

East Asian Economic Integration

The Role of China, Japan & South Korea

By Chang Jae Lee



Author Chang Jae Lee

Two very important events relating to East Asian economic integration took place in Phnom Penh recently. On Nov. 20, 2012 the leaders of 16 countries — the 10 ASEAN members, China, Japan, South Korea, India, Australia and New Zealand — agreed to start negotiations on a Regional Comprehensive Economic Partnership (RCEP), while the trade ministers of China, Japan and South Korea also agreed the same day to the launch of a China-Japan-Korea (CJK) FTA.

Although functional economic integration has proceeded rather rapidly in East Asia, the region has been regarded as lagging behind other major economic areas in terms of institutional economic integration. However, having concluded many bilateral FTAs with both regional and non-regional countries over the past 10 years, the East Asian nations seem to realize now the need for forming a region-wide FTA.

Intra-regional Trade Dependency of East Asia

Over the past 20 years functional economic integration seems to have progressed quite well. In fact, the share of intra-regional trade, which could be regarded as a good indicator of the degree of functional economic integration, has substantially increased. The share of intra-regional trade among ASEAN+3 (China, Japan and South Korea) rose from 28.6% in 1990 to 39.7% in 2010, while the share of intra-regional trade among ASEAN+6 (CJK, plus India, Australia and New Zealand) grew from 33.0% to 45.1% during the same period. In addition, when Hong Kong, Macao and Taiwan (HMT) are included, the intra-regional shares of ASEAN+3+HMT and ASEAN+6+HMT increased from 41.3% to 51.9%, and from 44.6% to 56.2%, respectively. As a result, in 2010, the share of intra-regional trade of ASEAN+3 (39.7%) was close to that of NAFTA (40.5%), whereas the share of intra-regional trade of ASEAN+6+HMT (56.2%)

was almost at the same level as that of the EU-15 (56.3%) (Chart 1).

With regard to the intra-regional trade dependency of East Asian countries, it increased in all ASEAN+6 countries except Cambodia between 1990 and 2010. In particular, such dependency increased substantially for South Korea and Japan, rising from 32.5% to 50.5% for the former and from 26.1% to 47.0% for the latter. However, compared to Japan and South Korea, China's trade dependency rate *vis-à-vis* the ASEAN+16 countries recorded only a moderate growth from 23.2% to 32.0% (Chart 2).

FTAs among East Asian Countries

Although East Asian countries have jumped upon the FTA bandwagon belatedly, they have managed to conclude many such agreements among themselves within a relatively short period of time, and there are others under negotiation or preparation.

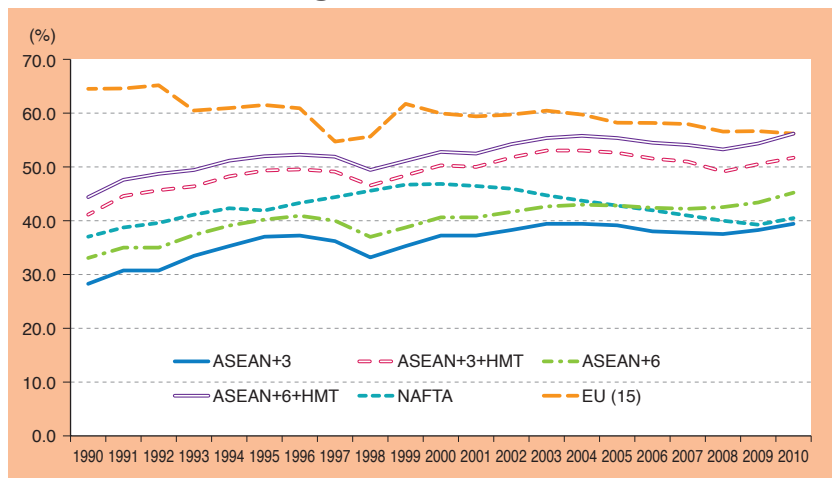
The first regional trade agreement concluded among Asia-Pacific countries was the Asia-Pacific Trade Agreement, which was signed by Bangladesh, India, South Korea, Laos and Sri Lanka in 1975 and went into effect in June 1976. Then, the Laos-Thailand Preferential Trading Arrangement was concluded in 1991. These two accords were reported to the GATT as preferential trade agreements under its Enabling Clause.

Additionally, the ASEAN Free Trade Area (AFTA) was signed by six countries — Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand — in January 1992. Vietnam joined in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. The AFTA was also reported to the GATT under the Enabling Clause but as an FTA.

However, it was at the turn of the century that East Asian countries joined the worldwide

CHART 1

Shares of intra-regional trade in East Asia



Source: Calculated from IMF (2011), *Direction of Trade Statistics and Taiwan Bureau of Foreign Trade, Trade Statistics*

CHART 2

Intra-regional trade dependency rates of East Asian countries (%)

	ASEAN+3		ASEAN+6	
	1990	2010	1990	2010
Brunei	81.7	77.5	83.4	94.3
Cambodia	68.6	60.8	71.6	61.5
Indonesia	51.6	58.4	55.9	66.1
Laos	85.7	84.5	86.5	85.7
Malaysia	49.6	60.6	53.8	65.6
Myanmar	58.7	80.8	65.4	90.5
Philippines	32.8	58.1	36.1	60.3
Singapore	39.5	48.9	43.3	55.0
Thailand	42.6	50.4	45.6	56.6
Vietnam	27.8	52.7	28.6	57.2
China	21.3	26.8	23.2	32.0
Japan	21.2	41.5	26.1	47.0
South Korea	29.1	45.7	32.5	50.5
Australia	–	–	42.9	63.5
India	–	–	17.7	29.7
New Zealand	–	–	44.1	58.8
East Asia	28.6	39.7	33.0	45.1

Source: Calculated from IMF (2011), *Direction of Trade Statistics*

regionalism trend by concluding FTAs under GATT Article 24. The New Zealand-Singapore FTA went into effect in January 2001 and the Japan-Singapore one in November 2002.

East Asian countries then concluded many FTAs among themselves as well as with non-regional countries. Among those within the region, it is noteworthy that ASEAN has concluded FTAs with China, South Korea, and Japan, as well as Australia-New Zealand and India. It signed a Trade in Goods Agreement (November 2004), Trade in Services Agreement (January 2007) and Investment Agreement (August 2009) with China, and three separate similar agreements, in August 2006, November 2007 and June 2009 respectively, with South Korea. With Japan, ASEAN signed a Comprehensive Economic Partnership Agreement in June 2008. In addition, the ASEAN-Australia and New Zealand FTA was signed in February 2009, and the ASEAN-India Trade in Goods Agreement in August 2009.

Singapore has concluded bilateral FTAs with all regional countries, in addition to those under ASEAN, while Japan has also concluded such bilateral agreements with ASEAN+6 members and Vietnam. Other bilateral FTAs involving ASEAN members include those concluded by Thailand with China, Australia, and New Zealand, and those concluded by Malaysia with New Zealand and India. Among ASEAN dialogue partners there are FTAs between Australia and New Zealand, South Korea and India, Japan and India, and China and New Zealand, and when other economies in the region are included the list extends to the China-Hong Kong Closer Economic Partnership Arrangement (CEPA), China-Macao CEPA, New Zealand-Hong Kong CEPA and the China-Taipei Economic Cooperation Framework Agreement.

Such complex webs among East Asian countries were realized mainly because ASEAN dialogue partners also concluded separate FTAs with some individual ASEAN members.

In addition to all these, other bilateral FTAs under negotiation include Thailand-India, Malaysia-Australia, Indonesia-Australia, Indonesia-India, China-Australia, Japan-Australia, South Korea-

Australia, South Korea-New Zealand, Australia-India, New Zealand-India, and South Korea-China.

So as of November 2012, among ASEAN and its dialogue partners, only the Japan-South Korea, China-India and Japan-New Zealand FTAs are still in preparation, but not even preparatory work is under way for a China-Japan FTA. The situation will be different when both RCEP and CJK FTA negotiations start in 2013.

Region-wide FTA in East Asia

In October 2001, the East Asia Vision Group recommended the establishment of an East Asian Free Trade Area (EAFTA) in a report to the leaders of ASEAN+3, and in November 2002 the East Asia Study Group made a similar proposal.

In 2004, ASEAN+3 Economic Ministers (AEM+3) decided to set up an expert group initiated by China to conduct a feasibility study on an EAFTA, and this group reported the outcome of its study to AEM+3 in August 2006. Then South Korea proposed a follow-up in-depth study, which was welcomed by the leaders at the 10th ASEAN+3 Summit in January 2007. The outcome of the EAFTA Phase II Study was presented at the AEM+3 Consultations in Bangkok on Aug. 15, 2009.

On the other hand, at the second East Asia Summit in January 2007, the leaders also agreed to launch a Track 2 study on a Comprehensive Economic Partnership in East Asia (CEPEA), which was initiated by the Japanese government, among ASEAN+6 to deepen integration. The outcome of this study was also presented at the AEM+3 Consultations in Bangkok.

The ministers welcomed the final reports on both EAFTA and CEPEA, and on the basis of their recommendations they agreed to upgrade the joint studies for a region-wide FTA in East Asia conducted by experts to government-level discussions by establishing working groups on rules of origin, tariff nomenclature, customs-related issues, and economic cooperation. Later, this decision was confirmed at the 12th ASEAN+3 Summit and the 4th East Asia Summit.

However, due to the different positions of China and Japan regarding the initial participating countries in those working groups, ASEAN+3 versus ASEAN+6, the process of forming a region-wide FTA in East Asia has been delayed.

Emergence of the RCEP

In November 2011, ASEAN leaders agreed to establish a process of setting out principles under which the association would engage its interested FTA partners in establishing a region-wide FTA, i.e. the ASEAN Framework for the RCEP. Thus, ASEAN finally decided to take the leading role in establishing a region-wide FTA.

Following the ASEAN leaders' agreement in April 2012 to announce the launch of the RCEP negotiations at the next summit, the leaders of 16 East Asian countries declared the start of the RCEP negotiations in Phnom Penh on Nov. 20, 2012.

In my view, ASEAN's decision to launch the RCEP talks was due to

three factors. First, as mentioned, the process of forming a region-wide FTA in East Asia was delayed due to the discord between China and Japan. Second, given the possibility of an FTA being formed by the three Northeast Asian countries, ASEAN seemed to feel that its centrality could be threatened. Third, the fast-proceeding Trans-Pacific Partnership (TPP) became a major competitor to a region-wide FTA in East Asia and could also be a dividing factor among the ASEAN countries, since four members (Singapore, Brunei, Malaysia and Vietnam) had already decided to participate in the TPP.

The RCEP aims to be a comprehensive, high-quality and mutually beneficial economic partnership agreement among ASEAN's member states and its FTA partners. In addition, taking into consideration the different levels of development, the RCEP is supposed to include provisions on special and differential treatment for developing ASEAN members, plus additional flexibility for its least-developed members.

However, it remains to be seen whether the RCEP can be a high-quality FTA in terms of trade and investment liberalization, considering the diversity of participating countries. Given the likelihood of adopting a common concession approach for trade in goods due to the number of participating countries, it will be difficult to turn it into a high-level agreement.

One of the main reasons for forming a region-wide FTA in East Asia is to overcome the "spaghetti bowl" phenomenon caused by the proliferation of bilateral and plurilateral trade agreements with different rules of origin and tariff schedules. So far, the RCEP does not seem to be intended to replace all such existing FTAs, and in that sense it could only be a symbolic region-wide FTA in East Asia. Nevertheless, it could replace at least the existing ASEAN+1 FTAs.

Role of China, Japan & South Korea in Regional Economic Integration in East Asia

Since ASEAN has succeeded in forming FTAs with China, Japan, South Korea, India, Australia and New Zealand, it is regarded both as the FTA hub in East Asia and as the driving force of regional economic integration. In contrast, the role of China, Japan and South Korea in East Asian economic integration appears quite limited.

However, a closer look at what has happened in terms of proliferation of FTAs among East Asian countries and recent joint studies on a region-wide FTA would provide a different verdict regarding the role of China, Japan and South Korea in East Asian economic integration. In reality, it was former Chinese Premier Zhu Rongji who first proposed an ASEAN-China FTA, and this proposal was then followed by similar ones from Japan and South Korea. Thus, China, Japan and South Korea have played a more active role than ASEAN in the process of forming ASEAN+1 FTAs. In addition, as mentioned earlier, when it comes to joint studies on a region-wide FTA in East Asia, China and South Korea took the initiative for the EAFTA studies by experts from ASEAN+3 countries, while the CEPEA study by experts from ASEAN+6 countries was led by Japan.

Thus, we have to acknowledge the fact that until the conclusion of ASEAN+1 FTAs and during the course of joint studies on a region-

wide FTA in East Asia by regional experts, China, Japan and South Korea assumed an active role, even though it could be argued that these initiatives were motivated more by regional geopolitical dynamics than regional economic integration rationales.

However, the competition among the three Northeast Asian countries, which had played a positive role up to the conclusion of ASEAN+1 FTAs, turned into major stumbling blocks regarding the advancement of a region-wide FTA. As mentioned, the working groups could not function properly due to arguments about ASEAN+3 versus ASEAN+6. Furthermore, the lack of FTAs between China, Japan and South Korea constitutes a serious obstacle to the formation of a region-wide regional FTA.

In this regard, the recent announcements in Phnom Penh on Nov. 20, 2012 signaling the launch of both the RCEP and CJK FTA marked another turning point regarding the role of the three Northeast Asian countries in economic integration in East Asia.

Since the negotiations for both the RCEP and CJK FTA will proceed simultaneously from 2013, the three countries have an opportunity to assume a positive role to accelerate economic integration in East Asia. They could do that in two ways. First, they could actively participate in the negotiations on the RCEP which are led by ASEAN. In addition, they could indirectly lead the RCEP negotiations by accelerating the CJK FTA talks. In fact, the latter will be technically much easier than the RCEP negotiations involving 16 countries. Therefore, should the three countries decide to proceed rapidly with the CJK FTA talks by agreeing on coverage and modality, including rules of origin, they could set an example for the RCEP negotiations to follow. In order to do that, China, Japan and South Korea should have the RCEP negotiations in mind when they conduct the CJK FTA talks.

However, given the current political climate in Northeast Asia, such an optimistic scenario seems to have little chance of being realized. Recently, Sino-Japanese relations as well as South Korean-Japanese relations have been seriously strained by territorial disputes. Thus, the prospects for a CJK FTA being realized smoothly do not look very bright.

At this juncture of regional economic integration, China, Japan and South Korea have a choice. The first option is to focus their efforts on achieving a CJK FTA by overcoming the political difficulties they are now facing. In doing so, they could realize a CJK FTA within a relatively short period of time and also assume a *de facto* leading role in the process of forming the RCEP by providing an example for the RCEP talks to follow. Or they could surrender to the whims of domestic politics and fail to form a CJK FTA in time to lead the RCEP process, thus becoming an obstacle instead. To my mind, the choice seems evident. I hope that it will also be clear to the leaders of the three countries.

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Chang Jae Lee is a senior research fellow at the Korea Institute for International Economic Policy (KIEP). He was a member of the Joint Expert Group for EAFTA before assuming the chairmanship of the EAFTA Phase II Study, and was also a member of the Joint Study Committee for a China-Japan-Korea FTA.