992,0	34,08
1996	1388,8	5796,2	23,96	6119,9	167,0	20,14	681,3	5410,9	12,59	1900,3	5272,4	36,04
1997	1402,1	5878,0	23,85	5793,2	193,4	19,12	730,4	5621,6	12,99	1865,1	5470,5	34,09
1998	1414,6	5959,0	23,74	5279,5	205,4	17,48	691,7	5523,9	12,52	1295,4	5425,9	23,87
1999	1426,0	6038,6	23,61	5961,3	219,1	19,03	743,4	5721,0	12,99	1609,0	5663,8	28,41
2000	1436,5	6118,1	23,48	6463,1	220,5	19,99	886,8	6443,5	13,76	2151,6	6435,5	33,43
2001	1446,4	6195,7	23,34	5989,3	248,5	18,64	800,9	6178,6	12,96	1927,2	6163,8	31,27
2002	1455,5	6272,5	23,20	6010,6	289,0	18,00	885,4	6453,1	13,72	2073,2	6395,3	32,42
2003	1464,0	6349,2	23,06	6587,7	271,8	17,54	1087,1	7510,3	14,47	2493,3	7415,7	33,62
2004	1471,9	6426,1	22,90	7309,4	263,9	17,29	1392,6	9102,1	15,30	3146,9	9023,6	34,87
2005	1479,6	6503,2	22,75	7673,6	285,2	16,80	1619,9	10340,2	15,67	3672,4	10293,1	35,68
2006	1487,1	6580,5	22,60	8021,5	330,0	16,21	1922,1	11944,8	16,09	4337,2	11837,7	36,64
2007	1494,3	6658,5	22,44	8899,6	371,9	15,95	2287,8	13801,7	16,58	5002,1	13619,8	36,73
2008	1501,3	6737,2	22,28	10302,4	400,2	16,83	2615,9	15848,4	16,51	6077,6	15726,8	38,65
2009	1508,1	6815,8	22,13	10860,5	432,1	18,76	2107,3	12304,1	17,13	4659,5	12087,7	38,55
2010	1514,6	6904,6	21,94	12433,8	461,7	19,69	2773,0	14987,4	18,50	6180,4	14721,9	41,98
2011	1521,7	6973,7	21,82	14301,9	324,5	20,43	3243,6	17820,4	18,20	7684,3	17615,0	43,62

Source: World Bank and own calculations.

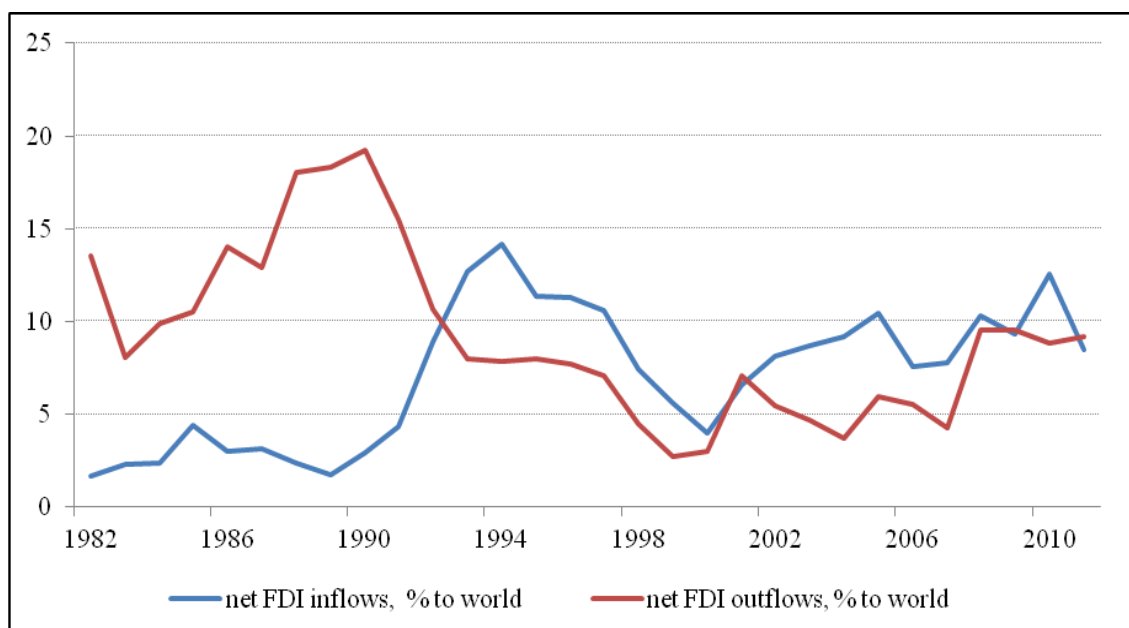
Note: CJK means China, Japan and South Korea as a whole. The unit for population is million people; the unit for GDP and export & import is US\$ billion.

Foreign trade and FDI have significantly contributed to the “East Asian miracle”



(World Bank, 1993). FDI has been complementary to, rather than a substitute for, foreign trade expansion in East Asia over the past several decades (Kawai and Urata, 2002: 1-6). Conversely, the expansion of intra-regional trade driven by FTAs has also stimulated intra-regional FDI, because the higher interdependence with foreign trade has promoted intra-regional FDI. In addition, some FTAs contain not only terms of foreign trade, but also concern FDI liberalization<sup>III</sup>. Therefore the increasing FDI between China, Japan and South Korea reflects their higher interdependence with intra-regional trade. It requires more trade policies such as the FTA-CJK to improve intra-regional trade in East Asia.

Figure 1: Share of total FDI inflows and outflows in China, Japan and South Korea from the world's total FDI inflows and outflows, 1982-2011 (in percentages)



Source: World Bank and Ministry of Commerce of People's Republic of China.

China has been the largest FDI recipient country for decades until 2010. But, more recently, China's outward FDI has also increased substantially, from US\$ 2.7 billion in 2002 to US\$ 74.65 billion in 2011<sup>IV</sup>. Japan and South Korea as the most developed economies in East Asia have been the main capital output countries. The share of total FDI inflows and outflows of the three countries to the world's total FDI has increased steadily, since 2000, even though it declined in 1995-1999 (see Figure 1). In 2011, their share of the world's total inward and outward FDI represented 8.5 and 9.2 per cent, respectively. Intra-regional



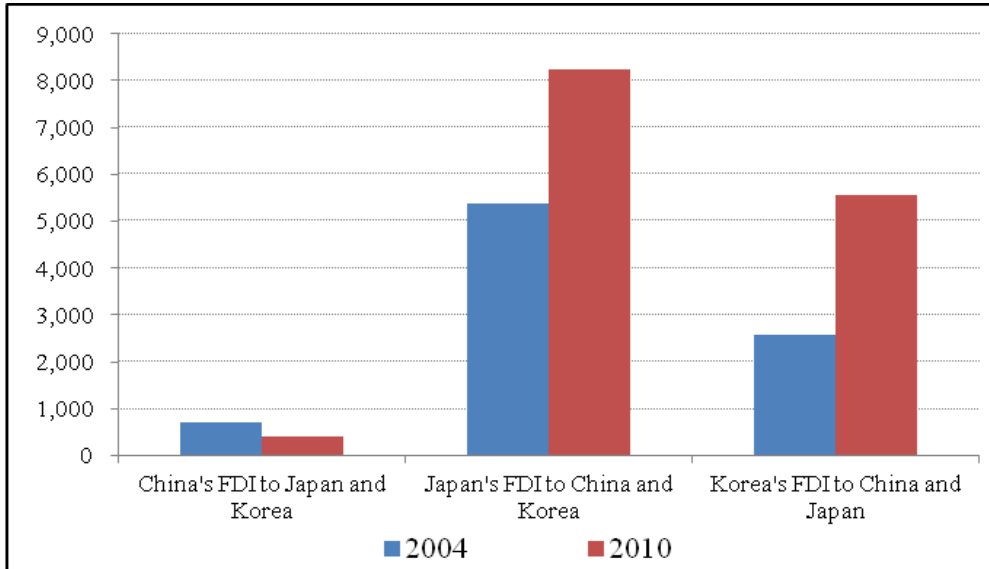


FDI among China, Japan and South Korea has also increased dramatically, except for China (see Figure 2). South Korea's FDI in China and Japan nearly doubled between 2004 and 2010. Similarly, Japan's FDI in China and South Korea grew considerably, from US\$ 5,378.80 million in 2004 to US\$ 8,226.93 million in 2010. By contrast, China's FDI in Japan and South Korea declined from US\$ 704.52 million in 2004 to US\$ 418.16 million in 2010. Moreover, the share of Japan's FDI in China and South Korea of its total outward FDI remained almost the same, at about 15 percent between 2004 and 2010, while South Korea's share of FDI in China and Japan accounting for its total outward FDI dropped sharply, from 43.25 to 20.75 per cent, during the period of 2004 to 2010. Finally, the percentage of China's FDI in Japan and South Korea of its total outward FDI also dropped, from 1.57 to 0.55 per cent, during the same period. It is notable that the share of South Korea's inward and outward FDI in the other two countries was much higher than the comparable figures for Japan and China. This reflects that China has been Japan's and South Korea's main investment target country over the past decade. But the majority of China's investment went to South America, Africa and Australia, which are natural resources-rich regions, rather than to Japan and South Korea. FDI inflows from Japan and South Korea have significantly contributed to China's economic growth through promoting China's FDI-induced exports and improving the productivity over the past several decades. Meanwhile, the Japanese and South Korean economies also benefited considerably from China's huge market and economic growth.

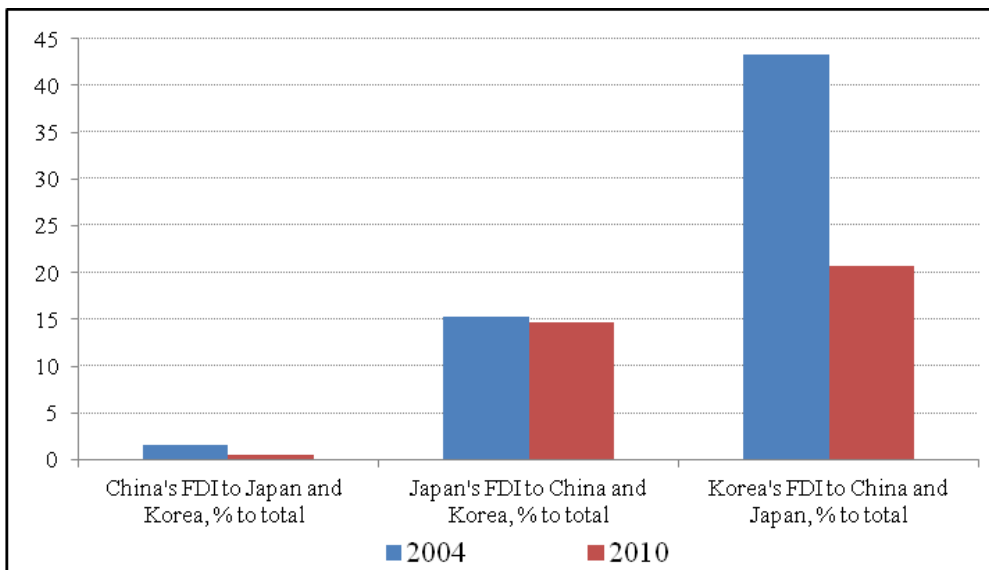


Figure 2: Intra-regional FDI of China, Japan and South Korea, in 2004 and 2010

Amount of intra-regional FDI, in US\$ million



Share of total outward FDI (in %)



Source: OECD and 2010 Statistical Bulletin of China's Outward Foreign Direct Investment, Ministry of Commerce of the People's Republic of China.

Intra-regional trade among China, Japan and South Korea has grown considerably over the last decade. China has become both Japan's and South Korea's biggest trading partner. China's exports to Japan and South Korea reached US\$ 270.49 billion in 2011, up from US\$ 101.32 billion in 2004, which is more than double, although the share of China's exports to Japan and South Korea from China's total exports dropped from 17.08 per cent



in 2004 to 12.03 per cent in 2011 (see Table 3). This is mainly so because bilateral trade between China and the EU increased significantly during that period. The EU has become China's largest trade partner since 2004. By contrast, Japan's exports to China and South Korea grew substantially, from US\$ 118.02 billion in 2004 to US\$ 227.33 billion in 2011. Its share also increased from 20.90 per cent in 2004 to 27.70 per cent in 2011. Exports from South Korea to China and Japan jumped to US\$ 173.90 billion in 2011, compared to US\$ 84.26 billion in 2004. The share of South Korea's exports to the other two countries remained stable, at about 26 per cent, between 2004 and 2011. In addition, we can see from Table 3 that, in terms of foreign trade, China, Japan and South Korea are all important for each other. The dynamics of trade and FDI among the three countries over the past decade implies that the FTA-CJK negotiation is a crucial step for China, Japan and South Korea to expand their intra-regional trade and to strengthen their competitiveness in the global market.

Table 3: Intra-regional trade between China, Japan and South Korea in 2004 and 2011

	2004			2011		
	Japan & South Korea	China & South Korea	China & Japan	Japan & South Korea	China & South Korea	China & Japan
<b>China's exports to</b>	101.32 (17.08%)	-	-	270.49 (12.03%)	-	-
<b>Japan's exports to</b>	-	118.02 (20.90%)	-	-	227.33 (27.70%)	-
<b>South Korea's exports to</b>	-	-	84.26 (26.83%)	-	-	173.90 (26.15%)

Source: Japan External Trade Organization, National Bureau of Statistics of China, Country Report of Ministry of Commerce of People's Republic of China, World Bank and own calculations.

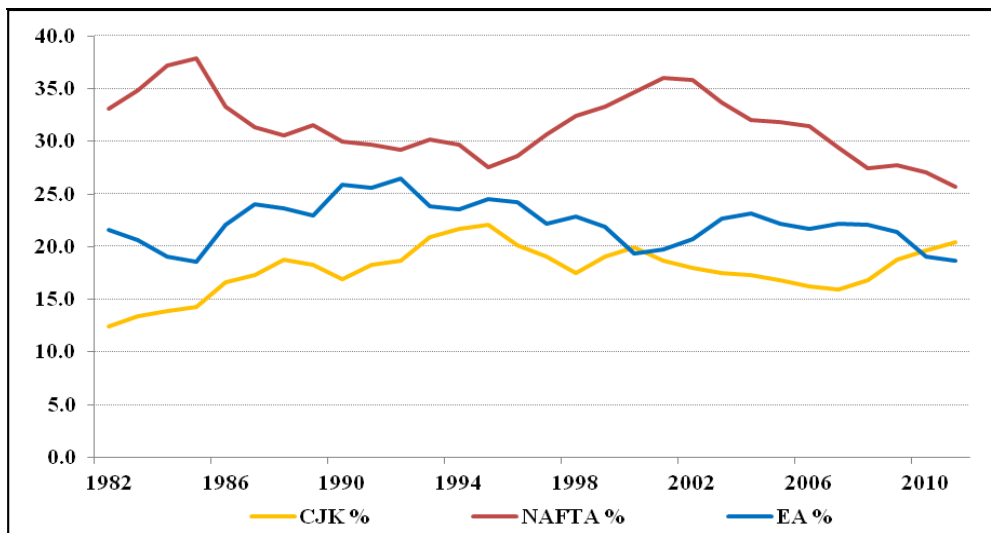
Notes: total value of each country's exports to other two countries, in billion US\$; percentage in brackets represents share of country's total exports.

Comparing with the Euro Area (EA) and North American Free Trade Area (NAFTA), two of the largest existing free trade areas in the world, the forthcoming FTA-CJK also illustrates the tremendous potential to become another large free trade area in the world. Figure 3 shows that the FTA-CJK is comparable to both the EA and NAFTA in terms of economic size and trade volume. The GDP of China, Japan and South Korea together



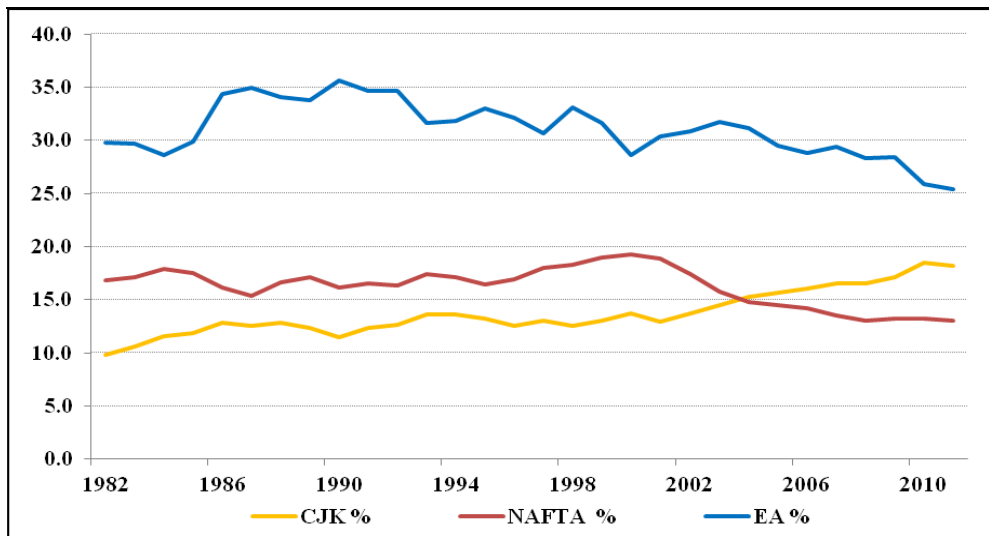
accounts for 20.43 per cent of the world's total output in 2011, which is less than the 25.70 per cent of NAFTA but higher than the EA's share, which is 18.68 per cent. What is more, the share of the EA's and NFATA's GDP of the world's total GDP has declined since 2003-2004. The FTA-CJK's total GDP share, however, has shown a strong upward trend since 2007. For exports, the share of the three countries' exports together from among the world's total exports continuously grew, from 1982 to 2011, in stark contrast with the decline of both the EA's and NAFTA's respective shares. In 2011, compared to the 12.99 per cent of NAFTA and the 25.45 per cent of the EA, the share of China's, Japan's and South Korea's exports together accounted for 18.20 per cent of the world's total export volume. The above analysis clearly shows that the economic interdependence between China, Japan and South Korea has been significantly enhanced through global production networks and the international trade system over the past several decades. The establishment of the FTA-CJK would thus significantly impact on the Asian and worldwide economy through further increasing intra-regional trade between China, Japan and South Korea.

Figure 3: Comparison of FTA-CJK, EA and NAFTA  
Share of (combined) GDP from the world's total GDP





Share of exports from the world's total exports



Source: World Bank and own calculations.

Note: CJK represents China, Japan and South Korea combined.

China, Japan and South Korea, the three largest economies in East Asia, are still export-oriented economies. They are committed to expanding their share of foreign trade and enhancing their participation in global supply chains and production networks to sustain economic growth. FTAs, as a way to liberalize trade, are especially meaningful for these three countries. Over the past decades, these three countries have been the most active participants in the Asian FTA development. China has signed 12 FTAs with other countries up to September 2012 (see Table 4). Currently, there are six FTAs under negotiation. In addition, seven FTAs have been proposed to be discussed between China and other countries. Japan is also a very active FTA participant country; FTA studies were conducted much earlier than in other Asian countries. Until September 2012, Japan has implemented 13 FTAs (one FTA was signed but is not yet in force). Also, two FTAs are under negotiation and eight FTAs are proposed or being studied. South Korea has signed nine FTAs (one FTA was signed but is not yet in force). More strikingly, there are more FTAs that are being proposed or negotiated (seven FTAs are under negotiation and eight FTAs are proposed/under consultation and study). Finally, in Asia as a whole, more than 100 FTAs have been concluded and more and more FTAs are under negotiation or were proposed until September 2012. This shows us that FTAs are expanding rapidly in Asia.



Table 4: China, Japan and South Korea's FTAs at different stage of development

	Proposed/Under Consultation and Study	Under Negotiation		Concluded		Total
		(FA) Signed/FTA under Negotiation	Under Negotiation	Signed but not yet In Effect	Signed and In Effect	
China	7	2	4	0	12	25
Japan	8	0	2	1	12	23
South Korea	16	2	5	1	8	32
Asia	72	14	43	29	92	250

Source: Asia Regional Integration Center, Asia Development Bank, until September 2012.

Note: Asian FTAs are those FTAs engaged with by any of the 48 ADB member countries in the Asia-Pacific region with another country or economic bloc within or outside that region.

The three countries are both the key and most active participants in the process of Asian FTA development. China, the largest economy in Asia, has signed 12 FTAs until September 2012. Besides the 'Closer Economic Partnership Arrangement' with Hong Kong and Macau (signed in 2004) and the 'Economic Cooperation Framework Agreement' with Taiwan (2010), China also signed FTAs with its most important trade partners, the ASEAN and some ASEAN member countries. In addition, China also signed non-Asian FTAs with Chile (2006), Costa Rica (2011), Peru (2010) and New Zealand (2008). Japan seems to put more attention on ASEAN member countries. Eight of Japan's 12 Economic Partnership Agreements (EPAs) or FTAs are with ASEAN and ASEAN member countries. Moreover, Japan implemented EPAs with Chile (2007), India (2011), Mexico (2005) and Switzerland (2009). South Korea, which is the fourth largest economy in Asia, has signed only nine FTAs, less than other two countries. However, South Korea has signed FTAs with the US and the EU, which are the largest economies in the world. The US and the EU, as the main importers, are crucial trading partners for Asian export countries such as China and Japan. We find that China, Japan and South Korea have all adopted active FTAs strategies. Partly this is because the three countries have used FTAs as a strategic tool to strengthen their relationships with their trading partners, such as ASEAN member countries (Urata, 2004: 7-10). A bilateral FTA between any two of these three countries would force the third country to join because no country wishes to be excluded from the regional market.



Table 5: List of all bilateral and plurilateral FTAs with China, Japan and South Korea

	Free Trade Agreements signed and in effect	Date of signed and in effect
China	China and Chile FTA	01 Oct., 2006
	China and Costa Rica FTA	01 Aug., 2011
	China and Hong Kong Closer Economic Partnership Arrangement	01 Jan., 2004
	China and Macau Closer Economic Partnership Arrangement	01 Jan., 2004
	China and Pakistan FTA	01 Jul., 2007
	China and Peru FTA	01 Mar. 2010
	China and Singapore FTA	01. Jan., 2009
	China and Taiwan Economic Cooperation Framework Agreement	12 Sep., 2010
	China and Thailand FTA	01 Oct., 2003
	Asia-Pacific Trade Agreement	17 Jun., 1976
	ASEAN and China Comprehensive Economic Cooperation Agreement	01 Jul., 2005
	New Zealand and China FTA	01 Oct., 2008
	Japan	Japan and Brunei FTA
Japan and Chile Economic Partnership Agreement		03 Sep., 2007
Japan and India Comprehensive Economic Partnership Agreement		01 Aug., 2011
Japan and Indonesia Economic Partnership Agreement		01 Jul., 2008
Japan and Malaysia Economic Partnership Agreement		13 Jul., 2006
Japan and Mexico Economic Partnership Agreement		01 Apr., 2005
Japan and Philippines Economic Partnership Agreement		11 Dec., 2008
Japan and Singapore Economic Agreement for a New-Age Partnership		30 Nov., 2002
Japan and Switzerland Economic Partnership Agreement		02 Sep., 2009
Japan and Thailand Economic Partnership Agreement		01 Nov., 2007
Japan and Vietnam Economic Partnership Agreement		01 Oct., 2009
ASEAN and Japan Comprehensive Economic Partnership		01 Dec., 2008
South Korea	South Korea and Chile FTA	01 Apr., 2004
	South Korea and European Free Trade Association FTA	01 Sep., 2006
	South Korea and European Union FTA	01 Jul., 2011
	South Korea and Peru FTA	01 Aug., 2011
	South Korea and Singapore FTA	02 Mar., 2006
	Asia-Pacific Trade Agreement	17 Jun., 1976
	ASEAN and South Korea Comprehensive Economic Cooperation Agreement	01 Jun., 2007
India and South Korea Comprehensive Economic Partnership Agreement	01 Jan., 2010	

Source: Asia Regional Integration Center, Asian Development Bank, until September 2012.

Note: lists the Free Trade Agreements engaged into by China, Japan and South Korea with another country or economic bloc within or outside the region.

#### 4. Prospects for the FTA-CJK

China, Japan and South Korea are still export-oriented economies which account for around 20 per cent of the world's total exports. The FTA-CJK would help the three countries to further enhance their competitiveness in the global market through improving trade volume and FDI, thereby maintaining economic growth. More particularly, China's economic growth benefited considerably from the trade liberalization after joining the World Trade Organization (WTO) in 2001. The FTA-CJK would allow China to expand its



trade volume with other two countries, which are two of China's largest trade partners. For Japan, FTAs are expected to work as a catalyst for economic growth because Japan has experienced a sluggish economy for decades. To maintain Japan's international competitiveness and stimulate economic growth, the Japanese government needs to undertake a structural reform of its economic system (Urata, 2005: 8). The FTA-CJK, applying external pressure, could contribute to such a reform. South Korea's economy finally showed quite high a flexibility and resilience during the periods of both the 1997 Asia Financial Crisis and the 2008 Global Financial Crisis. Most studies on FTAs show that South Korea benefits more from East Asian FTAs than China and Japan (Lee *et al.*, 2007: 37-43 and Abe, 2007: 13-21). After establishing FTAs with ASEAN, the EU and the US, to conclude FTAs with China and Japan, South Korea's two very important neighbors and trade partners, is South Korea's next strategic goal.

The empirical literature assesses the macroeconomic impact of FTAs on economic growth and trade volume by applying the CGE model, which is the most widely used model in FTA analysis. The Global Trade Analysis Project's (GTAP) various databases have been employed in CGE model studies related to FTA analysis. But the relatively new FTA-CJK has not been extensively studied. Table 6 lists recent studies of the FTA-CJK by applying the CGE model and GTAP's database. We can easily conclude that the South Korean economy would gain the most from the FTA-CJK in terms of GDP growth. Meanwhile, the impact of the FTA-CJK on China's exports and imports seems to be bigger than that on Japanese and South Korean trade. The effect of the FTA-CJK on Japan would also be smaller than for the other two countries in term of GDP growth and trade volume. In previous simulation studies on the FTA-CJK we also find that the FTA-CJK would expand the trade volume and increase economic growth in all three countries.

Table 6: Previous studies of the macroeconomic impact of the FTA-CJK, using the CGE model

Papers	Database used for analysis	Aggregation of regions and sectors	Findings (complete liberalization)
Lee, Choi and Park (2003)	GTAP database: version 5.0 (1997)	8 regions and 17 sectors	GDP, %: China: 2.31; Japan: 0.93 and South Korea: 2.25 Welfare, %: China: 0.97; Japan: 0.48 and South Korea: 3.55





Lee <i>et al.</i> (2005)	GTAP database: version 6.0 (2001)	-	GDP, %: China: 1.54; Japan: 1.21 and South Korea: 5.15 Welfare, %: China: 0.69; Japan: 0.28 and South Korea: 3.45 Exports, %: China: 12.18; Japan: 5.19 and South Korea: 9.77 Imports, %: China: 16.28; Japan: 5.82 and South Korea: 10.62
Abe (2007)	GTAP database: version 6.0 (2001)	24 regions and 25 sectors	Welfare, US\$ mn: China: 4,789; Japan: 5,398 and South Korea: 14,163
Yoon, Gong and Yeo (2009)	GTAP database: version 6.0 (2001)	6 regions and 12 sectors	GDP percentage change: China: 0.60; Japan: 0.99 and South Korea: 2.53 Exports, %: China: 5.98; Japan: 2.13 and South Korea: 3.17 Imports, %: China: 8.37; Japan: 4.58 and South Korea: 5.98 Welfare (equivalent variation), US\$ mn: China: 3,595.32; Japan: 5,938.79 and South Korea: 6,133.04 Terms of Trade, %: China: -0.24; Japan: 1.07 and South Korea: 1.20

Source: own summary.

Note: see Baldwin and Venables (1995) for the impacts on national welfare.

In addition to the macroeconomic impact of the FTA-CJK on the three countries, wider geopolitical factors need to be carefully considered, too. China, Japan and South Korea are the most important economic and political powers in East Asia. Each of the three countries looks at FTAs as an important strategic tool to strengthen its influence in East Asia, which is one of the most important growth engines of world economy. The recent completion of bilateral FTA negotiations between ASEAN & China, ASEAN & Japan and ASEAN & South Korea is evidence for this. For China, East Asia is not only a destination of its exports but also the supplier of energy and other natural resources. Japan and South Korea do not provide China with natural resources. However, China imports a great deal of electronic components and other intermediate products from Japan and South Korea. On the other hand, Japan and South Korea, like China, also consider FTAs as a strategic tool to establish a stable market network to compete in the global market. Furthermore, in addition to being a powerful neighbor, China's huge market and economic potential are very attractive for Japan and South Korea to promote exports to China. Therefore, the establishment of the FTA-CJK would meet the three countries' strategic goals both economically and politically.



## 5. Challenges of the FTA-CJK

However, the FTA-CJK negotiation is not a smooth process, but plastered with many economic and political obstacles. The three governments will encounter fierce opposition in their own countries. China's high-tech and manufacturing sectors, particularly the automobile industry, are relatively less developed and vulnerable compared to those in Japan and South Korea. China's government would try to protect its automobile industry in the FTA-CJK negotiation. On the other hand, Japan's agricultural sector is always sensitive when Japan negotiates FTAs with other countries. Opposition from labor unions in Japan is another challenge for the Japanese government. Finally, South Korea, in addition to having an agricultural sector that is less competitive than that of China, is also concerned by its excessive dependence on China's market and Japan's core components and technology. Nevertheless, South Korea has showed more interest in a bilateral FTA with China, which is South Korea's largest trade partner. South Korea is reluctant to enter into a bilateral FTA with Japan because of the similarity in industrial structure and its own relative competitive advantage over Japan. Thus the FTA-CJK will be more difficult to be established than any bilateral FTA between two of the three countries.

The emerging Trans-Pacific Partnership (TPP), which involves nine countries from the Asia-Pacific area, has added further complications to the FTA-CJK negotiation. Japan and South Korea expressed enthusiasm to join the US dominated TPP to strengthen ties with other Asia-Pacific countries, especially with the US. South Korea has already signed FTAs with most of the TPP countries. So it will not be overly complicated for South Korea to join the TPP talks. Japan also showed a willingness to participate in the TPP talks and became an observer in 2010. It seems that China is excluded from the TPP at the current stage. China apparently showed only a passive attitude to joining the TPP talks. This is partly so because China regards the TPP as part of the US "Return to Asia" strategy to enhance its economic influence in East Asia. Instead, China was more actively involved in FTA-CJK and FTA+6<sup>V</sup> talks to counteract the effect of its exclusion from the TPP. But China also understands that it cannot remain an outsider to this trans-Pacific free trade area forever, especially not once the TPP comes into effect. On the other hand, none of TPP participant countries can ignore China's huge market and economic potential. Each of the



three countries has adopted a different strategy during the TPP and FTA-CJK preparation. Together, they could use the FTA-CJK negotiation to strengthen their bargaining power in the TPP talks. In the same way, the TPP talks may ultimately change the three countries' strategies in the FTA-CJK negotiations. Thus the TPP talks render the FTA-CJK negotiations more complicated.

In reality, however, political economy considerations significantly affect the process of FTA-CJK negotiations. Recent territorial disputes between the three countries about islands in the East China Sea and the Sea of Japan underline the uncertainty and difficulties of FTA negotiations. Historical conflicts, political distrust and territorial disputes among China, Japan and South Korea will always haunt the three countries in the foreseeable future. This inevitably hinders the process of FTA-CJK negotiation. In addition, differences as regards the political system are another factor which could impair the negotiation of the FTA-CJK. But, in the long term, the three countries need to enhance their economic cooperation to eventually achieve economic integration and political understanding. Europe's successful experience as regards economic and political integration proves that economic integration improves mutual understanding and political cooperation. Thus the FTA-CJK could be expected to play a positive role in enhancing the economic and political ties in East Asia.

## 6. Conclusions

The emerging FTA-CJK provides new evidence that Asian countries are seeking to deepen their economic integration by applying FTAs as a policy tool to achieve sustainable economic growth. Empirical studies and policy analyses illustrate that the FTA-CJK would expand the intra-regional trade volume and stimulate economic growth in all the three countries. However, given the tremendous differences in economic structure and development stage among the three countries, as well as political economy considerations, the FTA-CJK negotiation will not be a smooth process. In order to identify winners and losers in each industry in each of the three countries, a sector-based assessment is needed. It is necessary and important for the three countries to adopt a more pragmatic and practical strategy in the FTA-CJK negotiations to create a win-win-win situation.



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<sup>I</sup> APTA, which came into effect in 1976, is the first preferential trade agreement between developing countries in the Asia-Pacific region. Today, member countries include Bangladesh, China, India, South Korea, the Lao People's Democratic Republic (Laos), Sri Lanka, Nepal, and the Philippines.

<sup>II</sup> Rules of origin (ROOs) describe the criteria needed to determine the national source of a product for the purposes of international trade.

<sup>III</sup> Some free trade agreements are called Economic Partnership Agreements (EPAs) and include the deregulation of investments and immigration in addition to trade liberalization.

<sup>IV</sup> See 2011 Statistical Bulletin of China's Outward Foreign Direct Investment from the Ministry of Commerce of the People's Republic of China.

<sup>V</sup> Japan supports the ASEAN+6 FTA comprises the 10 ASEAN member nations and China, Japan, South Korea, Australia, New Zealand and India. While China proposed and strongly supports ASEAN+3 FTA (the ten ASEAN member nations and China, Japan and South Korea). But recently China presented more flexibility and showed more interest in ASEAN+6 FTA and FTA-CJK.

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