

Strategic Analysis of the China-Japan-Korea Free Trade Zone

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Abstract

China, Japan, and Korea represent pivotal economies on the global stage and are each other's key trading partners. Establishing the China-Japan-Korea Free Trade Zone (CJK FTZ) fosters deep cooperation among these nations within a robust institutional framework, significantly benefiting regional economic activities. The development of the CJK FTZ is a crucial element of China's broader strategy for external regional economic collaboration. It necessitates a high-level recognition of its importance, a precise understanding of its role and impact within China's regional economic cooperation strategy, and harmonization with other regional economic initiatives. Such alignment is essential to protect and enhance national economic interests and further accelerate economic integration in East Asia and the broader Asia-Pacific area.

Keywords

Free Trade Zone; China-Japan-Korea Strategy; Regional Cooperation

Introduction

Free Trade Areas (FTAs), designated as FTA Kuang 2015, significantly impact their member countries' economies by removing tariffs and non-tariff barriers, which expands markets and encourages efficient resource use. This arrangement helps countries specialize based on their strengths, improving industrial competitiveness and national welfare. Additionally, FTAs stimulate investment within the region and from outside, enhancing the growth of competitive industries. For non-member nations, FTAs mean facing higher trade barriers. Within the FTA, the agreement shifts the balance towards exporting over direct investment due to reduced transaction costs. Companies are motivated to establish production in various countries to minimize costs, leading to a mix of trade and investment that expands the market size and fosters a common market among member states.

Economic Insights into the China-Japan-Korea Free Trade Zone:

The concept of a Free Trade Zone among China, Japan, and Korea, proposed by scholars in the late 20th century, aimed to foster closer economic ties. By 2001, key research institutions from these countries joined forces to explore the potential of such a zone. A study in 2002, using economic models, found that creating this free trade zone could significantly boost economic growth, trade, and welfare in all three nations Zhao and Chen 2015. The proposal gained official recognition during a 2003 leadership meeting in Bali, Indonesia, where the leaders of China, Japan, and Korea signed a declaration to enhance tripartite cooperation. By 2009, the countries agreed to establish a joint research committee, bringing together government, industry, and academia to further study the zone's strategic impacts. This committee has since met multiple times, discussing various

trade and economic cooperation issues, and paving the way for formal negotiations that began in 2012.

Changes in Trade and Investment

The appreciation of the Renminbi has impacted China's trade and investment, making exports less competitive and increasing the cost for foreign investors. Despite these challenges, the stronger currency also supports capital and technology-intensive businesses, aiding industrial advancement and making the economy more competitive internationally. This situation encourages foreign investment in sectors less affected by currency changes, enhancing China's technological capabilities and product competitiveness on the global stage.

The China-Japan-Korea Free Trade Agreement aims to improve this environment further by creating a massive regional market with 1.5 billion consumers and a combined GDP of over 7 trillion USD Xu 2014. This agreement will ease the flow of goods, services, technology, and capital, fostering stronger economic ties and boosting intra-regional trade significantly. In a world where global free trade is becoming more challenging, such zones offer a focused way to efficiently allocate resources and achieve economies of scale. Currently, trade among China, Japan, and Korea is substantial, with each country being a crucial partner to the others. The FTA could enhance this relationship by promoting industrial cooperation, increasing direct investment, and facilitating technology transfer. This collaboration aims to improve the regional competitiveness and meet global market demands more effectively (Liu and Li 2014).

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Economic Impact of the China-Japan-Korea FTA

The China-Japan-Korea Free Trade Agreement (FTA) aims to boost trade within the region, creating more trade opportunities and encouraging investments among the three countries. By lowering tariffs and other trade barriers, the FTA is expected to reduce import costs, increase exports, and allow for the freer movement of goods and resources. This could lead to larger markets and more efficient economies. Initially, China might face challenges due to its higher tariffs and different industrial structures compared to Japan and Korea, leading to increased imports from these countries and potential impacts on its domestic industries. However, over time, as China's industrial competitiveness improves, the negative effects on GDP, consumption, and investment are expected to turn positive and even surpass Japan and Korea's metrics.

The FTA also supports the accumulation of human and knowledge capital, enhances the efficiency of resource allocation, and increases GDP and income, contributing to longer-term economic growth and competitiveness. Research suggests that under the FTA, China could see a 3.38% GDP growth, with exports and imports increasing significantly, leading to a substantial trade surplus and net welfare gain (Yuan 2013).

Developing the China-Japan-Korea FTA Pathways

Utilizing Bilateral FTAs for Expansion:

The approach considers evolving bilateral FTAs between any two of China, Japan, and Korea into a trilateral, multilateral FTA. However, a direct China-Japan FTA may not be ideal for China due to an expected increase in imports from Japan, negatively impacting Chinese industries. On the other hand, a China-Korea FTA appears mutually beneficial, improving trade and welfare for both nations. But introducing Japan into an existing China-Korea FTA could reduce the welfare gains for China and Korea, making their consent to include Japan unlikely (Xu 2013).

If a Japan-Korea FTA were established first, bringing China into the fold could significantly enhance welfare and trade benefits for all three countries. This method presents a feasible route to establishing a comprehensive China-Japan-Korea FTA, centered on the collective advantages of increased trade and welfare improvements.

Establishing the China-Japan-Korea FTA with a Hub-and-Spoke Approach

This method explores the possibility of forming a trilateral China-Japan-Korea FTA through a series of steps: First, identify if any two countries establish an FTA; next, see if they're willing to include the third country; and finally, assess if these steps can lead to a comprehensive trilateral agreement.

From the outset, it's unlikely for China and Japan to partner in an FTA first (Wang 2012). If a China-Korea FTA is established, there are two potential outcomes: China and Japan might form an FTA, or Korea and Japan might do so,

each impacting the welfare of the non-participating country. After the China-Korea FTA, both China and Korea could look to establish FTAs with Japan, which aligns with Japan's interests too. However, the welfare of the non-participating country would likely decrease. Eventually, if a hub-and-spoke model is created, it could lead to the signing of new bilateral FTAs among the countries, paving the way for a full China-Japan-Korea FTA.

Should Japan and Korea first form an FTA, both would then be motivated to create a new FTA with China, seeking to be the hub in the structure. This would improve welfare levels for those involved, despite potential losses for the non-participating country. Forming such a structure could eventually facilitate the establishment of a comprehensive China-Japan-Korea FTA.

Strategies and Recommendations

Strengthening Exchanges and Building Trust Among China, Japan, and South Korea

China, Japan, and South Korea are the principal economies in East Asia, representing over half of the region's economic output. Establishing a free trade area among them could unlock significant potential and drive substantial progress in regional economic integration. However, creating a China-Japan-South Korea Free Trade Area involves complex interests and requires collaborative efforts to navigate the inherent contradictions and conflicts. Currently, the primary challenges for these nations are to build political trust and resolve differences. Historical issues, particularly Japan's wartime actions in China and Korea, have long fueled political tensions and hindered trust-based diplomatic interactions. Recent years have seen problematic visits by Japanese leaders to the Yasukuni Shrine, which have strained relations and hurt the sentiments of the Chinese and Korean peoples. Nonetheless, there have been notable improvements, starting with Japanese Prime Minister Shinzo Abe's visit to China in October 2006, which marked a thaw in China-Japan relations. This was followed by reciprocal high-level visits that have significantly enhanced bilateral relations. Such high-level interactions are crucial for building political trust and are beneficial for advancing the free trade area initiative.

Moreover, addressing the historical, territorial, and maritime disputes between China, Japan, and South Korea requires ongoing dialogue and compromise. It is vital for these countries to adhere to the principle of finding common ground while respecting differences. They must directly confront historical issues and the political factors that influence their economic and trade relations to clear the path for establishing a free trade area. On the economic front, it might be beneficial to consider separating political and economic issues initially. By prioritizing economic relations and adopting a strategy of mutual development, the countries can promote investment liberalization and increase trade volumes. This economic cooperation is likely to foster political collaboration, further deepening friendly relations among neighbors.

Promoting Investment and Trade Liberalization and Facilitation

1. **Tariff and Non-Tariff Barriers:** As WTO members, China, Japan, and South Korea must address high tariffs and non-tariff barriers (Yang 2011). Under WTO commitments, tariffs should have been reduced to below 5% by 2010. However, high tariffs persist, such as China's 25% duty on imported cars and similarly high tariffs by Japan and South Korea on Chinese agricultural products. The three countries need to expedite the creation of specific free trade plans and adjust tariffs on non-sensitive goods to reasonable levels to enhance mutual trade. Additionally, reducing restrictions on import and export volumes and export subsidies can increase the fairness of international trade.
2. **Customs Cooperation:** Inspired by ASEAN's transportation facilitation agreements, China, Japan, and South Korea could benefit from unified customs procedures. This includes harmonizing entry and exit inspections, adopting electronic customs systems, and standardizing inspection criteria for products to streamline customs processes. Implementing unified rules, coordinating competition policies, standardizing e-commerce, and simplifying visa processes can facilitate the smooth flow of people, goods, capital, and information. Leveraging technology to minimize paper-based trade can enhance the efficiency and security of e-commerce environments. Overall, simplifying customs procedures can accelerate goods circulation, shorten clearance times, and provide a more efficient trading environment for businesses across these three nations.

Rapid Adjustment of Domestic Industrial Structure for Enhanced Competitiveness

In international trade, the proportion of high-tech products is a critical measure of a country's trade prowess. Currently, China primarily exports low-end, processed goods, positioning it as a major trader but not a strong one. To transition from this status, China should fully liberalize industries where it holds competitive advantages, allowing them to compete globally. This strategy could mitigate trade barriers and boost China's industrial competitiveness. For industries where China is less competitive, such as automotive and electronics, a strategy of encouragement and restriction could be beneficial. This might include supporting joint ventures while limiting wholly-owned enterprises and focusing on attracting technology investments from Japan and South Korea, rather than purely manufacturing investments. Simultaneously, China should prioritize enhancing its innovation capabilities and efficiency, improving its own high-tech industries' competitiveness on the global stage.

Navigating a Tripartite Win-Win Scenario and Accelerating Global Integration

In shaping the China-Japan-South Korea Free Trade Area (FTA), China must consider not only the interests within

the region but also significant external influences such as the United States. The U.S., with its strategic military presence in Japan and South Korea, plays a vital role in Northeast Asia's security dynamics, particularly regarding North Korea—a key issue also closely tied to China. The establishment of the FTA is expected to substantially increase trade volumes and promote the internationalization of the Japanese yen and the Chinese yuan, challenging the dominance of the U.S. dollar.

Therefore, China should enhance its political, military, and economic engagement with the U.S. to build trust and interdependence, ensuring U.S. support for the FTA. Equally important is China's relationship with Japan and South Korea. Japan's economic prowess and global integration significantly influence the FTA's prospects, while South Korea's role, although smaller in trade volume, is crucial in the regional economy. Exclusion from an FTA would severely impact China's economic interests. Thus, improving relations and fostering economic and technological cooperation with Japan and South Korea is essential. Additionally, China should expedite the development of the ASEAN Free Trade Area. If China establishes a China-ASEAN FTA before Japan and South Korea, it could spur them to enhance their "10+1" cooperation with ASEAN or join the China-ASEAN FTA, potentially leading to an East Asian economic community based on a "10+3" model.

Managing a Tripartite Win-Win Scenario and Accelerating Internationalization

China, in forming the China-Japan-South Korea Free Trade Area (FTA), needs to balance regional interests with those of significant external players, notably the United States. The U.S. has strategic military and economic stakes in Northeast Asia, particularly concerning North Korea, which directly affects China. Establishing the FTA will boost trade significantly and could challenge the dominance of the U.S. dollar through the internationalization of the yen and yuan. China should therefore deepen its political, military, and economic ties with the U.S. to foster mutual trust and support for the FTA. Maintaining strong relations with Japan and South Korea is also critical. Japan's economic leadership and South Korea's regional role mean that excluding China from the FTA would have substantial economic repercussions. Thus, enhancing cooperation with these nations is essential. Additionally, China should prioritize establishing the ASEAN Free Trade Area. Leading this effort could encourage Japan and South Korea to intensify their cooperation with ASEAN or to join the China-ASEAN FTA, paving the way for a broader East Asian economic community based on a "10+3" model.

Leveraging Local Initiatives to Enhance National FTA Strategies

Although Free Trade Agreements (FTAs) are national in scope, local projects can significantly propel their negotiation and implementation. For instance, cities like Qingdao and Dalian can pilot FTA strategies by collaborating with Korean and Japanese-funded enterprises, respectively. These local efforts could involve transforming export

processing zones into import processing zones and initiating duty-free sales within specific areas. Sub-regional economic cooperation, such as in the Tumen River area, can also play a critical role in facilitating trade liberalization and improving economic information systems. This approach helps lay a solid foundation for the eventual creation of a China-Japan-South Korea FTA and supports broader East Asian economic cooperation. Integrating smaller markets into a unified larger market facilitates specialization, mass production, and optimal resource allocation. Addressing systemic differences and promoting openness are essential to avoid disputes and ensure the success of the FTA. Once established, the FTA is expected to enhance regional competitiveness, increase market share, reduce production costs, and yield significant economic benefits.

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