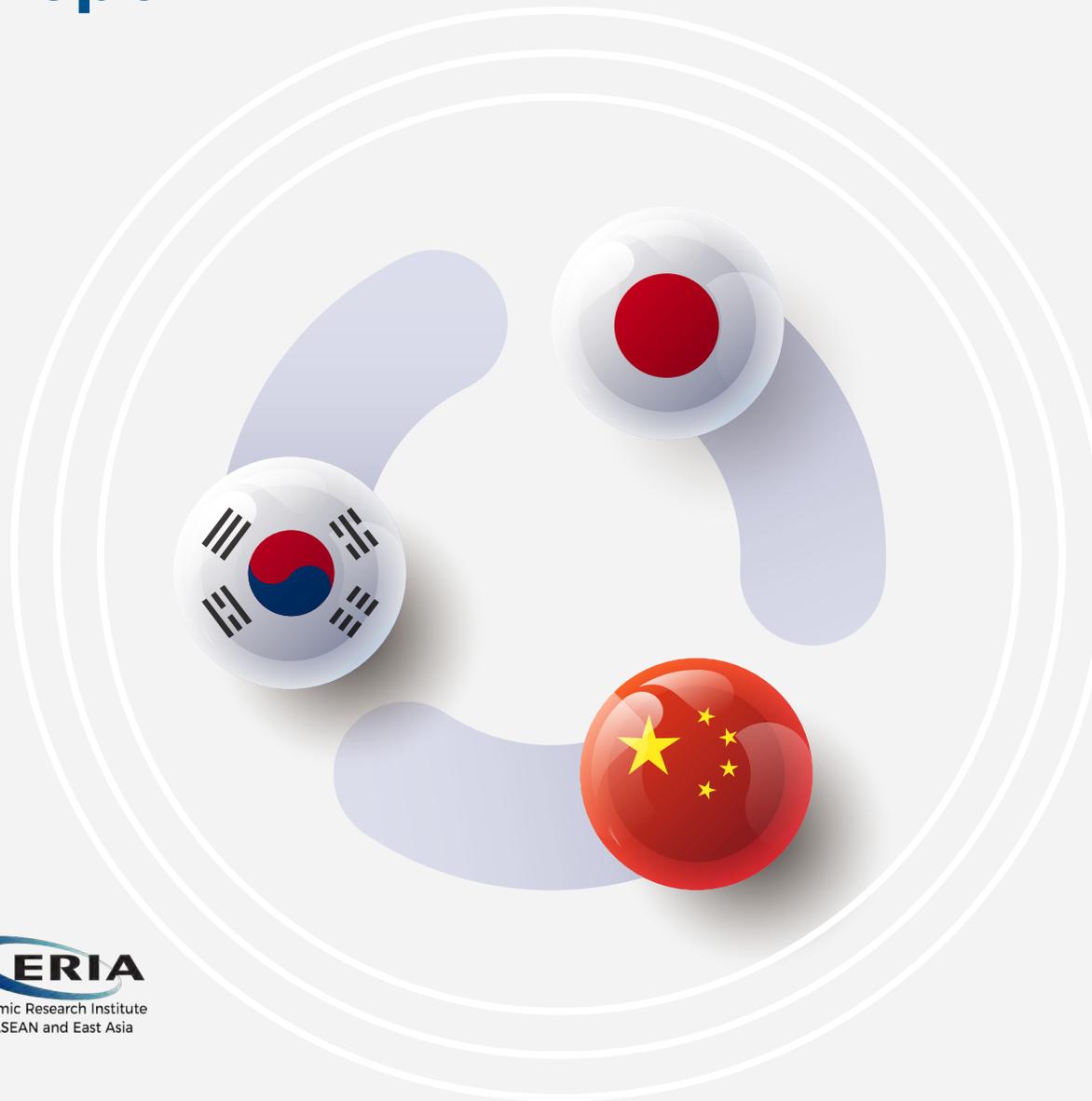


2023

Trilateral Economic Report



2023

**Trilateral
Economic
Report**

Foreword

OU Boqian

Secretary-General
Trilateral Cooperation Secretariat



I am delighted to present the 2023 Trilateral Economic Report (TER), one of the flagship projects of the Trilateral Cooperation Secretariat (TCS). The TER has been published since 2013 which provides annual updates on the macroeconomy of China, Japan, and the Republic of Korea (CJK), examines trilateral economic relations, and offers policy recommendations to the three governments.

This year, the theme of the report is ‘Regional Economic Integration and the Outlook of Trilateral Cooperation in the Post-Pandemic era’. Collaborating with seven distinguished economic scholars from East Asia and ASEAN, the 2023 TER delves into the economic performance of the region, with a particular focus on the period encompassing the Covid-19 pandemic (2020-2023) and the geopolitical risks facing the ASEAN+3 Economy. This year’s report primarily examines regional economic cooperation and the Regional Comprehensive Economic Partnership (RCEP), which represents the first-ever economic partnership agreement including China, Japan, and the Republic of Korea. The report analyzes the progress of regional cooperation in East Asia and ASEAN providing valuable insights for the effective implementation of RCEP.

The global economy has been severely impacted by the Covid-19 pandemic and geopolitics. As of 2023, the global economy is experiencing a slow recovery. In 2022, the GDP of the CJK region expanded by 13.7% compared to 2020, with GDP per capita reaching USD 15,340, surpassing the global average of USD 12,880. However, various uncertainties and risks, including

TCS

banking instability, inflation, and geopolitical fragmentation, persist. Against this backdrop, the implementation of RCEP, which encompasses one-third of the global population and GDP, serves as a catalyst for enhanced economic and trade cooperation among East Asian and ASEAN countries.

The benefits of RCEP will contribute to the establishment of a predictable and sustainable trade and investment environment in the region through the consolidation of a broad spectrum of trade rules, commitments to the digital economy, reduced trade barriers, a dynamic global value chain, tariff reduction, and flexible rules of origin. While promising, there are challenges to the successful implementation of RCEP, including the transition to a negative-list approach, raising awareness among relevant stakeholders, and including contemporary issues such as labor and the environment. Given these factors, conducting an analysis of recent developments and exploring future paths for enhancing regional economic integration and cooperation would be a meaningful endeavor.

I hope this report will enhance people's understanding of regional economic cooperation, particularly in the areas of trade and investment. Additionally, I look forward to this report serving as a platform for discussion and the exchange of ideas on how to foster improved economic cooperation that will contribute to lasting peace, common prosperity, and shared culture in this region.

Foreword

Professor Tetsuya Watanabe

President

Economic Research Institute for ASEAN and East Asia



On behalf of the Economic Research Institute for ASEAN and East Asia (ERIA), I would like to extend my congratulations on the successful publication of the Trilateral Economic Report 2023, which focuses on the Regional Comprehensive Economic Partnership (RCEP). It is an honour for ERIA to collaborate with esteemed research institutes from China, Japan, the Republic of Korea, and the Trilateral Cooperation Secretariat (TCS) in examining one of the world's largest Free Trade Agreements (FTAs).

RCEP, signed in 2020, has emerged as the largest FTA globally. It encompasses the 10 member states of the Association of Southeast Asian Nations (ASEAN) and five of ASEAN's Dialogue Partners (Australia, China, Japan, the Republic of Korea, and New Zealand). RCEP plays a crucial role in unlocking significant resources for trade and investment while fostering dynamic regional and global value chain activities.

Given the current global uncertainties resulting from events like the Russia-Ukraine war, the inward-looking policies prompted by the COVID-19 pandemic, and the US-China trade dispute, RCEP assumes even greater importance for global trade and regionalism. It serves as a vital catalyst for global trade and investment, redirecting domestic and regional activities in

ERIA

East Asia towards open regionalism and global trade and investment.

RCEP's emphasis on a rules-based international trading order is pivotal for the effective and efficient functioning of international production networks (IPNs) in East Asia. It strengthens production networks between Japan, the Republic of Korea, and China under an unprecedented FTA framework.

As a research institute mandated to support regional integration in East and Southeast Asia, ERIA's chapter on the perspective of RCEP from ASEAN Member States in this report highlights areas for further cooperation amongst Japan, the Republic of Korea, China and the ten ASEAN members. It aims to deepen and expand the networks of production that have been established over the past 3 decades.

In conclusion, ERIA considers it a privilege to be involved in the trilateral cooperation process amongst Japan, the Republic of Korea, and China. This endeavor aligns with the Institute's mission to consistently support activities that foster greater integration amongst East Asia Summit member countries.

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Abbreviation

AFTA	ASEAN Free Trade Area
AI	Artificial Intelligence
AMRO	ASEAN+3 Macroeconomic Research Office
AMS	ASEAN Member States
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASEAN+3	Association of Southeast Asian Nations, China, Japan and the ROK
BOP	Balance Of Payments
BPO	Business Process Outsourcing
CAGR	Compound Annual Growth Rate
CAICT	China Academy of Information and Communications Technology
CASS	Chinese Academy of Social Sciences
CDO	Chief Data Officer
CHY	Chinese Yuan
CI	Composite IndexPU
CJK	China, Japan, Republic of Korea
CMIM	Chiang Mai Initiative Multilateralization
CMIM-PL	CMIM Precautionary Line
CMIM-SF	CMIM Stability Facility
CNY	Chinese yuan renminbi
CO	Certificate of Origin
CPC	National Congress of the Communist Party of China
CPI	Consumer Price Index
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
EC	European Commission
ECB	European Central Ban
ECCL	Enhanced Conditioned Credit Line
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EFTA	European Free Trade Association
EPA	Economic Partnership Agreement
ESM	European Stability Mechanism
ETF	Exchange-Traded Funds
EU	European Union
FCL	Flexible Credit Line

FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTAAP	Free Trade Area of the Asia-Pacific
FLAR	Fondo Latinoamericano de Reservas (Latin American Reserve Fund)
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GII	Global Innovation Index
GVC	Global Value Chain
IMF	International Monetary Fund
IMF-DLP	IMF-delinked portion
IMF-LP	IMF-linked portion,
IPN	International Production Network
IPR	Intellectual Property Rights
IT	Information Technology
JCER	Japan Center for Economic Research
JPY/JP¥	Japanese Yen
J-REITs	Japan Real Estate Investment Trusts
KC FTA	The Republic of Korea-China Free Trade Agreement
KIEP	Korea Institute for International Economic Policy
KISDI	Korea Information Society Development Institute
KPO	Knowledge Process Outsourcing
KRW	South Korean Won
MOU	Memorandum of Understanding
NAB	New Arrangements to Borrow
NAFA	North American Framework Agreement
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
PCCL	Precautionary Conditioned Credit Line
PPI	Producer Price Index
PLL	Precautionary and Liquidity Line
QQE	Quantitative and Qualitative Monetary Easing
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
RIETI	Research Institute of Economy, Trade and Industry
RMB	Ren Min Bi

ROK	Republic of Korea
ROO	Rules of Origin
RTA	Regional Trade Agreements
SBA	Stand-by Arrangement
SCC	Supply Chain Connectivity
SCF	Stand-by Credit Facility
SMEs	Small and Medium-sized Enterprises
STEM	Science, Technology, Engineering, and Math
SLL	Short-term Liquidity Line.
TCS	Trilateral Cooperation Secretariat
TEU	Twenty-foot Equivalent Unit
TFP	Total Factor Productivity
TiVA	Trade in Value Added
TRQ	Tariff Rate Quotas
UAE	United Arab Emirates
UNCTAD	United Nations Conference on Trade and Development
USD/ US\$	United States Dollar
VUIs	Voice User Interfaces
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
YCC	Yield-Curve Control
YoY	Year on year

Authors

Statistics Team

Trilateral Cooperation Secretariat

C H A P T E R



Main Statistics of China, Japan and the ROK

- 1 Main Indicators of China, Japan and the Republic of Korea**
- 2 Gross Domestic Product**
- 3 Total Merchandise Trade**
- 4 RCEP Enhancing the Regional Economic Integration**

Main Statistics of China, Japan and the ROK



This chapter's contents are based on the Trilateral Statistics Hub. The Trilateral Statistics Hub aims to provide a comprehensive understanding on the development trend of the three countries as well as to understand the importance of Trilateral Cooperation by analyzing the integrated statistics of China, Japan and Republic of Korea (CJK).



1.1 Main Indicators of China, Japan and the Republic of Korea



1.2 Gross Domestic Product (GDP)

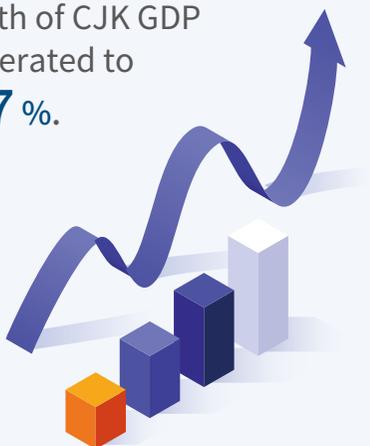
CJK GDP accounting for **23.4%** of the world GDP in 2022



The sum of three countries GDP is **USD 24.35 trillion** in 2022.



From 2020 to 2022, growth of CJK GDP accelerated to **13.7%**.



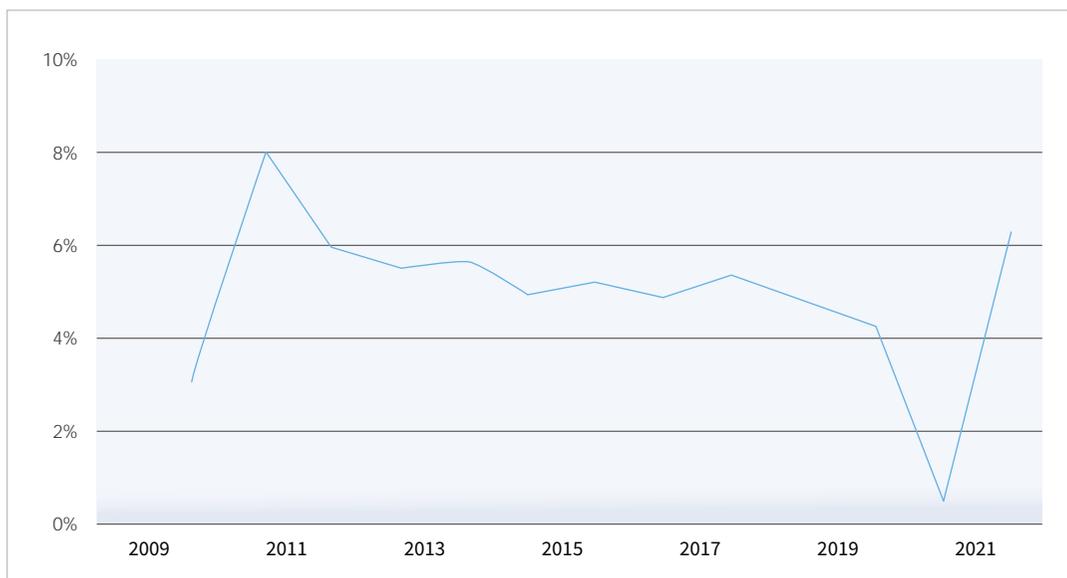
CJK GDP per capital is **USD 15,340** in 2022. Compared to 2020, the growth rate increased to **13.8%**.



Economic Recovery and Growth after COVID-19

After a sharp contraction in 2020, the CJK GDP expanded by 13.7% in 2022, compared to 2020. East Asia has bounced back from recent shocks and are back on track to economic growth. In 2022, CJK GDP per capita reached USD 15,340, which is higher than the world average GDP of USD 12,880.

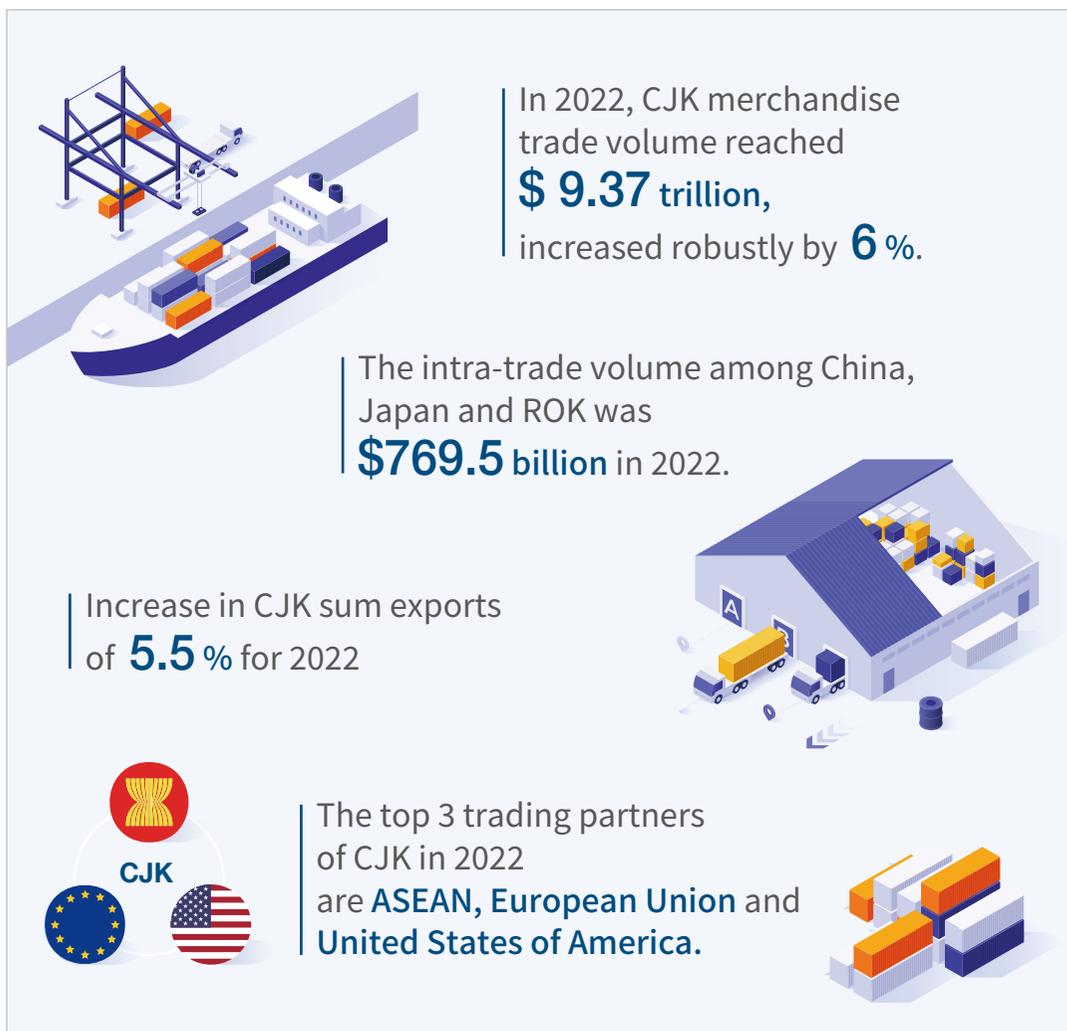
In 2011, the three countries accounted for 18.5% of world GDP. Whereas by 2022, the share of world GDP was 23.4%. This upward trend has been consistent for the past 11 years.

Figure 1 CJK GDP Annual Growth Rate

Table 1 Gross Domestic Product and Gross Domestic Product Per Capita

Economies	Value		Annual growth rate	
	Nominal GDP	Nominal GDP(NGDP)* Per capita	Real GDP*	Real GDP(RGDP)* per capita
	(USD Billion)	(USD)	(%)	(%)
	2022	2022	2022	2022
World	100 220	12 880	3.4	
G7	43 780	56 580	2.3	
ASEAN-5*	3 130	6 330	5.5	
China	18 100	12 810	3	3
Japan	4 230	33 820	1.1	1.5
The ROK	1 670	32 250	2.6	2.4
CJK	24 000	15 340	2.7	2.9

- Note*
1. ASEAN-5 refers to Indonesia, Malaysia, Philippines, Singapore and Thailand
 2. Gross domestic product is the total value of all of the goods and services produced by a nation in a given period, usually monthly, quarterly, and yearly

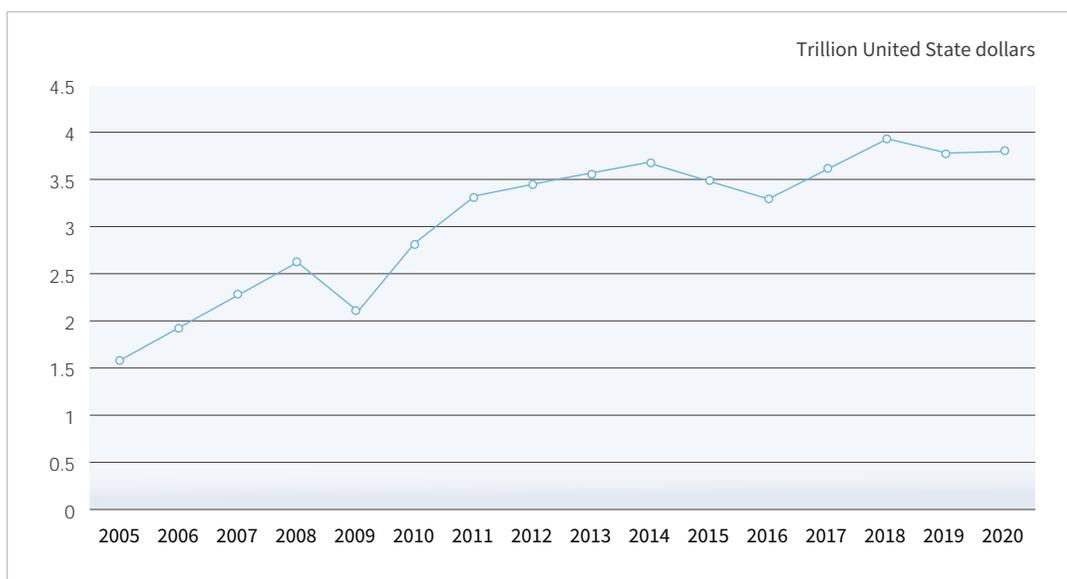
1.3 Total Merchandise Trade



Trade Recovery in the Post-pandemic

In 2022, the value of CJK merchandise exports increased robustly by 6% exports amounted to USD 9.37 trillion, which is USD 1.28 trillion higher than the pre-pandemic value recorded two years before in 2020. The three countries' share of world total trade in merchandise was 19.7% amounting to USD 8.84 trillion.

Merchandise export served as an engine of growth for the three countries, totaling USD 5.0 trillion, accounting for 20.6% of CJK GDP in 2022. Separately, the ratio of merchandise trade in each country's GDP were reported to be 20.9% (China), 27% (Japan), and 51.1% (ROK).

Figure 2 CJK Merchandise Exports, yearly

Table 2 Merchandise Trade of CJK

Economies	Exports			Imports			Trade balance
	Value		Annual growth rate	Value		Annual growth rate	Value
	(USD billion)		(%)	(USD billion)		(%)	(USD billion)
	2021	2022	2022	2021	2022	2022	2022
China	3364	3590	6.7	2687.5	2720	1.2	870
Japan	756	751.6	-0.6	769	902.6	17.4	-151
ROK	644.4	683.6	6.1	615.1	731.4	18.9	-47.8
CJK	4764.4	5025.2	5.5	4071.6	4354	6.9	671.2

1.4 RCEP Enhancing Regional Economic Integration

In 2022, the 15 member countries account for about **30 %** of global GDP and **29.3 %** of the world population.



In 2022, trade volume between three countries and ASEAN achieved **USD 1436.9 billion**, increased by **12.1 %** compared to 2021.



CJK's trade with other RCEP members accounted for **30.8 %**, **42.3 %** and **32.8 %** of each country's total foreign trade.

The **RCEP** rule of origin provides and creates a unified market for intermediate goods.



As of 2022, the 15 member countries of the Regional Comprehensive Economic Partnership (RCEP) accounted for about 30% of world GDP (USD 30.7 trillion) and 29.3% of the world's population (2.31 billion). The 15 participating countries also cover an area of 22.54 million km², which corresponds to approximately 14.9% of the earth's habitable surface.

CJK and ASEAN are critical economic partners, as the value of trade in goods between CJK and ASEAN reached USD 975.3 billion, USD 254.2 billion and USD 207.4 billion respectively in 2022. ASEAN and China have been each other's largest trading partner for several years, and ASEAN is Japan' and the ROK's second largest trading partner.

In 2022, China's trade with other RCEP member countries reached CNY 12.95 trillion (USD 1.92 trillion), increasing 7.5% year on year and accounting for 30.8% of China's total foreign trade. Japan's trade with RCEP member countries reached USD 700 billion in 2022, accounting for 42.3% of Japan's total foreign trade. The ROK trade with RCEP member countries reached USD 464 billion in 2022, accounting for 32.8% of ROK's total foreign trade.

Trade in intermediate goods among three countries and ASEAN has maintained continuous growth. The RCEP rule of origin provides and creates a unified market for intermediate goods, which will facilitate the establishment of a sound regional supply chain and continue to promote trade in this area.

Figure 3 World Largest Trade Bloc; RCEP

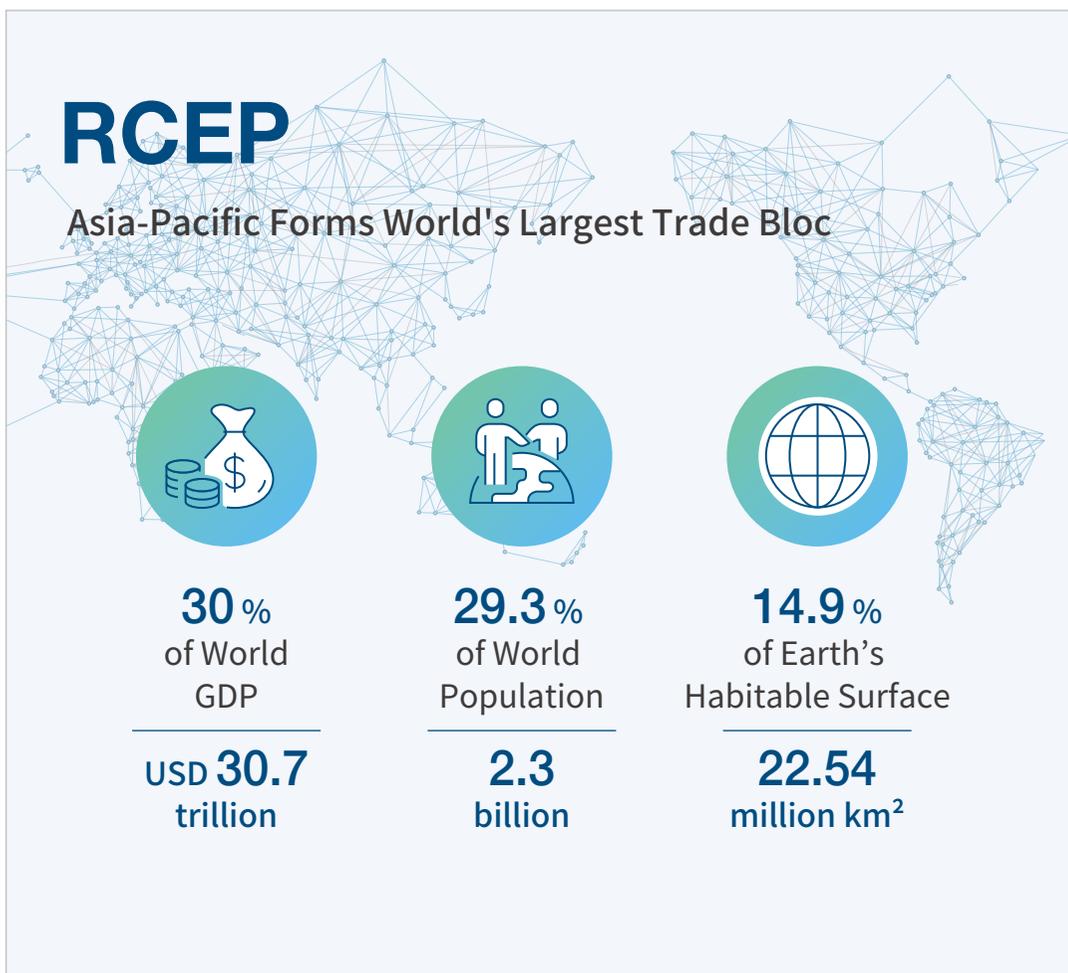


Table 3 Trade in Intermediate Goods

(USD billion)		2020	2021	2022
China	ASEAN	441.4	-	648.2
	Japan	158.1	165	191.5
	ROK	207.7	-	282.6
	RCEP members	940.2	1190	1290
	Total	2684.5	3134	3942.8
Japan	ASEAN	113.7	142.5	-
	RCEP members	331.1	413.2	-
	Total	686.3	862.1	-
ROK	ASEAN	99.4	-	-
	RCEP members	334.5	-	-
	Total	648.7	700	-

Note - means no data available

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C H A P T E R



Economic Performance of China, Japan, and the ROK

1 Global and Regional Economies and New Trends

- Impact of COVID-19 and Geopolitical Risks on the Global Economy
- ASEAN+3 Economy in 2020-23

2 China's Economic Performance

- China's Macroeconomic Performance
- China's Economic Adjustment and Policy Direction
- China's Economic Prospects

3 Japan's Economic Performance

- Japan's Macroeconomic Performance
- Japan's Economic and Policy Adjustment
- Japan's Economic Policy Direction
- Japan's Economic Prospects

4 The ROK's Economic Performance

- The ROK's Macroeconomic Performance
- The ROK's Economic Adjustment and Policy Direction
- The ROK's Economic Prospects

Economic Performance of China, Japan, and the ROK



2.1 Global and Regional Economies and New Trends

2.1.1 Impact of COVID-19 and Geopolitical Risks on the Global Economy

The COVID-19 pandemic hit the global economy severely. World GDP shrank by 3% in 2020, with both advanced and developing economies experiencing negative growth, whereas it shrank by only 0.1% in 2009, with only advanced economies registering negative growth. The war in Ukraine and the associated hikes in energy, food, and other commodity prices added global uncertainty and raised inflation all over the world. Sharp monetary policy tightening in the US and Europe to contain inflation has led to banking sector turmoil in these economies and poses external debt sustainability risks in developing economies.

In 2023, the global economy continues to recover, while banking sector turmoil could threaten the recovery and raise recession concerns. The International Monetary Fund (IMF) projects global output growth to fall from 3.4% in 2022 to 2.8% in 2023 (and 3.0% in 2024), assuming banking sector stability is maintained. Global headline inflation¹ is set to fall from 8.7% in 2022 to 7.0% in 2023 on the back of lower commodity prices, but underlying core inflation might be persistently high.

Risks to the recovery outlook are heavily skewed to the downside (IMF, 2023). First, banking sector stress could be amplified and weaken the real economy through a sharp deterioration in global financial conditions. Second, sovereign debt distress could escalate and become more systemic due to higher interest rates and lower growth. Third, the Ukraine war could intensify and further raise food and energy prices. Fourth, high core inflation may continue to require tight monetary policy. Fifth, geoeconomic fragmentation could undermine output growth.

1 Headline inflation is the raw inflation figure reported through the Consumer Price Index (CPI), while core inflation removes volatile food and/or energy prices from the overall CPI.



To maximize positive prospects and minimize risks, as long as banking sector stress remains non-systemic, central banks facing high inflation should maintain monetary tightening to control inflation. Second, to safeguard financial stability, financial authorities should avoid risks in banks, non-bank financial firms, and the real estate sector. Third, fiscal authorities should tighten policy to maintain debt sustainability and/or ease inflation pressures. Finally, in the event of sudden capital outflows, emerging economies should combine policies to reduce risks, such as foreign exchange market interventions and capital flow management measures.

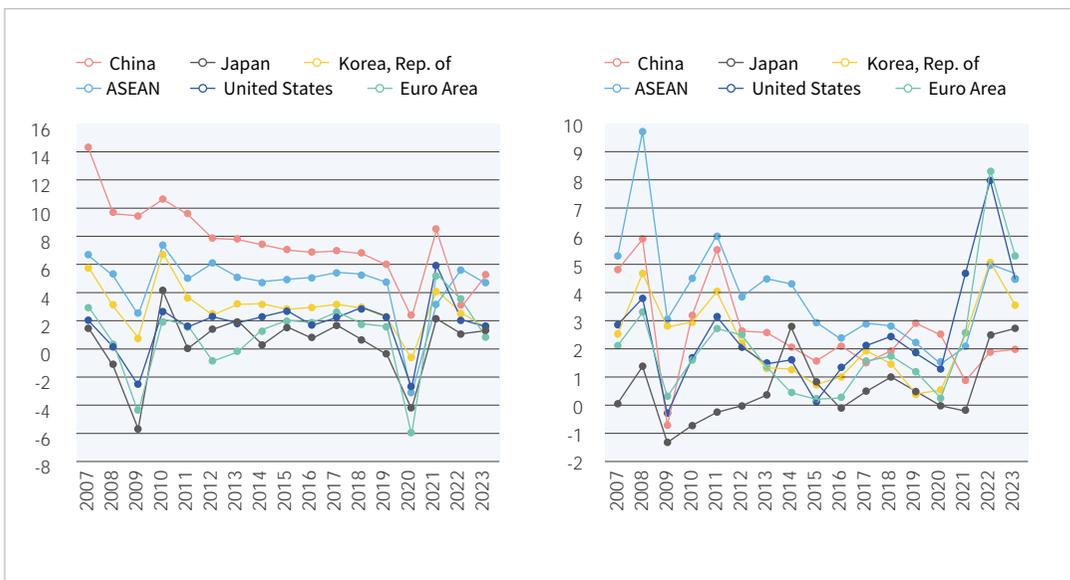
2.1.2 ASEAN+3 Economy in 2020-23

The ASEAN+3 economies were also hit hard by the COVID-19 crisis (Figure 1). China, the ROK, and ASEAN countries saw a sharp economic contraction in 2020 and recovered relatively quickly in 2021, while Japan's recovery was slow. Inflation has also risen in the ASEAN+3 economies and remains high in the ROK and some ASEAN economies. ASEAN+3 Macroeconomic Research Office (AMRO) estimates that the ASEAN+3 region grew 3.2% in 2022, with the inflation rate of 6.5% (AMRO, 2023).

Figure 1 Real GDP Growth and Inflation Rates for Asian and Other Major Economies

1A. Real GDP Growth Rate, 2007-23 (%)

1B. Consumer Price Index (CPI) Inflation Rate, 2007-23 (%)



Note ASEAN data are weighted averages, with weights being the shares of PPP-based GDP. Data for 2023 are based on projections made by the IMF.

Source Adapted from *World Economic Outlook database*, by the IMF, April, 2023.

AMRO projects the ASEAN+3 region to grow faster at 4.6%, largely thanks to the re-opening of China, and inflation to come down to 4.5% in 2023. AMRO identifies three downside risks to this projection. First, prolonged weakness in China's real estate sector could hinder the economy's recovery and regional growth. Second, the outbreak of more virulent COVID-19 variants could affect social and economic activity. Third, the deepening of strategic competition between the US and China could exacerbate global economic fragmentation and regional growth prospects. Policymakers in ASEAN+3 would need a calibrated policy mix to support the expansion of regional trade and investment and better manage the US-China competition.

2.2 China's Economic Performance

China's economy is still the “anchor of stability” for world's economic development. China has become a major trading partner of more than 140 countries and regions, with USD 320 billion of Chinese direct investment going to the world every day and more than 3,000 foreign-funded enterprises settling in China every month. Over the past decade, the contribution of China to the global economic growth has been more than the total contribution made by the G7. Bloomberg indicates that China's share of global GDP growth will be 22.6% of the total global growth by 2028, which will provide greater certainty to the world's economic growth, continue to stimulate new momentum and vitality, and allow countries around the world to share in the opportunities and dividends of China's development(IMF World Economic Outlook, 2023).

2.2.1 China's Macroeconomic Performance

First, China's economy is generally stable in the midst of chaos and confusion. In 2020, after the outbreak of the COVID-19 virus, the US, Europe and Japan experienced negative economic growth, while China maintained positive growth of 2.2%. In 2021, the US, Europe and Japan, driven by large-scale stimulus policies, grew by 5.9%, 5.3% and 2.2%, respectively, while China's GDP was up 8.4%, accounting for 18.5% of the world economy. In 2022, China's economy achieved a growth rate of 3%, which was relatively fast compared to major economies, with a total economic volume of CNY 121 trillion. While most countries around the world were suffering from high inflation, China's prices were still stable and the national CPI in 2020 and 2021 was below 2%. The CPI rose by 2.0% year-on-year(YoY) in 2022, and the average rate of increase in consumer prices from 2020 to 2022 was 1.8%. The annual increase rate has always been lower than the expected target. This reflects the resilience, potential and vitality of the Chinese economy. China's GDP grew by 4.5% at constant prices in 2023Q1, with activity repaired beyond market expectations. China's economy was repaired in the 2023Q1, recovered in Q2, rebounded strongly in Q3, and will reach the pre-epidemic level or higher in Q4. The World Bank, IMF, OECD and other international organizations have raised their expectations for China's economy, and the rebound of its economy has provided certainty and stability to the world in recession.

Second, China is the main driver of economic growth in Asia and the world. China's economy is full of resilience and vitality, and the global economic community continues to be bullish on the Chinese economy. According to a professor at Nanyang Technological University, adopting a recent World Bank model analysis, a 1%p drop in China's GDP would result in a 1.2%p drop in Singapore's, a 0.8 %p drop in Malaysia's, and a 0.6 %p drop in Indonesia's. China's average

annual contribution to the world economic growth from 2013 to 2021 is 38.6% exceeding the total contribution of the G7 countries (World Bank report). China's total economy grew from CNY 53.9 trillion in 2012 to CNY 114.4 trillion in 2021, firmly in second place in the world. Between 2013 and 2021 China's economy grew at an average annual rate of 6.6%, a figure significantly higher than that of the world's 2.6% over the same period and 3.7% for developing countries. IMF projects that China's economy will contribute more than 1/3 of the world's economic growth in 2023, and the World Bank predicts it will reach 40%.

Third, China is still a hot spot of FDI net inflows. In the past three years, China's actual utilization of foreign investment increased from USD 144.4 billion in 2020 to USD 189.1 billion in 2022, which is the best example of foreign investors' confidence in China. Particularly in 2022, when the economy was hit by the outbreak of COVID-19 and the global economies were complicated and severe, China's actual use of foreign investment amounted to CNY 1232.68 billion, up 6.3% YoY on a comparable basis (equivalent to USD 189.13 billion, up 8%). In 2023Q1, the actual use of foreign investment in China was CNY 408.45 billion, up 4.9% YoY; more than 10,000 new foreign-invested enterprises were established, up 25.5% YoY, with a steady growth of FDI, and a number of new foreign investment projects were implemented in China.² HSBC Bank is confident in the long-term development of China, and the HSBC Group's new investment in mainland China is expected to exceed CNY 3 billion from 2020 to 2025. China's open policy environment, market stability, and its vitality will keep attracting foreign investors.

Fourth, China has become the most risk-resistant manufacturing base in the world. In 2022, China's total industrial added value reached CNY 40.2 trillion and manufacturing added value reached CNY 33.5 trillion, both ranking first in the world and maintaining China's role as the world's top manufacturing country³ for 13 consecutive years.⁴ China's share of manufacturing value added in the world increased from 22.5% in 2012 to nearly 30% in 2021, and the figures for high-tech and equipment manufacturing increased from 9.4% and 28% to 15.1% and 32.4%, respectively, during the same period. In 2022, the output value of the global manufacturing industry reached USD 44.5 trillion, and the world's top countries in manufacturing value added are: China (No. 1), the US, South Korea and Italy. In 2022, COVID-19 and the Ukraine war significantly affected global economic development which coupled with the impact of U.S.

2 German companies BASF and Volkswagen invested and expanded in China, and the global beauty giant L'Oréal held a bullish view on the Chinese market and continued to raise its investment in China, announcing the establishment of its first investment company in the Chinese market and laying the foundation for building its first intelligent operation center in Suzhou.

3 China is among the top 10 countries in manufacturing output in the world, and its manufacturing output is 1.5 times as high as the US.

4 China has 41 major industrial categories, 207 medium industrial categories and 666 small industrial categories, as the only country that has all the industrial categories listed in the United Nations Industrial Classification.

interest rate hikes.; while growth in global economy and manufacturing slowed down, global manufacturing value added was only USD 16.9 trillion. The value added of China's national manufacturing sector in 2022 was CNY 33.52 trillion, accounting for 27.7% of its GDP growth. Several major achievements have been made in China in 5G, high-speed rail, nuclear power, aerospace and other important fields leading the world, and a number of high-quality enterprises and national brands have emerged. China currently accounts for 29.47% of global manufacturing value added, or nearly 30%. China is still the highland and base with the most complete manufacturing industry system and the strongest support capacity.⁵ China's manufacturing sector showed a rapid recovery in 2023Q1, with the added value of the industries above national scale growing 12.3% YoY, up from 10% a year earlier, which became an important factor in the country's sustained economic growth.

2.2.2 China's Economic Adjustment and Policy Direction

China's superb new infrastructure lays a solid foundation for its development in the decades ahead having a world-class infrastructure and ecosystems. Since the 18th National Congress new digital infrastructure represented by 5G, fiber optic broadband, industrial Internet and data centers has witnessed rapid development. China built the world's largest and most technologically advanced network infrastructure, with more than 2.4 million 5G base stations as of March 2023, and 8 national computing hubs for "channeling computing resources from the east to the west" being accelerated. In 2022, China continued to accelerate the development of its digital economy, integrate digital and real economy, and build an internationally competitive digital industry cluster. With "digital-real integration" as the main line, the digital infrastructure construction has been further improved. The layout of digital infrastructure is being accelerated throughout China. Its current data center scale is growing at a rate of more than 25%, with the world's second largest scale of computing power, and the scale of the computing power core industry has reached CNY 1.8 trillion. In Shenzhen, the government launched the construction of a new phase of the Smart Computing Center and Supercomputing Center.⁶ The Yangtze River Delta Manufacturing Digital Competence Center has served more than 1,300 manufacturing companies since its establishment. The scale of the digital economy of China currently accounts for 40% of its

5 According to Bloomberg, it will take Apple about eight years to move just 10% of its production capacity out of China, and for the business shifted by Apple to Vietnam and India, 25% of Intermediate goods, or core components will be imported from China.

6 This Smart Computing Center will be officially put into operation at the end of the year, and will then provide services to more than 400 core enterprises in the new network and artificial intelligence fields in the Guangdong-Hong Kong-Macao Greater Bay Area.

GDP and has become the most active area of innovations, with human experience beginning to be transformed into a data knowledge information transfer network, which is an extremely explosive driver in China's manufacturing sector.

2.2.3 China's Economic Prospects

China's mega market will continue to release dividends, China will continue to be not only the "world factory" but also the "world market" for many years to come. China's global GDP per capita ranking for 2022 dropped three places from its 2021 ranking to 68th, with a GDP per capita of USD 12,814 (IMF), creating continued growth in consumption power. Total retail sales of consumer goods was around CNY 44 trillion in 2022, with online retail sales of physical goods reaching CNY 12 trillion (China's National Bureau of Statistics). China remains the world's second largest consumer market and the number one online retail market, and its mega-market will continue to provide dividends. After the removal of restrictions due to COVID-19, the market saw a return to greater popularity, and consumption quickly recovered and rebounded. 308 million domestic trips were made nationwide during the 2022 Spring Festival holidays, up 23.1% YoY and recovering to 88.6% of the same period in 2019; domestic tourism revenue reached CNY 375.843 billion, up 30% YoY and recovering to 73.1% of the same period in 2019 (China's Ministry of Culture and Tourism). In 2023Q1, the total retail sales of consumer goods increased by 5.8% YoY, and the contribution of final consumption expenditure to economic growth reached 66.6%, as the demand potential of China's mega domestic market is being rapidly released. The added value of the accommodation and catering industry grew by 13.6% YoY, and the added value of wholesale and retail trade grew by 5.5% YoY.

China will maintain a stable economy in 2023. It will implement an active fiscal policy and prudent monetary policy, expanding macro policy regulation and control and strengthening the coordination and cooperation of various policies to promote its high-quality development. It will try to make up for the weaknesses of the industrial supply chain in a faster way; enhance the endogenous power and reliability of the domestic economic cycle; and improve the quality of the international cycle. China is aiming to attract global resources with a large domestic circulation, improve the quality of trading and investment cooperation, continuously expand market access, create a market-oriented, legal, and internationalized first-class business environment, and promote a high level of opening to the outside world.

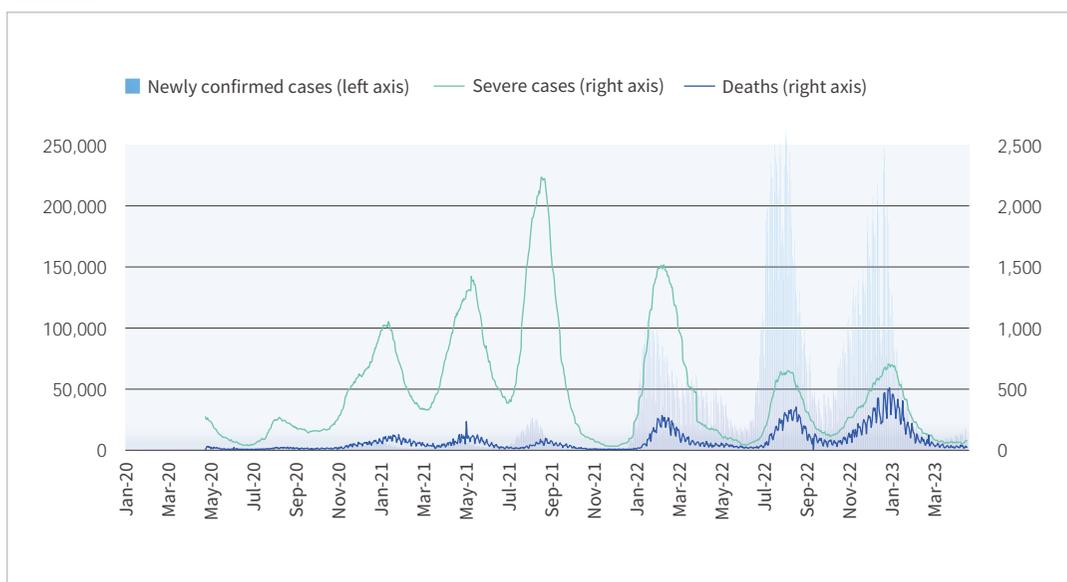
2.3 Japan's Economic Performance

2.3.1 Japan's Macroeconomic Performance

Spread of COVID-19 Infections

Japan has been affected by major waves of COVID-19 infections since its first case was discovered in January 2020 (Figure 2), and the government declared a state of emergency four times between April 2020 and September 2021. Surges of infection cases discouraged people from going out and suppressed consumption of services requiring face-to-face contact. Introducing its vaccination program in February 2021, the government tried to support social and economic activities, but voluntary or national restrictions and business shutdowns limited economic recovery each time a large wave of infections occurred. Despite the negative impact of the war in Ukraine, conditions for a sustained economic recovery were established in 2022 with the introduction of the "living with COVID-19" initiative and the end of state of emergency measures.

Figure 2 Numbers of COVID-19 Infection Cases, Severe Cases, and Deaths in Japan 2020-23



Source Adapted from *Visualizing the Data: Information on COVID-19 Infections*, by the Ministry of Health, Labour, and Welfare (MHLW). <https://covid19.mhlw.go.jp>

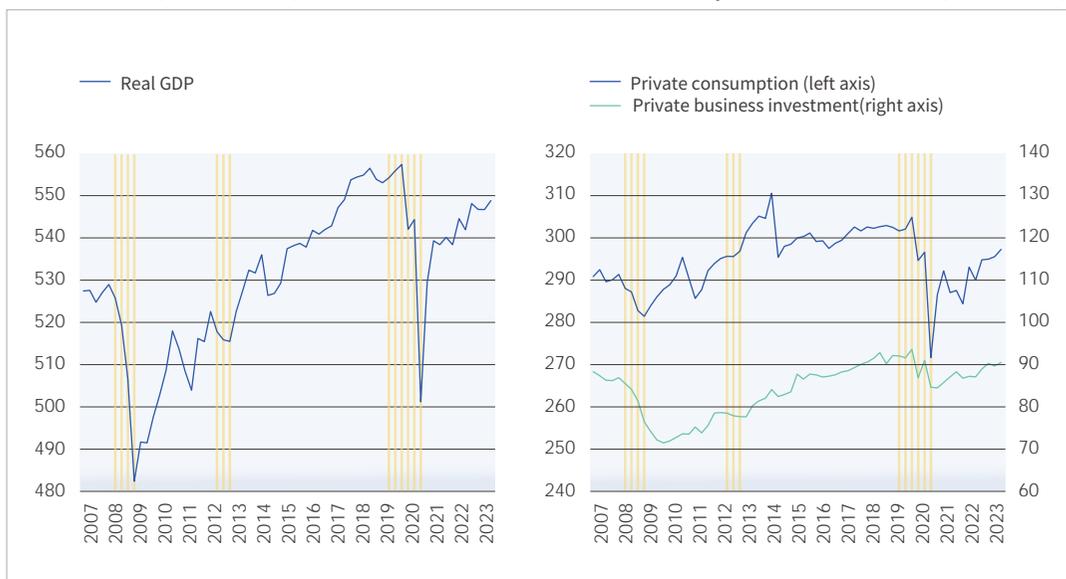
Real GDP, Consumption, and Investment

The COVID-19 pandemic caused a sharp contraction in real GDP in 2020Q2 (Figure 3A). This contraction was the deepest experience in post-World War II Japan. A remarkable decline was observed in private consumption (Figure 3B). Real exports and imports decreased markedly, with exports decreasing much more than imports, and net exports posted a substantial fall (Figure 4A), contributing to a sharp contraction in real GDP.

Figure 3 Japan's Real GDP, Consumption, and Investment, 2007Q1-2023Q1

3A. Real GDP (JPY Trillion)

3B. Real Consumption and Investment (JPY Trillion)



Note Quarterly data are seasonally adjusted. Yellow denotes recession periods, as defined by the Cabinet Office.

Source Adapted from *Quarterly Estimates of GDP, National Income Accounts, by the Cabinet Office*. https://www.esri.cao.go.jp/jp/sna/data/data_list/sokuhou/files/2022/qe224_2/gdmenuja.htm

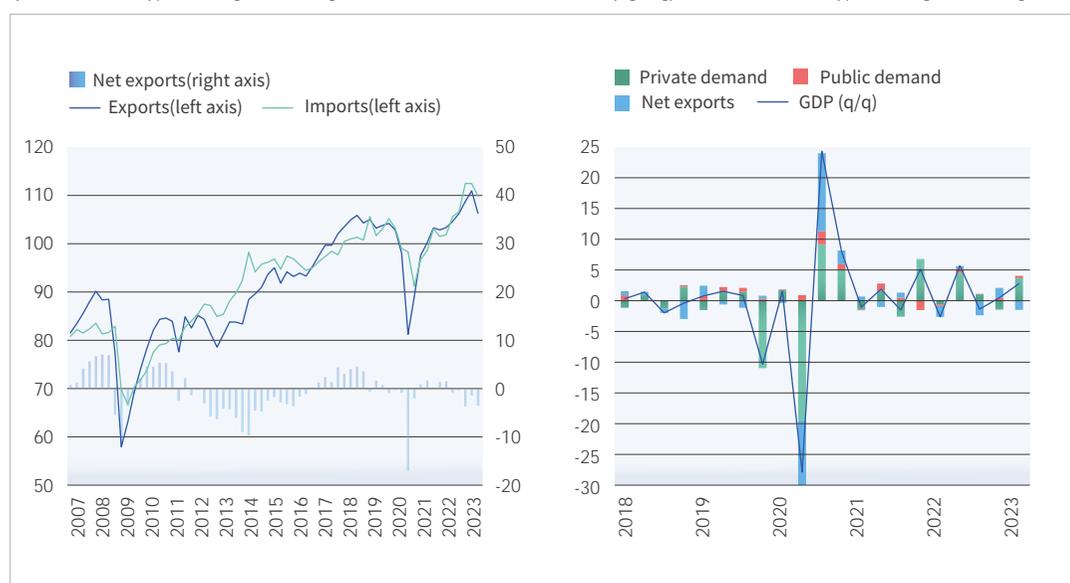
Real GDP rebounded in 2020Q3 and Q4 with a recovery in net exports, private demand, and public demand (Figure 4B). However, during 2021-22, real quarterly GDP showed a cycle of negative and positive growth, along with ups and downs in the number of new infection cases. The Japanese economy registered positive annual growth of 2.1% and 1.0% in 2021 and 2022, respectively, and continued to recover in 2023Q1.

Still, the level of real GDP achieved in 2023Q1 was below the pre-COVID-19 peak. This is in sharp contrast to other major economies which quickly recovered pre-COVID real GDP levels.⁷ A challenge for Japan is to realize a strong recovery in private consumption, which is currently 96% of the highest level recorded in 2014Q1, and in private business investment, which is currently 97% of the highest level reached in 2019Q3. In contrast, both exports and imports have already surpassed pre-COVID peaks.

Figure 4 Japan's Real Exports, Imports, and Net Exports and Real GDP Growth and Growth Contributions

4A. Real Exports, Imports, and Net Exports (JPY Trillion), 2007Q1-2023Q1

4B. Real GDP Growth and Growth Contributions (QoQ, Annualized %), 2018Q1-2023Q1



Note Quarterly data are seasonally adjusted. The QoQ GDP growth rate and contribution rates in 4B are annualized.

Source Adapted from Quarterly Estimates of GDP, National Income Accounts, by the Cabinet Office.

⁷ For example, China, the US, and Euro Area exceeded their pre-COVID peak levels, all of which had been recorded in the fourth quarter of 2019, in 2020Q2, 2021Q1, and 2021Q4, respectively. In contrast, Japan's real GDP in 2023Q1 is 99% of the peak level in the third quarter of 2019.

Employment and Wages

Despite a continued decline in the working-age population (aged 15-64), total employment rose steadily from 2015 to 2019, peaking at 60.7 million employees. Women and elderly's increased participation in the labor market led to this rise. Total employment declined by 1.2 million between 2019Q4 and 2020Q2, as non-regular employment fell by 1.5 million while regular employment rose by 0.3 million (Figure 5A). Non-regular employment recovered slightly in 2021-22 but remains less than its peak recorded in 2019Q3, while regular employment remains above pre-COVID levels after peaking in 2021Q3. A decline in non-regular employment is notable in the accommodations, eating and drinking services, living-related and personal services, and amusement services sectors requiring face-to-face contact (Cabinet Office, 2021). In contrast, regular employment expanded particularly in the information and communication sector and the medical, health care, and welfare sector. Overall, the unemployment rate rose modestly from 2.4% in 2019 to 2.8% in 2020 and 2022-2023Q1 thanks to corporate business strategies hoarding employees despite difficult times and public policy employment support.

Nominal wages rose between 2014 and 2018 and declined in 2019 and 2020. They began to recover in 2021, and registered 2% growth in 2022 and less than 1% growth in 2023Q1 (Figure 5B). Despite a recovery in nominal wage growth, this lagged behind in comparison with CPI inflation, leading to a decline in real wages in 2022-23Q1.



Figure 5 Japan's Employment and Wages, 2007-23
5A. Number of Employees (Million employees) 5B. Rates of Change in Nominal and Real Wages (%)


Source Adapted from *Labor Force Survey and Monthly Labor Survey*, by the MHLW. <https://www.stat.go.jp/english/data/roudou/index.html>;

Inflation and the Yen Exchange Rate

The pandemic turned core CPI⁸ inflation to the negative from the spring of 2020, and price deflation continued until the summer of 2021 (Figure 6A). Core inflation started to rise gradually from the fall of 2021 but remained well below the 2% inflation target until the impact of the war in Ukraine set in. Oil price hikes led to a surge in Japan's inflation exceeding 2% in the spring of 2022 and reaching 4.2% in early 2023.

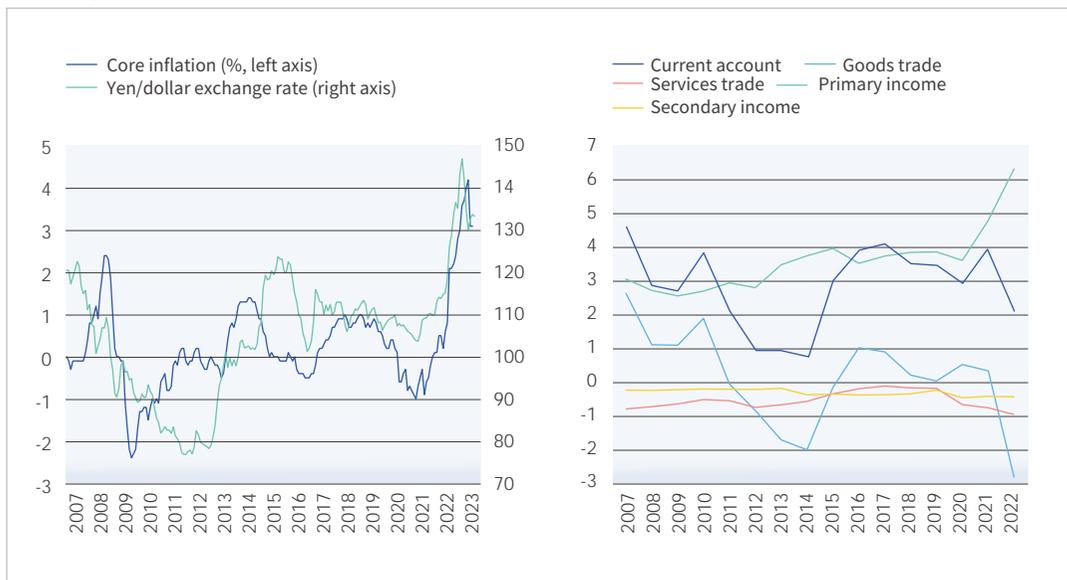
The Japanese yen began to depreciate against the US dollar from the second half of 2021, accelerated the pace of depreciation from the spring of 2022 due to widened interest rate differentials and rapid rises in oil prices, and exhibited further depreciation than implied by underlying fundamentals from early summer (IMF, 2023). With the exchange rate exceeding 140 yen to dollar, the authorities intervened twice in the foreign exchange market to purchase yen in September and October and successfully contained excessive yen depreciation.

8 Japan's core inflation is the rate of change in the CPI excluding fresh food prices.

Figure 6 Japan's Inflation, Yen/Dollar Exchange Rate, and Current Account Balance, 2007-23

6A. Core Inflation (YoY, %) and Yen/Dollar Exchange Rate

6B. Current Account Balance (% of GDP)



Note Core inflation is a YoY rate of change in the CPI (excluding fresh food), and is adjusted to exclude the impact of consumption tax increases in April 2014 (5% to 8%) and October 2019 (8% to 10%). The exchange rate is the monthly average.

Source Adapted from *Consumer Price Index*, by the e-Stat of the Ministry of Internal Affairs and Communications (MIC). Data for the yen/dollar exchange rate are from the Bank of Japan. Data for the current account balance are from *Balance of Payments (Historical Data)*, by the Ministry of Finance, Japan.

Current Account Balance

The goods trade balance deteriorated sharply in 2020Q2 due to a decline in goods exports, but rebounded strongly in Q3 and Q4. The goods trade balance improved for the year 2020 as a whole but deteriorated substantially in 2022 because of sharp increases in mineral fuel import prices (Figure 6B). The current account balance did not worsen significantly in 2020 from 2019, recording 3.0% of GDP, and continued to register surpluses in 2021 (3.9%) and 2022 (2.1%), broadly supported by the primary income surplus arising from Japan's large net international investment position and high net returns.

2.3.2 Japan's Economic and Policy Adjustment

Fiscal Policy Support

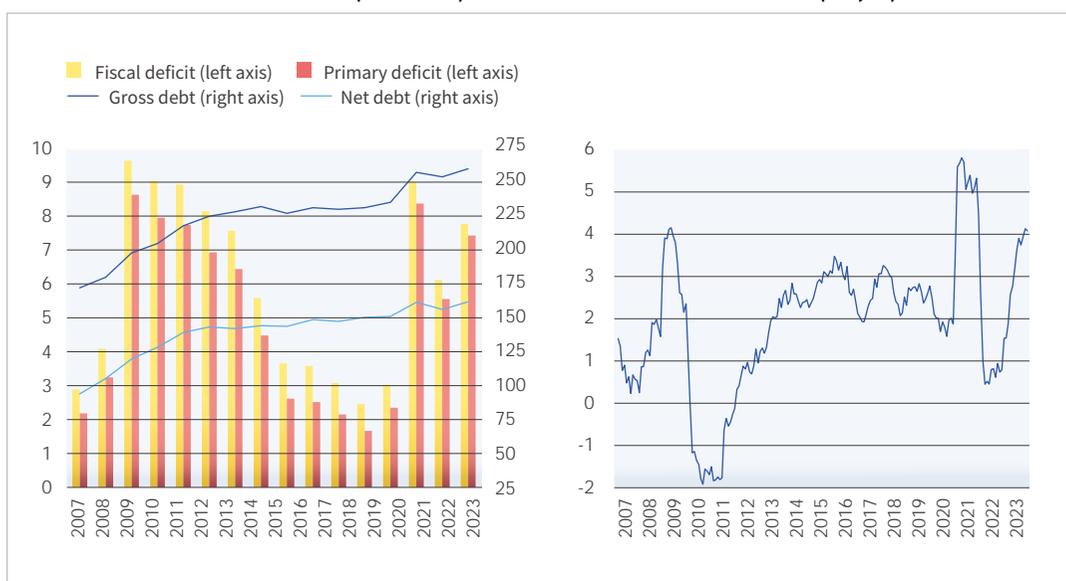
In April and December 2020, the government implemented large-scale economic packages to support households and businesses affected by COVID-19, notably through cash transfers to households and small and medium-sized enterprises (SMEs), employment maintenance subsidies, and concessional loans for firms in need of liquidity. These measures successfully kept unemployment low and prevented widespread corporate failures, despite a substantial contraction of economic activity. After the start of the war in Ukraine, the administration introduced further economic packages in April and October 2022 to address rising oil and general prices and achieve sustained economic recovery.

These packages led to a jump in the primary deficit from 2.4% of GDP in 2019 to the 5.6%-8.4% range in 2020-22. The exceptional fiscal support and the GDP drop raised the public debt-to-GDP ratio from 236% in 2019 to 261% in 2022 (Figure 7A).

Figure 7 Japan's Fiscal Deficit and Public Debt and Growth of Bank Loans, 2007-23

7A. Fiscal Deficit and Public Debt (% of GDP)

7B. Growth of Bank Loans (YoY, %)



Note Fiscal deficit and primary fiscal deficit are general government (GG) net lending and GG net primary lending, respectively. The growth of bank loans is relative to the same month in the previous year.

Source Adapted from *World Economic Outlook database*, by the IMF, April 2023 and *BOJ Time-Series Data Search, Deposits, Vault Cash, and Loans and Bills Discounted*, by the Bank of Japan.

Monetary and Financial Policy Support

The Bank of Japan (BOJ) reacted to the pandemic quickly to ensure a highly accommodative monetary policy and provide ample liquidity to stabilize financial markets. Bank lending rose rapidly due to surges in corporate demand for working capital, which was partially backed by government schemes (Figure 7B). The BOJ also introduced a special program to support bank financing of firms, particularly SMEs. From the spring of 2020, bank loan growth expanded sharply to 5.5%-6.0%, the highest since the collapse in the bubble of the early 1990s. Although bank loan growth decelerated in the spring of 2021, it once again rose fast from the spring of 2022 after the outbreak of war.

2.3.3 Japan's Economic Policy Direction

Boosting Potential GDP Growth

Japan faces gradual downward pressure on labor supply as the working age population continues to fall. To boost potential GDP growth, policies are needed to mitigate this downward pressure and enhance labor productivity. Employment had increased until the COVID-19 crisis thanks to the progress in female and elderly's labor participation. This trend needs to be restored in the post-COVID era by introducing flexible work arrangements and reducing work disincentives (Cabinet Office, 2021).

To enhance labor productivity Japan should raise total factor productivity through innovation, technological development, and efficient corporate organization via digital transformation and other measures. It should improve its R&D capabilities through open innovation, supporting start-ups, producing more Ph.Ds, encouraging cross-border exchanges among researchers, and stepping up industry-academia-government cooperation schemes. Japan should also stimulate investment, particularly in decarbonization and digitalization. It can also enhance the quality of labor through recurrent education, off-the-job training, and increased labor mobility.⁹

Attaining the 2% Inflation Target

The BOJ has been employing a Yield Curve Control (YCC) framework, introduced in September 2016, to achieve its 2% inflation target. Core inflation has risen to a level above 2% due to cost increases from higher import prices triggered by the war in Ukraine, but is projected to gradually fall to levels below 2% in late 2023 or 2024 after peaking in 2023Q1, as the effects of imported

⁹ Cabinet Office (2022) provides evidence that workers who receive both off-the-job training and personal development programs earn higher income than those who receive only one of the two.

inflation wane. Japan's GDP gap remains negative, indicating that inflationary pressure is weak. To achieve sustained 2% inflation, an accommodative monetary policy must be accompanied by increases in nominal wages. Enhanced labor productivity can result in increases in real and nominal wages and contribute to achieving 2% inflation.

Preserving Public Debt and Social Security Sustainability

Despite the high publicdebt-to-GDP ratio, debt rollover and issuance risks are contained thanks to large domestic savings, home bias, low interest rate policy, and a low share of debt held by foreign investors. However, debt sustainability risks are expected to rise as demographic trends continue to apply upward pressure on aging-related expenditures and downward pressure on potential GDP growth. Fiscal consolidation should aim to lower the debt-to-GDP ratio over the medium term by cutting expenditures and raising tax revenues, both as a percentage of GDP, as well as sustained growth of nominal GDP.

A viable social security system is needed to avoid large income disparities. Household income gaps before redistribution have widened due to the increase in single-person and elderly households. However, redistribution has contributed to a narrowing of income gaps, as observed in the reduction of the Gini coefficient, for more than 25 years (Cabinet Office, 2022).

Achieving Energy Security and Transitioning to a Low-Carbon Economy

The high energy prices in global markets observed in 2021 and aggravated by the war in Ukraine in 2022 have warned Japan of the importance of ensuring energy security. Energy security requires the diversification of sources of oil and gas imports and the development of domestic sources of energy, particularly renewables and nuclear power. The latter suggests that achieving a low-carbon economy can promote energy security.

The government committed in October 2020 to a target of net zero greenhouse gas emissions by 2050, and in April 2021 raised its intermediate target for 2030. Japan's green transformation (GX) strategy focuses on public investment in decarbonization, green technology financed by GX bonds, and providing incentives for private funding for green projects. Japan needs a comprehensive policy package aimed at increasing green investments, including R&D investments, to decarbonize electricity and transportation, and introducing market-based instruments such as carbon tax, a trading system, and a carbon-credit market.¹⁰

¹⁰ The elimination of untargeted subsidies for fuel and electricity can also support the transition. Climate policies should be complemented by measures to protect vulnerable people through a targeted cash transfer system.

Pursuing Digital Transformation

Japan lags behind its peers in digital adoption by the public sector, businesses (including e-commerce and telework), and financial institutions. The government established the Digital Agency in September 2021 to accelerate digitalization of the public sector, and introduced tax incentives to encourage private sector's digitalization. There is a general shortage of R&D investment in the information technology (IT) sector and IT human resources. Government priorities include expanding the coverage of “My Number” digital ID cards and linking them to public and private services; enhancing training in IT skills; and strengthening data privacy, consumer protection, and cybersecurity. For the private sector, as IT specialists are concentrated in the IT industry, non-IT firms need to pay high salaries to hire such experts and also upgrade the digital skills of their employees through recurrent IT-focused education.

Adoption of digital technology assists the transition to a low-carbon economy and local economy vitalization. It allows firms to estimate and monitor energy consumption and greenhouse gas emissions and set energy and emission reduction goals more easily. It can also improve rural business environments and various types of local infrastructure-derived services.

Maintaining an Open, Rules-Based Trade and Investment Regime

Japan has played a regional and global leadership role in promoting an open, transparent, and rules-based trade and investment regime in recent years.¹¹ Japan has also been working to reinvigorate the WTO, particularly supporting WTO reforms to re-establish an effective dispute settlement mechanism, modernize trade rules, and enhance its monitoring and enforcement functions. Japan has been actively involved in negotiations on e-commerce and investment facilitation as in the case of the recent plurilateral agreement on services domestic regulation.

11 It implemented the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) with 10 other member states in December 2018. It also forged economic partnership agreements with the European Union (February 2019) and the United Kingdom (January 2021). Japan worked with China, the ROK, ASEAN member states, Australia, and New Zealand to bring into force the Regional Comprehensive Economic Partnership (RCEP) in January 2022.

2.3.4 Japan's Economic Prospects

Momentum for economic recovery

The Japanese economy is recovering from the pandemic and the impact of the war in Ukraine thanks to pent-up demand, border reopening, global economic recovery, and policy support, as suggested by 2023Q1 real GDP growth at 2.7% (QoQ annualized). The service sector regained growth due to a recovery in consumer spending and the reopening of borders to foreign tourists. The labor market remains relatively tight, with the unemployment rate hovering at levels close to where it was before the pandemic, and nominal wages are expected to accelerate in 2023. CPI inflation remains high by Japanese standards, although core inflation peaked at 4.3% in January (YoY) and is expected to decline toward levels below 2.0% in late 2023 or 2024 due to a cooling-off of energy, food, and other import prices. However, inflationary pressures could grow if wage increases are more robust and supply chain adjustments are more costly than expected.

Excess savings accumulated by households during the pandemic assist with the recovery in domestic consumption. Firms were reluctant to make investments during the pandemic, but now many are looking to invest in labor-saving measures or improve labor productivity due to tight labor market conditions.

Another factor behind the economic recovery is inbound tourism, as Japan relaxed its border restrictions and resumed visa-free travel in October 2022. The number of foreign visitors has risen since then, with 6.7 million tourists visiting the country in January-April 2023 (61% of the level achieved in the same period of 2019). As inbound tourism from China in the first 4 months of 2023 was only 9% of the level recorded in 2019, a notable expansion of inbound tourism is expected once Chinese visitors increase in number in the coming months.

A series of price hikes in 2022 intensified calls for wage hikes. In the 2023 *shunto* negotiations, a wage hike rate of 3.7% was achieved for about 300 large firms, the highest level in 30 years.¹² The national wage hike will be less than this figure as SMEs tend to offer lower wage raises than larger firms. Nonetheless, tight labor demand in the service sector will force firms to offer higher wages than in the last 3 years in order to secure talent.¹³ Real wages may start rising once CPI inflation declines later in 2023 and 2024.

12 *Shunto* (or the spring offensive) is the wage negotiation process between major corporations and labor unions that take place every March. Between 2014 and 2022, the wage hike rates resulting from the annual *shunto* negotiations exceeded 2%—except for 2021, when the rate dropped to 1.9%—and the average rate was 2.1% (MHLW).

13 Enhanced labor productivity and earnings can also push wage growth further.

Growth Prospects

The IMF projects Japan's growth rates of 2023 and 2024 to be 1.3% and 1.0%, respectively. However, the economy faces several downside risks; deepening of geopolitical tensions and geo-economic fragmentation; an abrupt slowdown of the global economy like the spread of banking crises in advanced economies and external debt problems in emerging and developing economies; and the prospect of outbreaks of new lethal COVID-19 variants. Upside risks include higher-than-expected global economic growth; and a stronger recovery in domestic consumption and inbound tourism.

Japan's policy challenge in the near term is to maintain sound growth and achieve the 2% inflation target in a durable way while ensuring financial stability. In the medium term, the priority is to establish a dynamic, resilient, and sustainable economy through a combination of comprehensive and mutually reinforcing policies as described earlier. Prime Minister Kishida has a major opportunity to tackle these medium-term challenges.



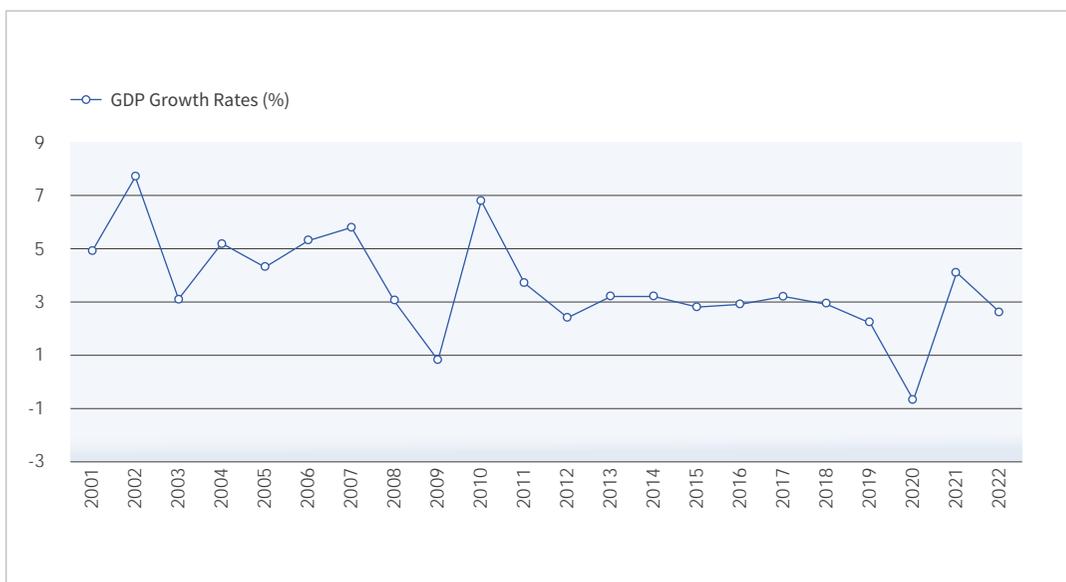
2.4 ROK's Economic Performance

2.4.1 ROK's Macroeconomic Performance

The ROK has emerged as one of the most advanced economies in the world, driven by its export-oriented manufacturing industries, technological innovation, and strategic government policies. From the 1960s to the 1990s, the country experienced rapid economic growth and modernization, “Miracle on the Han River” . Since then, the ROK has continued to grow, though at a slower pace. Here are some key facts and figures:

First, the ROK's GDP has grown significantly over the past few decades. As of 2022, the country's GDP was approximately USD 1.7342 trillion, making it the 13th largest economy in the world. The forecast for the ROK's growth rate in 2023 was revised downward to 1.5%, being down 0.1%p from the 2022 forecast.

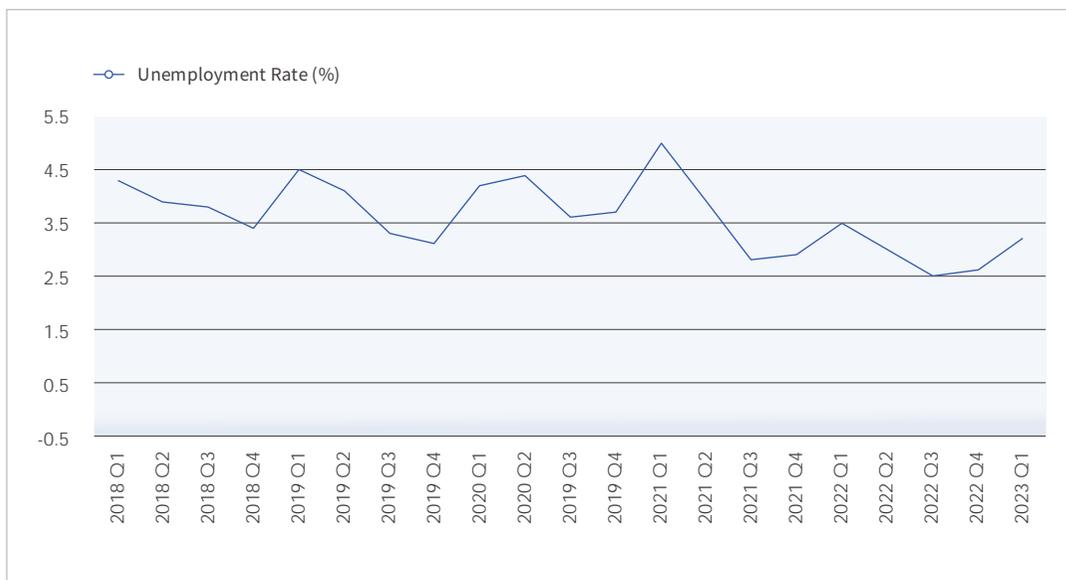
Figure 8 Trends in the ROK's GDP Annual Growth Rates



Source ECOSIS, Bank of Korea

Second, the ROK's unemployment rate has fluctuated over the years, but it has generally remained relatively low. The seasonally adjusted unemployment rate in the ROK increased to 2.7% in March 2023 from 2.6% in the previous month, amid concerns that the labor market will gradually feel the impact of an economic slowdown¹⁴.

Figure 9 Trends in the ROK's Quarterly Unemployment Rate Changes: 2018~2023

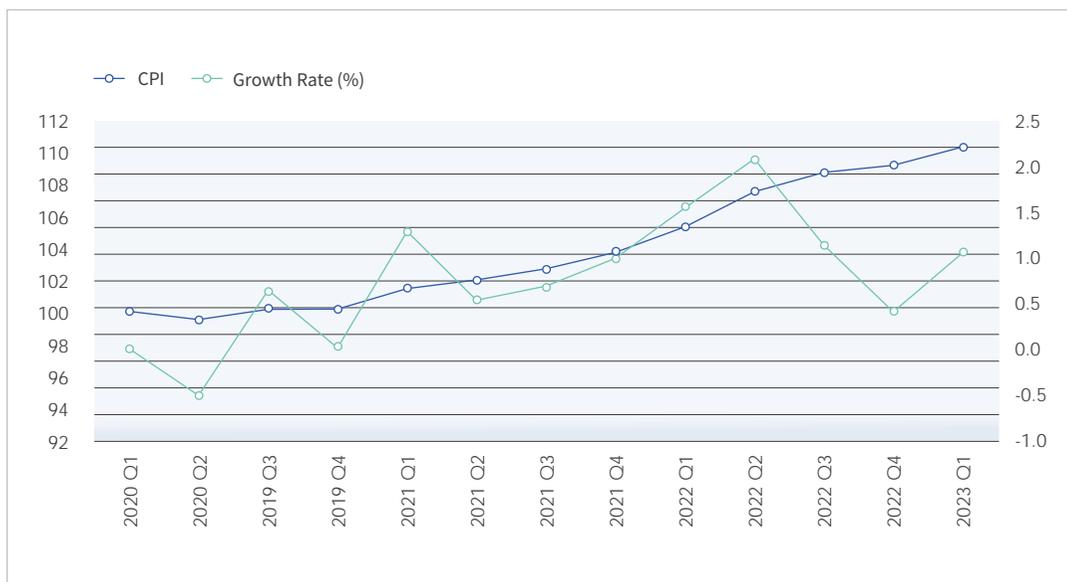


Source KOSIS, Korean Statistical Information Service

Third, the ROK's inflation rate has remained relatively stable. Although the consumer price inflation rate in 2023 March slowed down to the mid-4%, underlying inflationary pressures have not eased. Since the additional oil production cut by major oil-producing countries, it has been challenging to forecast future inflation movements. The prolonged period of high inflationary pressures could potentially complicate monetary policy decisions of the Bank of Korea as well. Socio-economic recovery has been delayed due to the prolonged COVID-19 pandemic; supply chain disruptions and rising inflation persist. The core inflation rate increased by 4.8% in March, showing a 0.6 %p higher increase than the overall CPI increase of 4.2% (Statistics Korea). This marks the first time in over two years since January 2021 that the core inflation rate has exceeded the overall CPI.

14 The economy added jobs for 24 straight months, but the growth continued to slow for the ninth consecutive month. The number of people employed was 28.22 million in March, up 469,000 from a year ago.

Figure 10 Trends in the ROK's CPI and Growth Rates



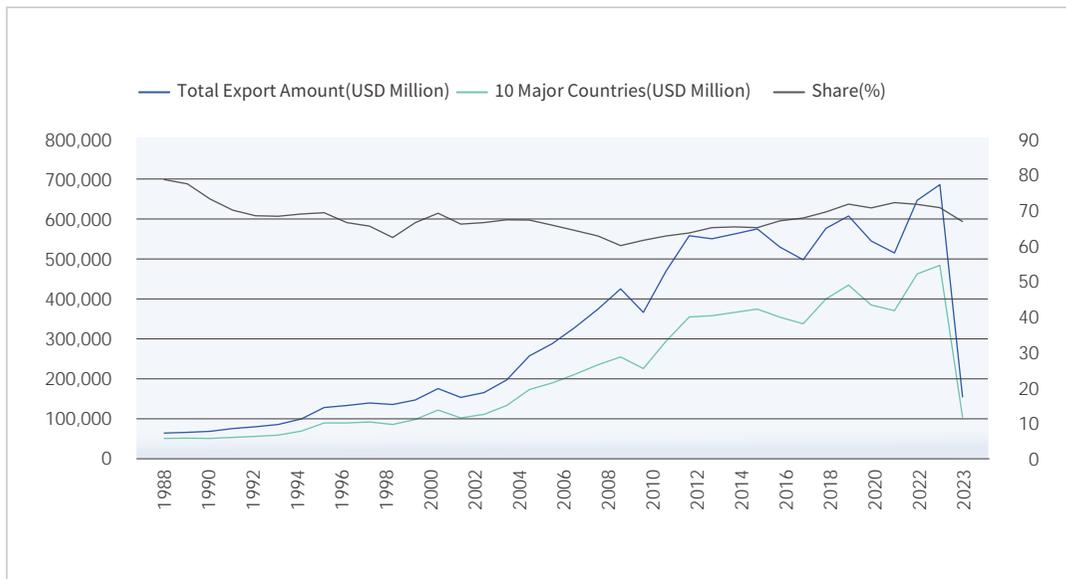
Source ECOS, Bank of Korea

Fourth, the ROK is an export-oriented economy, with major exports including semiconductors, automobiles, and electronics. Prolonged US-China trade disputes, the COVID-19 pandemic, and changes in supply chains and the globalization of the world economy are causing ripple effects across the ROK's export sector. The fact that the ROK's position as the top export market to China over the past 20 years is showing signs of shifting to the US can also be attributed to these structural trends.

The proportion of exports to China as a percentage of total exports from the ROK in the 2023Q1 is 19.5%.¹⁵ This is the first time since 2005 that China's share of the ROK's total exports has fallen below 20% in the first quarter. Last year, China's share of ROK's total exports was 22.8%. Over the past three years, semiconductors have accounted for approximately 30% of the ROK exports to China. With the escalation of the US-China trade dispute in the fall of 2018, China's share of ROK's total exports has decreased by 7.3 %p over the past five years. Currently, China's share of ROK's total exports is similar to that of 2004, which was 19.6%.

15 KITA also held a press briefing on the topic of "Diagnosis of Factors Causing Sluggish Exports and Response Strategies" on March 28th, 2023 at Trade Tower in Gangnam-gu, Seoul.

Figure 11 Trends in the Total Export Amounts of the ROK's Top 10 Trading Partners (1988~2023)



Source K-Stat, Korea International Trade Association

Table 1 ROK's Top 5 Exporting Partners in 2023

Order	Economy	Total Amount (USD, Million.)	Share (%)
1	China	29,511	19.5
2	US	26,855	17.7
3	Vietnam	12,473	8.2
4	Japan	7,082	4.7
5	Hong Kong	4,531	3.0

Source K-Stat, Korea International Trade Association

Factors such as China's improvement in technological capabilities, the shift towards domestic demand-driven growth, and deepening fragmentation of global supply chains have brought these changes. Experts states that the current situation differs from past periods of export decline and recovery. It is difficult to predict the path of recovery for the export sector, and a major overhaul of the export strategy is needed.

2.4.2 ROK's Economic Adjustment and Policy Direction

The ROK's economic policy have evolved over time. First, economic reform and restructuring occurred in the late 1990s. In 1997, the ROK faced a major economic crisis, with high levels of corporate debt and financial instability. The government responded with a series of economic reforms and restructuring efforts, including corporate debt reduction, bank restructuring, and labor market reform. The economic significance of a foreign exchange crisis lies in its close association with a country's external confidence.¹⁶ Therefore, international investors have dual criteria for exchange rate fluctuations.

Second, the ROK's economic adjustment focused on innovation and technology. In recent years, the government has implemented policies to support research and development (R&D) and initiatives to promote start-ups and entrepreneurship. In March 15 of 2023, the ROK announced strategy for fostering national advanced industries, focusing on investing in and nurturing six key industries; semiconductors, displays, secondary batteries, biotechnology, future vehicles, and robotics. The plan aims to enhance the competitiveness of these industries through a total of KRW 550 trillion in private investment and government support for the six priority tasks. Additionally, a total of KRW 25 trillion will be invested over the next five years for R&D of 12 strategic technologies, including quantum and artificial intelligence (AI), and the temporary investment tax deduction will be expanded to a maximum of 25%.¹⁷

Third, dealing with aging population is crucial as it affects the overall economy and society of a country. With a low birth rate and a rapidly growing elderly population, the ROK is experiencing one of the fastest aging populations in the world. As of 2020, the proportion of the population aged 65 or older has exceeded 15%, and this is projected to increase rapidly to over 40% by 2050. The government raised social welfare spending and encouraged immigration to boost the workforce.

16 In advanced countries, rapid fluctuations in domestic currency exchange rates are seen as a normal process of market adjustment whereby the exchange rates reflect the fundamentals. However, in developing countries, sudden exchange rate fluctuations are perceived as an exposure of previously unnoticed economic problems, leading to short-term speculative capital outflows and ultimately resulting in a foreign exchange crisis.

17 The ROK plans to invest a total of KRW 550 by 2026 in six key high-tech industries where the country's performance has strengths, with a focus on private sector-led investments. For the semiconductor industry, the vision is to achieve a "leap forward with the world's largest cluster and an organic ecosystem." The goal is to invest KRW 340 trillion over five years until 2026 to establish a mega-cluster for semiconductors, including new national industrial complexes, and to build advanced packaging hubs with KRW 24 trillion of private investment. In addition, KRW 3.2 trillion will be provided for R&D in three promising areas of next-generation semiconductor technologies, such as power, vehicles, and AI.

Fourth, the ROK has begun to prioritize environmental sustainability in its economic policy. The government set targets for reducing greenhouse gas emissions and increasing the use of renewable energy and has implemented policies to promote green industries and technologies.¹⁸ The role of environmentally friendly industrial policy becomes increasingly important. ESG (Environmental, Social, and Governance) is a crucial issue for all companies.

Overall, the government has implemented a range of policies to promote economic growth, social welfare, and environmental sustainability, while addressing challenges.

2.4.3 ROK's Economic Prospects

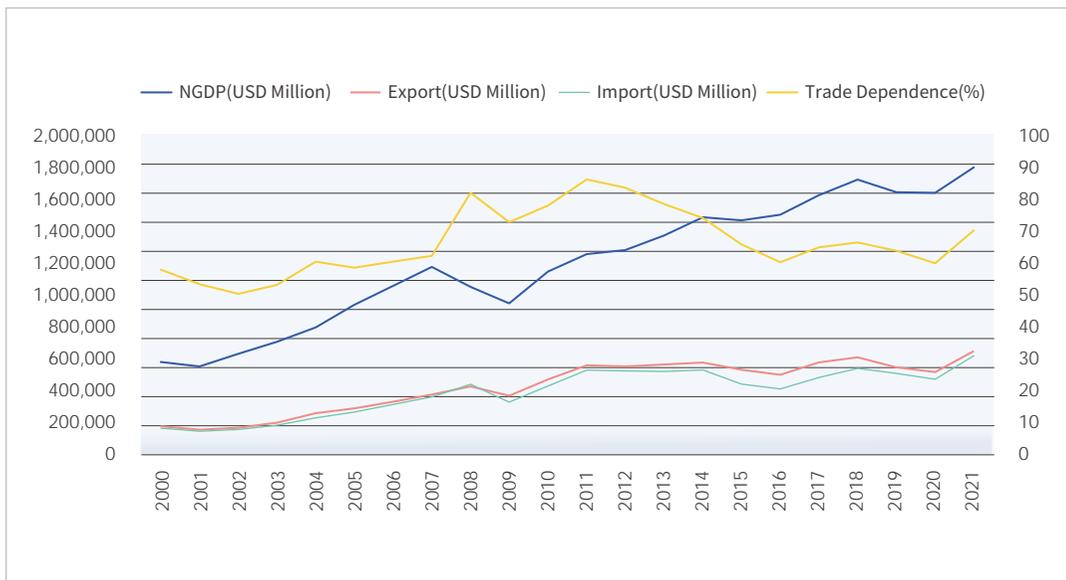
The ROK's economic prospects are generally positive, with a number of factors contributing to its potential for continued growth and development. Here are some key factors to consider.

First, the ROK is an export-oriented economy, with major exports including semiconductors, automobiles, and electronics. This has helped the country weather economic challenges and remain competitive in global markets. The ROK is heavily reliant on exports, and its economic performance is closely tied to global trade. The ongoing trade tensions between the US and China and other geopolitical risks pose a potential threat to ROK's export-driven economy.

The projected growth rate for the economy of the ROK in 2023 is 1.8% (IMF, 1.5%). The outlook for the first half of 2023 has been lowered from the previous estimate of 1.4% to 1.1%, while the outlook for the second half has risen from 2.1% to 2.4%. Most economic experts' reports and economic institutes' suggest that the first half of 2023 could hit the bottom of the economic cycle, with a slight rebound expected in the second half and beyond. It is predicted that the export performance of CJK with a high proportion of manufacturing will rapidly decline as global trade volume itself turns negative in 2023. The ROK's exports in October 2022 decreased by 4.7% compared to the previous year, marking the first negative growth in two years. The global trade slowdown is primarily due to the returning consumption of consumer goods, including durable goods, and a declining trend after the significant increase following the pandemic.

18 The ROK's environmentally friendly policies increased imports from China, but China's environmental policies have acted as a barrier to the ROK's mass exports. Among the ROK's main export items, petroleum products, one of the largest surplus items is "light cycle oil (LCO)" which has been subject to a consumption tax of KRW 270 per liter by the Chinese government for carbon emission reduction starting from the second half of 2021. As a result, the ROK's exports of LCO to China plummeted by 93.8% YoY to USD 212 million from January to October last year. (KIEP, , 2023)

Figure 12 The Trade Share in ROK's NGDP



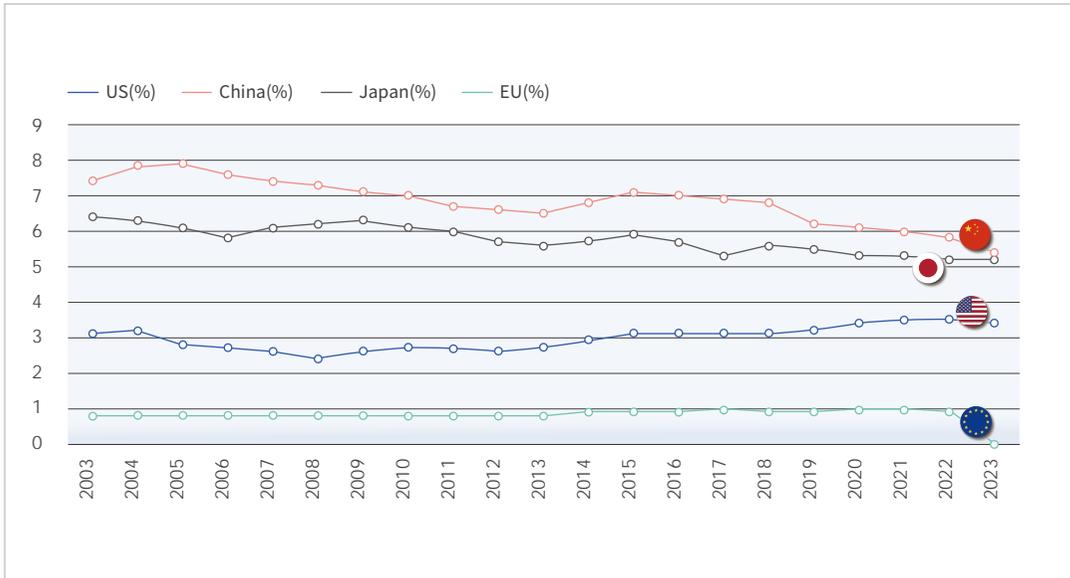
Source K-stat, KITA

The reopening of the Chinese economy is not expected to significantly benefit the export competitiveness of the ROK's economy.¹⁹ First, China is one of the largest export markets for ROK and an important destination for its exports. If the Chinese economy slows down or its reopening is delayed, it can affect ROK's exports. There is also still uncertainty in trade policies and trade conflicts among various countries, including China and the US.²⁰

19 It is true that some experts have high expectations for the reopening of the Chinese economy, but ROK's economy may not reap significant benefits from it. Factors such as the potential slowdown in the Chinese economy, uncertainties in trade policies, and trade conflicts among countries can all impact ROK's exports to China. It is important to consider the potential challenges and uncertainties that may affect the ROK economy's ability to fully benefit from it.

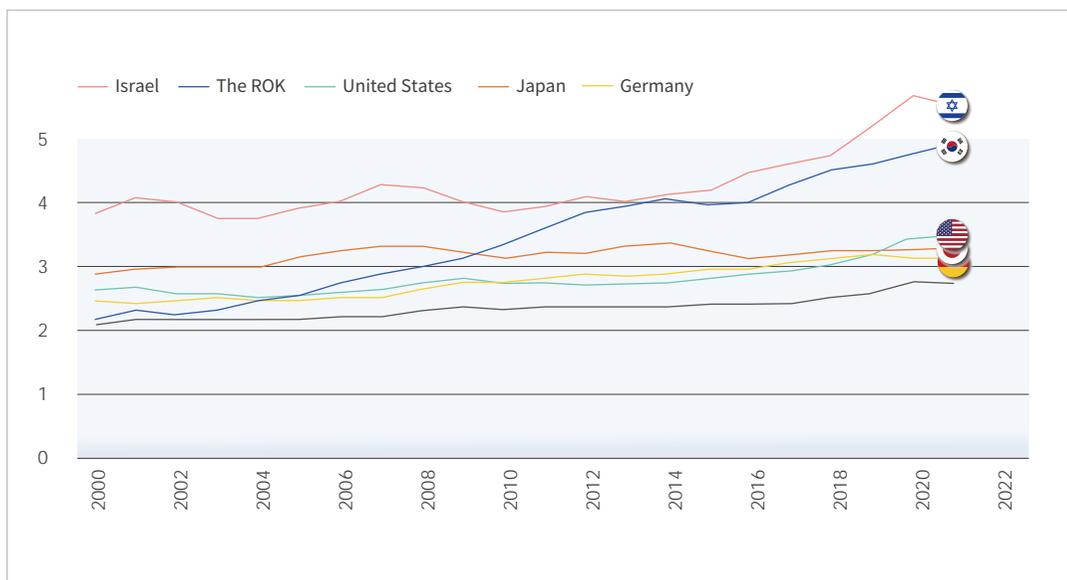
20 It has been found that the proportion of Korean products among the imports purchased by China from various countries is decreasing, while the ROK's dependence on imports from China is steadily increasing(KIEP, 2023).

Figure 13 ROK's Trade Share in Major Trading Partners



Source K-stat, KITA

Second, the ROK is a global leader in technological innovation; areas such as semiconductors, electronics, and electric vehicles. This has helped the country stay ahead of the curve in terms of economic development and competitiveness. The continued development of these industries is expected to drive economic growth and support job creation. In 2020, the ROK ranked 10th out of 131 countries in the Global Innovation Index (GII), which evaluates countries based on various indicators related to innovation, including R&D expenditure, patent applications, and high-tech exports. In 2022, the ROK jumped to 6th out of 132 countries. In 2022, the ROK's gross domestic expenditure on R&D (GERD) amounted to around 4.93% of its GDP, which is one of the highest R&D investment levels among all OECD countries. The ROK government has also implemented various policies and programs to promote R&D and innovation in key industries; information technology, biotechnology, and clean energy.

Figure 14 Gross Domestic Spending on R&D in 2000~2022 (% of GDP)

Source OECD

Third, the ROK has a highly skilled and educated workforce, with a strong emphasis on Science, Technology, Engineering and Mathematics (STEM) education. This helps support the development of new technologies and industries and the growth of existing ones.²¹ National research institution has suggested that with the expected decline in the school-age population in the next 20 years, many universities in non-metropolitan areas are at risk of extinction, and swift structural reforms are required to improve their competitiveness. First, education system should focus on specialization and differentiation. Universities with low competitiveness could choose their own areas of strength to develop into leading universities in those fields by strengthening research and enhancing practical-oriented education through close collaboration with industries. Second, regional collaboration and alliances are important. Non-metropolitan universities could collaborate closely with their local communities to contribute to regional economic and industrial development. Third, internationalization is a crucial element in enhancing the competitiveness of universities. Non-metropolitan universities could actively engage in international exchanges and research collaborations with overseas partners attract international students to compete in the

21 The ROK's STEM refers to the fields of study and careers related to science, technology, engineering, and mathematics in the ROK. These fields are considered crucial for the country's economic development and competitiveness in the global market. The ROK has been placing a strong emphasis on STEM education and workforce development, with various initiatives and policies.



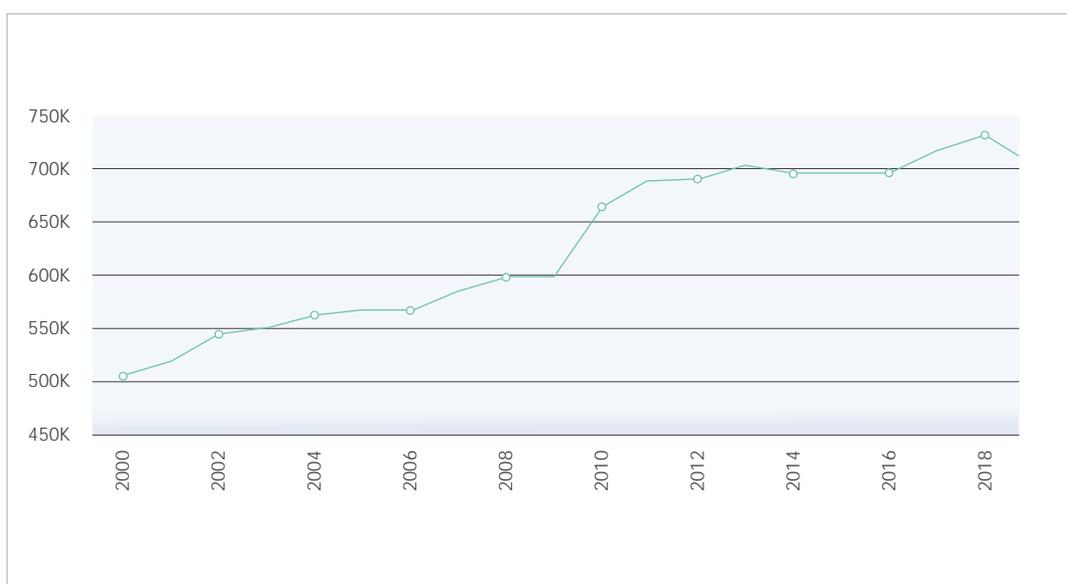
global market. In addition, the ROK government is to reform working hours and wage systems, which are key factors in the labor market and directly impact the lives of the majority of the population.

Fourth, the ROK has begun to prioritize environmental sustainability in its economic policy, with a focus on reducing greenhouse gas emissions and encouraging the use of renewable energy sources. It can create new growth opportunities in green technologies and industries. The “First National Carbon Neutrality Green Growth Basic Plan” (the Basic Plan) was virtually confirmed at the Presidential Commission on Carbon Neutrality and Green Growth, directly led by the President, on the 10th March, 2023. The Basic Plan lowered the reduction rate for the industrial sector, which accounted for 35% of the national greenhouse gas emissions in 2018, from the reduction rate of 14.5% set by the Moon Jae-in government’s Nationally Determined Contributions (NDC) to 11.4%.²² As a result, its companies are now allowed to emit an additional 8.1 million tons of carbon. The government will pursue detailed policies for climate crisis response by 2042.

²² It has been noted that the petroleum chemical industry, along with other industries, faces limitations and cost burdens in reducing carbon emissions.

The government's basic plan for Carbon Capture, Utilization, and Storage (CCUS) was revealed through the National Committee on Climate and Green Growth. The basic plan, which aims to absorb 1,120 million metric tons of carbon dioxide by 2030 through CCUS, an increase of 900,000 metric tons compared to the original plan, has been criticized as overly ambitious, given the relative lag in the ROK's CCUS technological capabilities compared to the US, which has the world's best technology, as well as China and Japan, which are 4 years and 2.3 years ahead, respectively. Although the ROK's technological capabilities are relatively low, its plan sets a high contribution to carbon neutrality.

Figure 15 Total Greenhouse Gas Emissions



Source Presidential Commission on Carbon Neutrality and Green Growth

There are also some challenges that the ROK faces. With a low birth rate and rapidly growing elderly population, a shrinking workforce may lead to reduced productivity and slower economic expansion. The government has implemented policies to address this challenge, expanding social welfare spending and encouraging immigration to boost the workforce. The ROK's economic prospects appear to be strong, with the potential for continued growth and development in the years to come.

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C H A P T E R



Regional Comprehensive Economic Partnership (RCEP) for Regional Economic Integration

- 1 Performance of Intra-Regional Trade and Investment**
 - Trade in Southeast and East Asia
 - Investment in Southeast and East Asia
- 2 Existing and Emerging Regional Trade Blocs**
 - Regional Integration in European and American Continents
 - Proliferation of Trade Agreements in East and Southeast Asia
 - Predicted Effects of RCEP
- 3 Importance of RCEP in Managing Regional Economic Integration in East Asia**
 - Distinctive Regional FTA
 - Further Liberalization of Trade in Goods and Increased Focus on International Production Networks
 - Progressive on Liberalization of Services

RCEP for Regional Economic Integration



RCEP is the largest ever Free Trade Agreement (FTA) and came into force on 1 January 2022. It was completed on 15 November 2020, comprising 10 members of ASEAN and six other countries in the region with which ASEAN had existing FTA—Australia, China, India, Japan, South Korea, and New Zealand. It came into effect with the ratification of the 6 AMS (Brunei Darussalam, Cambodia, Lao PDR, Thailand, Singapore, and Vietnam) and 4 non-ASEAN members (Australia, China, Japan, and New Zealand). RCEP is the world's largest trading block, consisting of nearly 30% of the global population, 30% of global Gross Domestic Product (GDP), and nearly 28% of global trade in 2019.

RCEP is the fruit of long interplay between market-driven forces and dynamism in international relations in East and Southeast Asia. The first element of this is the AMS having an interest in strengthening their integration with the broader region of East and Southeast Asia. Also, there is an emerging pattern of greater connection between the AMS and six economic partners, namely Japan, China, the ROK, Australia, New Zealand, and India—commonly known collectively as the East Asia Summit (EAS)/ASEAN+6 grouping.

Second, international production networks (IPN)/global value chains (GVC) have recently become more complex than a couple of decades ago when they first emerged in the Asian region. Advancement in transport and telecommunication technology reduces transaction costs and creates room for product fragmentation and establishment of production blocks throughout countries. Trade and investment liberalization supports this by creating agglomeration in many destination countries for 'separated production blocks', currently involving value chains not only across countries but within them as well.

Third, RCEP offers a solution to the efforts of countries in Southeast and East Asia to converge in an optimal regional institutional setting that ensures both regional peace and economic growth. The 'big powers' in the region, primarily ASEAN and its EAS partners, have engaged in long and varied institutional experiments to achieve these 'twin objectives' since the aftermath of the 1997/98 economic crisis (Soesastro 2006). In this context, RCEP brings the three large Northeast Asian economies together into a binding regional trade agreement for the first time.¹

¹ This is with the exception of the China-the ROK FTA.

3.1 Performance of Intra-Regional Trade and Investment

3.1.1 Trade in Southeast and East Asia

Trade between the AMS has been stable, at about 23-25% of total AMS trade for the period 2010-21 (Figure 1). The picture is different when trade by the AMS is expanded to its East Asia partners (i.e., the Plus Six), almost doubling in the share of Intra-ASEAN trade. The Intra-ASEAN share reflected in Figure 1 suggests greater orientation of trade between the AMS and countries outside the ASEAN region.

Figure 1 Intra-ASEAN and Intra-East Asia Trade



Source WITS and ASEAN Secretariat.

Table 1 Intra-ASEAN and Intra-East Asia Trade(Share of Total Member State Trade, in %)

Country	2010		2018		2021	
	Intra-ASEAN	Intra-East Asia ¹	Intra-ASEAN	Intra-East Asia ¹	Intra-ASEAN	Intra-East Asia ¹
Brunei Darussalam	20.7	93.8	29.8	87.8	33.6	79.9
Cambodia	23.1	44.1	26.5	59.4	28.6	60.4
Indonesia	27.4	67.2	23.9	66.6	20.6	66.5
Lao PDR	70.5	91.0	64.7	93.0	56.7	89.6
Malaysia	26.2	60.5	27.2	61.6	25.9	61.5
Myanmar	52.0	79.5	35.8	81.5	41.4	80.6
Philippines	25.4	57.0	21.9	60.8	23.8	64.6
Singapore	27.4	55.2	25.6	52.8	24.8	53.4
Thailand	20.5	57.3	23.6	59.8	21.1	60.9
Viet Nam	17.0	58.0	11.7	59.6	10.5	57.5

Notes East Asia here is defined following the membership of EAS, which consists of the AMS and the Plus-Six countries, namely Japan, China, the ROK, India, Australia, and New Zealand.

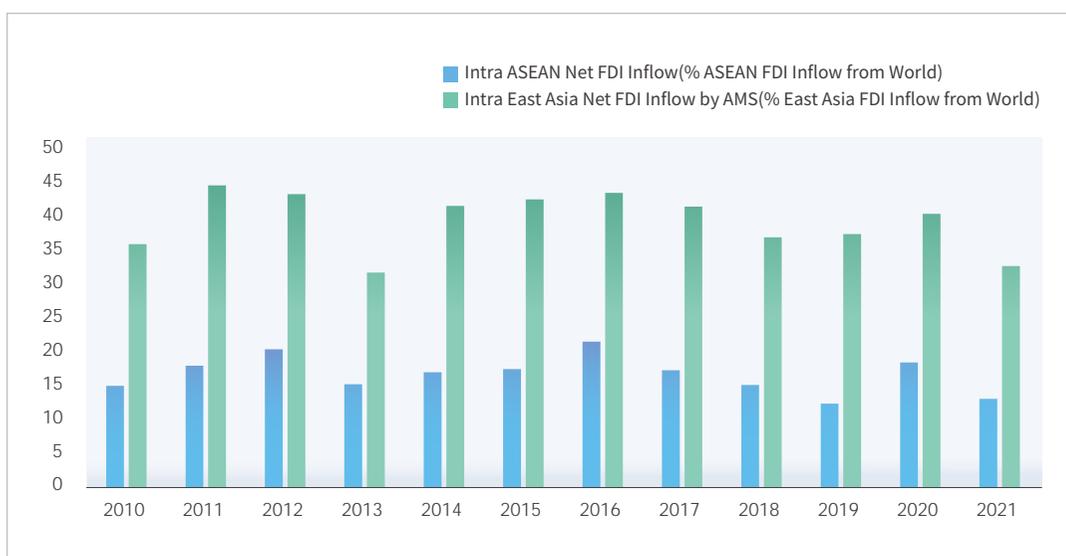
Source WITS and ASEAN Secretariat.

However, there is emerging variation in the share between the AMS (Table 1). The first group pertains to countries with moderate variations to the average level. The countries with the largest Intra-ASEAN trade share are Indonesia, Malaysia, and Singapore, while those with the smallest share are Thailand and Philippines. The second group consists of countries with either a very large share or very small share. The figures for Lao PDR and Myanmar are the highest at around 57-71% and 36-52%, respectively, indicating that these economies are highly dependent on their ASEAN neighbours. Cross-country patterns are similar in Intra-East Asia trade, reflecting the tendency of many AMS states to engage in more global trade.

3.1.2 Investment in Southeast and East Asia

The trend of intra-regional Foreign Direct Investment (FDI) has fluctuated to a greater extent than that of trade in the same period. The share of Intra-ASEAN net FDI inflows ranged between 15% and 21% over this period (Figure 2). Meanwhile, the share of Intra-East Asia has consistently been approximately doubled of the Intra-ASEAN's.

Figure 2 Intra-ASEAN and Intra-East Asia Net FDI Inflow



Notes 1. Bilateral FDI inflows between the AMS and Plus-Six countries are estimated by weighting FDI inflows from the Plus-Six countries with the share of FDI inflows in each AMS country from the rest of the world. Thus, for FDI inflows to an AMS country (x) from a Plus-Six country (y): $FDI_{x-y} = (FDI_{AMS-y}) * (\frac{FDI_{x-World}}{FDI_{AMS-World}})$

Source WITS and ASEAN Secretariat.

The extent of FDI between AMS can be considered high, suggesting the robust prospects of the economies in ASEAN region. This is also reflected in the Intra-East Asia pattern, indicating the high level of investment by the East Asian countries in AMS. The trend over time reflects the recovery from the global financial crisis in 2009-10, also showing its maximum level in 2016. The investment jumped in 2020 but dropped immediately the following year, suggesting greater uncertainty in the global economy after the COVID-19 pandemic.

There is great variation in the share of the FDI across countries, both for Intra-ASEAN and Intra-East Asia by the AMS, and this variation changes over time during the period (Table 2). The cross-country figures most likely reflect dynamism in business opportunities among the AMS.

Table 2 Intra-ASEAN and Intra-East Asia FDI Inflows(Share to Total Member State FDI Inflows, in %)

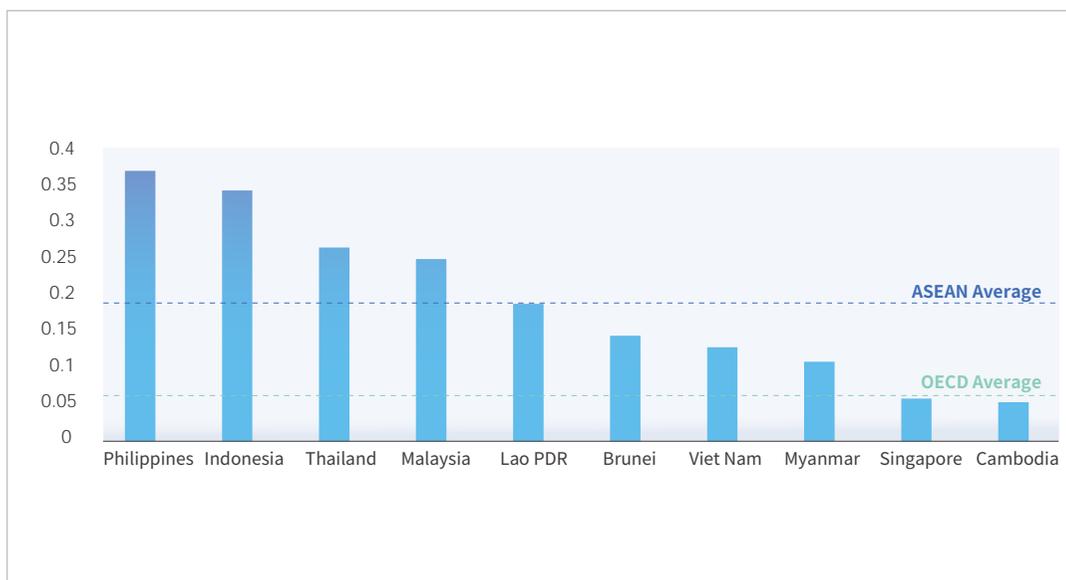
Country	2010		2018		2021	
	Intra-ASEAN	Intra-East Asia ¹	Intra-ASEAN	Intra-East Asia ¹	Intra-ASEAN	Intra-East Asia ¹
Brunei Darussalam	-7.30	19.8	-12.36	22.2	-3.03	16.7
Cambodia	1.22	41.5	1.36	26.2	0.90	20.7
Indonesia	8.6	41.6	5.7	40.1	6.13	25.9
Lao PDR	12.36	95.1	2.23	26.0	1.27	21.0
Malaysia	35.4	62.1	19.7	65.9	23.89	43.6
Myanmar	7.8	79.7	-3.10	65.2	0.63	20.4
Philippines	27.0	72.9	12.6	33.1	3.74	23.5
Singapore	16.2	49.3	19.5	49.7	16.00	35.8
Thailand	12.0	28.9	19.2	44.8	18.10	37.9
Viet Nam	5.2	40.8	3.3	28.3	2.28	22.0

Note See the Note of Figure 2 for the formula to calculate the share of Intra-East Asia FDI Inflows.

Source WITS and ASEAN Secretariat.

Growth prospect is outweighed by FDI restrictiveness, which is measurable using the OECD's FDI Restrictiveness Index (Figure 3 and 4). Few key observations are warranted. First, there is variation in the degree of FDI restrictiveness across the AMS as of 2019, ranging from the most restrictive Philippines and Indonesia, to the most open Singapore and Cambodia (Figure 3). Second, the investment regimes in AMS are more restricted than those of OECD countries as the average index for AMS is higher than that of OECD countries. Third, however, the restrictiveness for manufacturing is quite low. Restrictiveness is still relatively high for the service and primary sectors (Figure 4).

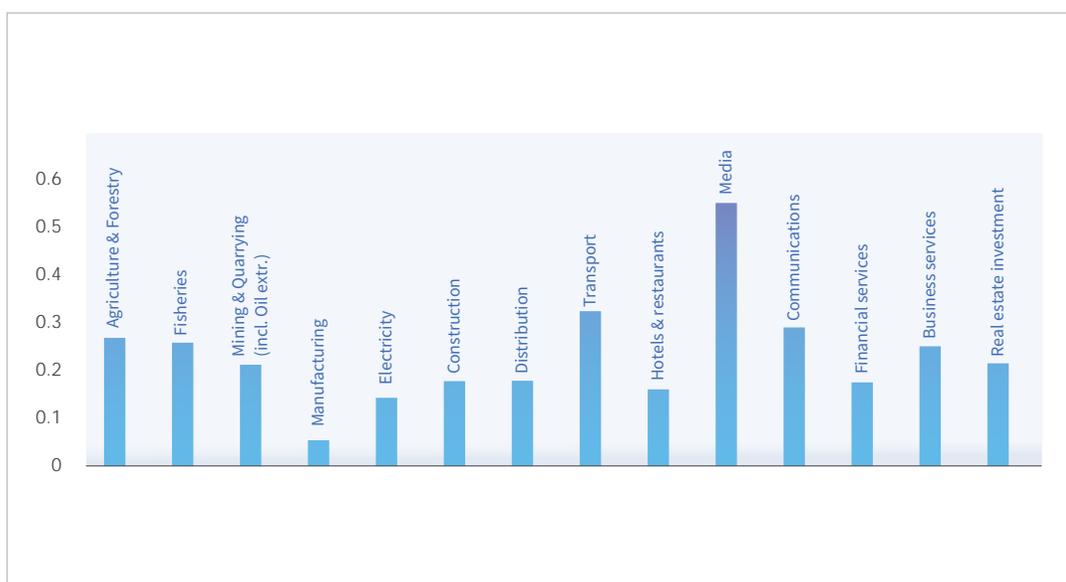
Figure 3 The OECD FDI Regulatory Restrictiveness Index, 2019



Note OECD FDI Regulatory Restrictiveness Index (open=0; closed=1). Data for Brunei Darussalam, Singapore, and Thailand are not available.

Source OECD FDI Index database, www.oecd.org/investment/fdiindex.htm

Figure 4 The OECD FDI Regulatory Restrictiveness Index: by Sectors, Average AMS, 2019



Source OECD FDI Index database, www.oecd.org/investment/fdiindex.htm

3.2 Existing and Emerging Regional Trade Blocs

3.2.1 Regional Integration in European and American Continents

The world rapidly developed trading blocs over the past fifty years or so, and these have become more important in recent years. Regional Trade Agreements (RTAs) were created in many parts of the world since the early 1960s and they have deepened and expanded across blocs. A jump in the number of RTAs to approximately 300 in 2019 from only around 50 in the 1990s (Mattoo et al., 2020). The scope, depth, and nature of membership and other trade agreement characteristics, have also been deeply transformed within a short time period.

Over time, trade agreements have widened not only to cover tariff liberalization but to include reductions also in non-tariff barriers or the inclusion of services and investment liberalization. They moved toward ‘open regionalism’ instead of a closed one as was typical in the past (World Bank, 2000). Recent trade agreements have expanded their policy areas to encapsulate those that are more specific in trade liberalization, such as Rules Of Origins (ROOs), or those that are not directly related to typical trade liberalization topics, such as labor, environment, competition policy, and movement of people (Mattoo et al., 2020).

RTAs in the European Union (EU) expanded very rapidly after the launch of the EU Single Market in 1992. A large wave of trade agreements was signed subsequently by the group of East European-former Soviet Union states in the 1990s and more recently with countries or regional groupings outside of Europe, including ASEAN or MERCOSUR.

There was a proliferation of RTAs in American continent, and some of the groupings that coexist currently include NAFTA, MERCOSUR, CAN, MCCA, CARICOM, and CALC. Unlike those established in the EU or Asia, there is significant variation in terms of how economic integration should proceed for RTAs in this region, ranging from a foundation of political alignment to one based on a shared perspective of open regionalism (Foxley, 2010). Nevertheless, these groups still exist as there is a mutual belief in trade gains as members of the agreement.

3.2.2 Proliferation of Trade Agreements in East and Southeast Asia

RCEP was born from the results of interplay between economic motives, major economic crisis, and complicated overlapping trade agreements in Southeast and East Asia. The 1997 Asian financial crisis weakened the ability of ASEAN to attract more FDI and to expand its export markets (Rillo et al. 2022).² At the same time, the AMS faced growing global challenges that threatened to further undermine its economic power and performance, from a fast-rising China and the beginnings of the WTO promoting unilateral trade openness.

It made ASEAN to integrate further and more formally with their neighbors in regional or bilateral trade agreements. The number of trade agreements involving the AMS increased to 14 bilateral agreements and six plurilateral RTAs, including five ASEAN+1 FTAs by November 2021. The five RTAs are the ASEAN–China Comprehensive Economic Cooperation Agreement (ACFTA), ASEAN–Japan Comprehensive Economic Partnership (AJCEP), ASEAN–the ROK Comprehensive Economic Cooperation Agreement (AKFTA), ASEAN–India Comprehensive Economic Cooperation Agreement (AICECA), and the ASEAN–Australia–New Zealand Free Trade Agreement (AANZFTA). Accordingly, Southeast and East Asia thus formed another highly integrated region of the world (Park, 2022; ADB, 2021).

This proliferation of trade agreements was also upheld by the established IPNs/GVC between East Asia countries, notably Japan or the ROK, and the AMS. The evolving trading bloc in this part of the world has always been driven by market motives.

However, the region encountered a side effect of the various trade agreements. They became unorganized and overlapping, resulting in suboptimal outcomes and requiring member countries to embark in discussions to form a consolidated trade agreement.

History records two tracks of progress toward this consolidation: the East Asia Free Trade Area (EAFTA) under the ASEAN+3 process, and the Comprehensive Economic Partnership in East Asia (CEPEA) under the ASEAN+6 process. While these two tracks seem to have competed with each other, the global financial crisis in 2009-10 provided an impetus for participating countries to blend the two processes into one, which was carried out successfully under the leadership of ASEAN. The background of it was the US joining the Trans-Pacific Partnership (TPP) which was the largest multilateral trade agreement in the world at that time. The US accession to the TPP was thus perceived to pose a credible competitive threat to many East and Southeast Asian countries.

2 Rillo et al. (2022) and Park (2022) present a more detailed narrative about the evolution of trade agreements in Southeast and East Asia as well as an historical account of the creation of RCEP.

All this led ASEAN leaders to endorse a “Framework for RCEP” in November 2011, replacing references to CEPEA and EAFTA with references to ASEAN FTA Partners (AFPs) and ending the debate on what the East Asia FTA would look like (Rillo et al., 2022, p.19).

The success of ASEAN to integrate the debate between EAFTA and CEPA highlights the importance of “ASEAN centrality” —a concept that assumes that “the Association should rightfully be the hub and driving force behind the evolving regional architecture of the Asia-Pacific area” (Tan, 2012, p.26)—as one key principle in the RCEP negotiations. It stamps the leadership of ASEAN not only on the processes moving toward or during negotiations, but also on the future implementation and any possible refinement of the agreement.

3.2.3 Predicted Effects of RCEP

Expansion of trade agreements toward countries or groupings outside a trading bloc or region is generally made possible by massive cost reduction in transport and communication (Foxley, 2010), and efficiency improvement by digitalization. Rapid formation of global trade agreements eventually creates a complicated web of overlapping agreements, encouraging formulation of the kind of mega-lateral FTAs that the world has seen recently, including most notably the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Free Trade Area of Asia-Pacific (FTAAP), and RCEP (Park, 2022).

Several FTAs do not necessarily improve trade performance. The relatively low intra-ASEAN trade vis-à-vis Intra East Asia trade makes this point. Restrictive or complex ROOs may be a reason for this ineffectiveness, and addressing this issue has then become one distinct feature of RCEP.

Less restrictive ROOs are suggested as a way to increase benefits or trade between RCEP members, and this is demonstrated by a number of predictions using the Computable General Equilibrium (CGE) method.³ Application of regime-wide ROO cumulation remarkably leads to gains for the AMS in terms of GDP and exports in the utilization of RCEP and the CPTPP (Figure 5). Further, these gains are found to be significant for CJK (Park, 2022, p.75).

3 As reported and summarized in Park (2022), these are from Ferrantino et al. (2019), Petri and Plummer (2020), and Park and Park (2021). These predictions adopt a framework that views size, interconnectivity, and provision-specific ROO schemes determine the magnitude of gains from FTAs.

Figure 5 Impact of the CPTPP, RCEP, and FTAA on RCEP Members': Gross Domestic Products and Exports



Source Adopted from Park (2022, p.76).

- Note
1. LINKAGE is the World Bank's global dynamic CGE model, which covers 17 production sectors and 35 countries. It simulates a reduction of tariffs and non-tariff measures in both trade in goods and services without and with a change in productivity over time (Ferrantino et al., 2019).
 2. Global CGE Model is a GTAP model that covers 140 regions and 57 commodities. It simulates a reduction of bilateral trade costs under different ROO cumulation schemes of RTAs, diagonal or full cumulation without and with capital accumulation over time (Petri and Plummer, 2021; Park and Park, 2021).
 3. The three CGE modelling predict the different outcome from different scenarios under CPTPP and RCEP implementation. The LINKAGE model simulation introduced a scenario of an implementation of services liberalization while the two Global CGE model simulations introduced scenario of with and without continuing US-China trade war under liberal ROO setting. The prediction provided by the model simulations underlines the benefit from significantly liberalizing services sector (LINKAGE) or from relaxing ROO regimes (Global CGE Model), all of which are the part of the key features of RCEP.

3.3 Importance of RCEP in Managing Regional Economic Integration in East Asia

3.3.1 Distinctive Regional FTA

RCEP significantly differs from other RTAs or mega FTAs as it relies on the concept of “ASEAN centrality” . The market-led initiative of RCEP fits with the idea of broader ASEAN integration from an international relations point of view, in which ASEAN centrality plays a critical role in managing the big powers in the region, the US, Japan, and China. RCEP thus constitutes an important agreement as it entrenches and expands ASEAN centrality and institutional precedence in the management of economic and political security interests with its neighbours (Armstrong and Drysdale, 2022).

RCEP was the first trade agreement that brought together the three Northeast Asian economies: CJK in one agreement. It became possible to lock in new liberalisation and trade rules that would help govern and deepen the China-Japan, and Japan-the ROK economic relationships.

3.3.2 Further Liberalization of Trade in Goods and Increased Focus on International Production Networks

RCEP presents a more liberalizing commitment for trade in goods and services. Commitments of low or no tariffs in RCEP are applied to a much larger proportion of intra-regional trade. These commitments cover about 90% of trade, compared to 60% or less in some bilateral ASEAN FTAs. In addition, CJK now share mutual commitments—something which has never occurred—facilitating deeper IPN/GVC expansion and intensification.

RCEP introduces flexibility to enable developing countries to catch up with their more developed counterparts. It allows developing countries to phase in their liberalisation over a considerable period, while it still ensures an endpoint of substantial liberalisation across a comprehensive range of goods and services. This flexibility covers the phasing out of tariff liberalisation for trade in goods and the time needed for many of AMS states to move from positive-list to negative-list liberalisation approaches for trade in services. Such flexibility, however, can be a weakness as it allows lower levels of commitment especially during the adjustment periods.

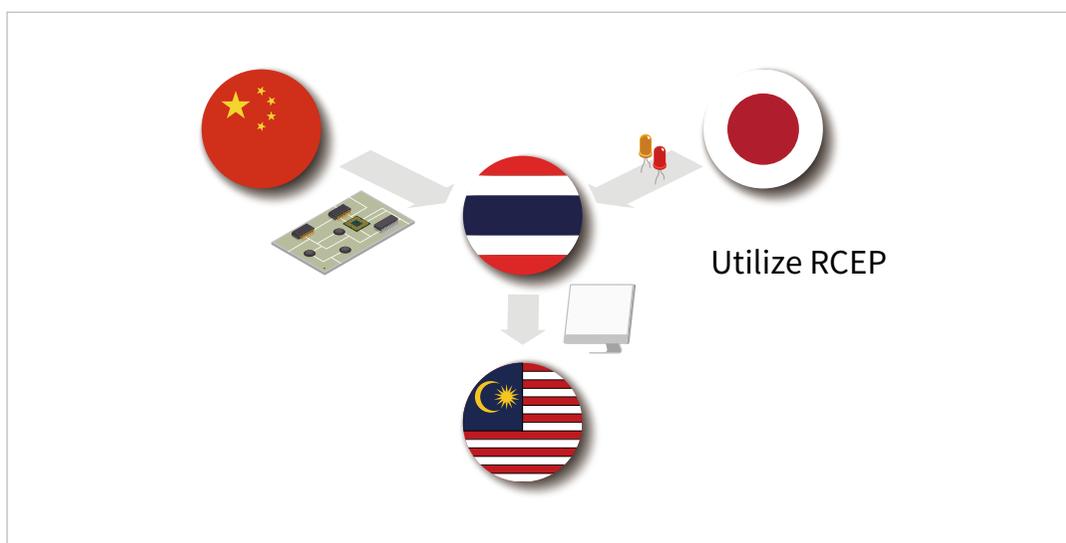
While RCEP consolidates and upgrades the tariff commitment of the ASEAN+1 FTAs, the overall depth of the commitment is still less than other mega FTAs such as CPTPP, since RCEP has not

included many behind-borders issues such as labour, environment, regulatory coherence, and enterprise reform.

RCEP significantly facilitates GVCs for its members by introducing liberal ROOs and the mechanisms that govern it, especially self-certification. The adoption of diagonal cumulation rules is likely to deepen and widen the extent of production networks already established in many AMS countries, promising significant gains from trade and much higher agreement utilization rates. Meanwhile, self-certification should magnify the gains from less-restrictive ROOs as it allows faster movement of parts and components at the heart of IPNs/GVC.

More liberalized and flexible ROOs means an expansion of the area from which an assembly company can source their inputs at lower costs relative to the alternative situation of needing to source such inputs via tariff schemes from different FTAs. The sourcing of a Thai manufacturer from Japan and China can be done cost-efficiently under RCEP instead of using two separate trade agreements (one between Thailand and Japan and the other between Thailand and China) (Figure 6). Utilization of RCEP is maximised when the Thai manufacturer exports to Malaysia, which is also a party to the agreement.

Figure 6 Horizontally-linked supply chain under RCEP



Source Adopted from Hayakawa (2022).

3.3.3. Progressive on Liberalization of Services

RCEP members commit themselves to progressive liberalisation of services, aiming for a significant increase in the growth of services within the region. One key feature is the commitment toward application of the negative list approach, whereby countries put on the table a list of service sectors to be liberalised. This approach includes standstill and ratchet provisions. Standstill clauses are intended to lock in the applied regime at the time when an agreement enters into force while ratcheting automatically binds the liberalisation undertaken unilaterally after the agreement is implemented (Seráfica and Intan, 2022). Other key features include rules on the temporary entry and temporary stay of natural persons and the requirement for members to make commitments under the Most-Favored Nation (MFN) treatment or transparency list.

Liberalization of services is expected to provide large marginal benefits to all RCEP members, especially the AMS. More seamless trade in services between countries is consistent with and supports IPN/GVC. At the same time, digitalization further transforms this production model towards an expanding backward linkage to cover goods and intermediate inputs service inputs.⁴

While promising, there are some challenges as well. The most important of these are transitioning to a negative-list approach and conducting regulatory reforms and fulfilling regulatory deficits (Seráfica and Ramli, 2022). Many of these elements require significant time to process, discern the status of relevant sectors accurately, map the current regulatory settings, and design the strategies and plans for all necessary adjustments.

3.3.4 Including and Engaging least-developed Economies in Modern FTAs

RCEP included the provision of economic and technical assistance to less developed countries (LDCs) to enable them to participate in the FTA more effectively. It includes capacity-building measures that target relatively disadvantaged stakeholders including micro-, small-, and medium-sized enterprises (MSMEs). MSMEs typically constitute more than 90% of business enterprises in all RCEP countries and they often face significant challenges that constrain them from participating in and benefiting from FTAs including RCEP.

⁴ This is commonly known as “servicification” these days, reflecting an increasing tendency for manufacturing firms to engage in services activities (Chun et al. 2021).

RCEP allows different timelines for the implementation for LDCs to give considerable time for these members to adjust. A good example here pertains to commitments for liberalization of services: given wide differences in service sector development, the agreement allows generous flexibility for countries to adjust their domestic regulation during the transformation from a positive- to negative-list approach.

3.3.5 Market friendly and ‘open-minded’ agreement

RCEP is considered as a trade agreement with a high degree of flexibility and one that is designed to consistently be relevant to the changing business environment. The chapter on e-commerce demonstrates this by acknowledging the rising importance of digital economy, but at the same time it offers significant room for flexibility in terms of commitment. The e-commerce chapter of RCEP highlights the significance of RCEP in promoting a more flexible approach that encourages cooperation for development of appropriate policy and regulation rather than rigid, enforceable rules that are subject to limited and uncertain exceptions (Kelsey, 2022).

RCEP recognizes more challenging global economic and business environment, and for this reason, Chapter 18 of the agreement mandates institutional set-up for implementation which includes a mechanism to allow inputs from the private sector for RCEP decision-making (Pambagyo and Gultom 2023). These inputs can reach the RCEP Joint Committee (RJC) through the ‘dialogue forum’ mechanism facilitated by the RCEP Secretariat. All this earns RCEP the label of a ‘living agreement’ and represents another distinct feature of the agreement.

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C H A P T E R



Regional Comprehensive Economic Partnership (RCEP) for China, Japan, and the ROK

1 Impact of RCEP

- Impact of RCEP for China
- Impact of RCEP for Japan
- Impact of RCEP for the ROK

2 Implementation status of RCEP

- Implementation Status of RCEP in China
- Implementation Status of RCEP in Japan
- Implementation Status of RCEP in the ROK

3 Trilateral cooperation under the RCEP

- Perspective of China
- Perspective of Japan
- Perspective of the ROK

27,410
26,218
26,190
25,214



Regional Comprehensive Economic Partnership (RCEP) for China, Japan, and the ROK

4.1 Impact of RCEP

4.1.1 Impact of RCEP for China

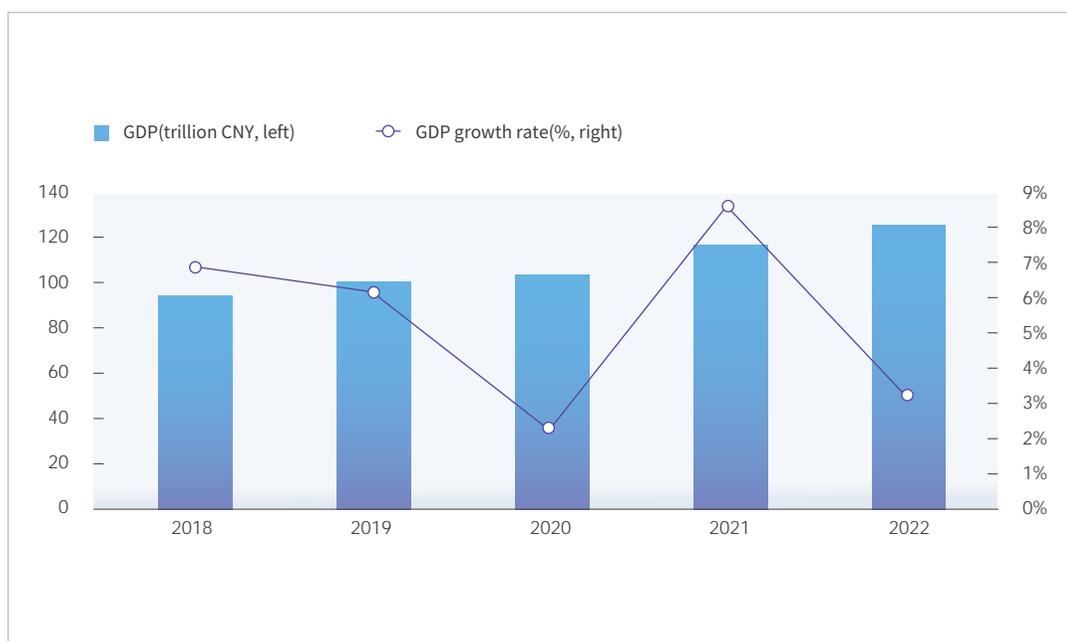
Under the pressure of the slowing global economic recovery and faced with complex and volatile global situation, RCEP has injected new impetus into China's economic growth. RCEP will stimulate the intra-regional trade and investment greatly and the economic vitality of Asia-Pacific Region. It will also make great contributions to stabilizing China's international trade and foreign investment and strengthening global value chains and collaboration in East Asia production networks, which further helps shaping China's new global competitiveness, stabilizing economic growth and employment. RCEP provides opportunities for the recovery, integration and prosperity of the regional industrial chain. It also promotes positive economic interactions and improves economic efficiency of China, Japan and the ROK. As the largest regional FTA in the world and a high-standard, modern and mutually beneficial platform for regional economic integration, the RCEP will be more conducive to deepening and expanding economic and trade cooperation between CJK, and will also play an important role in promoting CJK regional integration cooperation.

RCEP will significantly improve the situation of China's welfare and foreign trade, and increase its GDP, manufacturing output, and manufacturing employment (Li Chunding). China's welfare level will be raised by 1.11% on average, GDP by 0.28%, manufacturing output by 3.03% and manufacturing employment by 2.74%, respectively. Since RCEP came into force, China's GDP has grown by 3.0%, and cumulative manufacturing value added has increased by 5.89%. While China's national employment has declined by 1.7% Year-on-Year (YoY), the employment of manufacturing in urban units increased by 0.58% from 2020 to 2021. The trend of China's real economic growth is basically in line with the quantitative forecast effect.

RCEP Boosting China's GDP growth

RCEP has a positive impact on China's GDP and further boosts its economic growth. Over the past five years, China's GDP has grown steadily. Though suffering the adverse impact of the global pandemic, GDP growth rate still remained at 2.2% in 2020. In 2022, faced with a volatile international environment and arduous tasks of domestic reformation, China's economy has withstood the pressure to reach a new level, with an annual GDP of CNY 121.02 trillion, increasing by 3.0% over 2021 at constant prices. The increasing trade and investment brought by RCEP has made new contributions to GDP growth and employment in spite of the shock of COVID-19.

Figure 1 China's GDP, 2018-2022

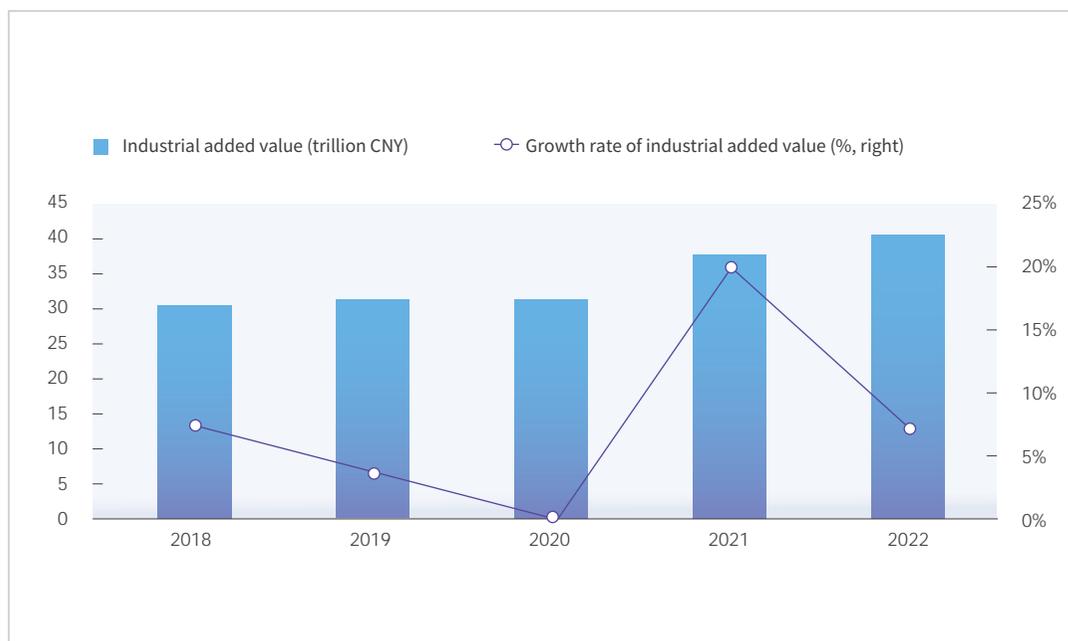


Source National Bureau of Statistics of China

RCEP Accelerating Intra-regional Production Capacity Cooperation in China's Manufacturing Industry and Developing to Medium-High End

RCEP brings significant opportunities for China's manufacturing industry to develop towards the medium-high end. China's industrial economy has generally maintained a stable growth trend since 2018, and the industrial added value reached CNY 40.16 trillion, with an increase of 7.2% YoY. Through tariff reduction, uniform rules of origin¹ and efficient facilitation measures, RCEP makes intraregional integration of industrial and supply chains closer, strengthens intraregional production, division and cooperation and has become an important opportunity and powerful grip for China's manufacturing industry to develop to the medium-high level.

Figure 2 China's Industrial Added Value, 2018-2022

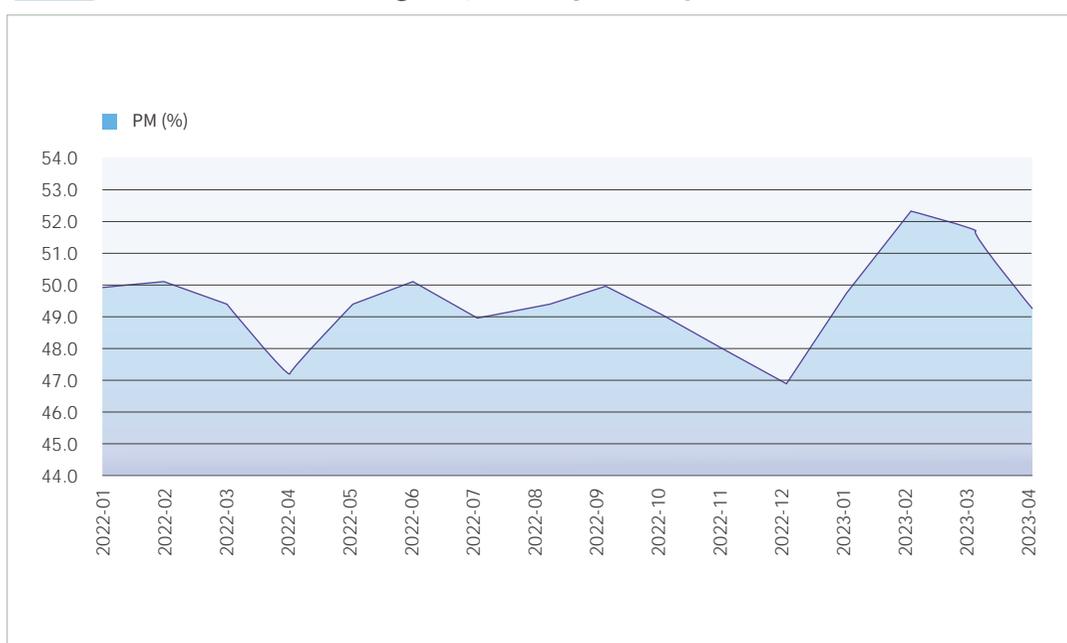


Source National Bureau of Statistics of China

¹ Rules of origin are the criteria needed to determine the national source of a product (WTO)

While China's manufacturing industry enjoys advantages of RCEP, related industries and companies face higher standard, stricter rules and stronger competition from RCEP. Since RCEP came into force, China's manufacturing PMI (Purchasing Manager Index) has remained below the dividing line between growth and contraction due to the impact of the epidemic. With the adjustment of epidemic prevention policy since 2023, the advantages of the formal implementation of RCEP appear, new export orders have picked up, and the internal driving force of China's economic growth has been further strengthened.

Figure 3 China's Manufacturing PMI, January 2022-April 2023

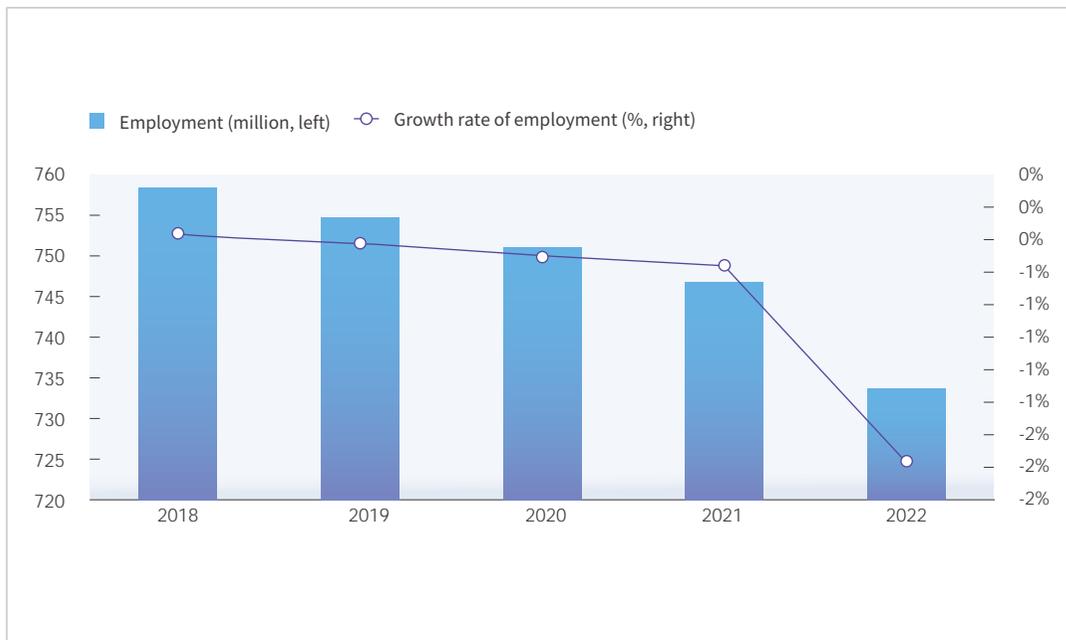


Source National Bureau of Statistics of China

RCEP Alleviating Employment Pressure

In the past five years, the employment has continued to decline, and in 2022, the employment decreased by 1.6% year on year (YoY). China's economy has entered the high-quality development stage from high-speed growth. The growth rate of China's economy has slowed down, but the unemployment rate has been kept under control. The implementation of RCEP makes economic and trade exchanges among member countries more frequent, and makes interactions among foreign-funded enterprises, Chinese-funded enterprises and Sino-foreign closer. RCEP plays a positive role in alleviating the pressure on employment.

Figure 4 China's Employment, 2018-2022



Source: China's Employment, 2018-2022

4.1.2 Impact of RCEP for Japan

The most significant outcome of the creation of RCEP for Japan is that it has finally allowed Japan to conclude an FTA with its two neighboring countries, China and the ROK. Negotiations for a CJK Free Trade Agreement (FTA), originally announced to be launched in 2012, have yet to be concluded due to various diplomatic challenges emerging among the three countries. Meanwhile, by the end of 2015, ASEAN, Australia, and New Zealand concluded FTAs with both China and the ROK, and a bilateral FTA was also concluded between China and the ROK. As a result, Japan became the only country in East Asia that has not signed any FTAs with China and the ROK.; and it did not gain preferential market access in either country until RCEP went into effect in 2022.

This asymmetric FTA network status among CJK, along with the fact that the average Most-Favored Nations(MFN)-applied tariff rates in China and the ROK were higher than those in Japan, placed Japanese firms at a significant competitive disadvantage in these countries. 66.6% of Japan's exports to China and 62.9% of its exports to the ROK were subject to tariffs in 2016, the year after the China-the ROK FTA entered into force (Table 1). This was more than the share of exports of China and the ROK to Japan that were dutiable.

Table 1 Share of Trade Subject to Tariffs Within Intra-CJK Trade in 2016

		Importer		
		Japan	China	ROK
Exporter	Japan		66.6%	62.9%
	China	20.2%		55.7%
	the ROK	28.8%	48.6%	
Average MFN tariff rates		4.0%	9.9%	13.9%

Note Average MFN tariff rates for the three countries in the table are as of 2016.

Source Kuno (2018).

The tariff line subjected to tariff elimination that the three countries mutually committed to under RCEP is scheduled to be less than 90%, which is not exceptionally high compared to other existing FTAs. However, in the pre-RCEP era, the share of duty-free items against imports from Japan was less than 10% in China and less than 20% in the ROK. As such, the enactment of this agreement is expected to significantly improve Japan's market access in the Chinese and the ROK's markets, and it will continuously bring significant economic gains to Japan in the future.

Japan is the member state that will enjoy the most significant economic gains from RCEP, boosting its economic growth rate by an additional 0.66% by 2030 (Kumagai and Hayakawa, 2021). UNCTAD (2021) also estimated that the biggest beneficiary of RCEP would be Japan, with a 5.5% increase in its exports to other RCEP member countries.

The benefits of RCEP are not limited to tariff reductions; flexible rules of origin in RCEP will further optimize supply chains in East Asia and facilitate the participation of SMEs in the supply chains. The agreement requires members to adopt procedures that allow goods to be cleared from customs within 48 hours of their arrival and the submission of all the necessary information, which is expected to facilitate trade within the region further. It also prohibits members from requiring foreign investors to transfer technology or unreasonably intervening in the level of royalties received by investors in the event of technology transfers. The chapter on electronic commerce requires RCEP members to allow foreign firms to transfer information across borders freely. It also prohibits members from requiring foreign firms to set up servers or other computing facilities in their countries.

These rules, which did not exist in the existing ASEAN+1 FTA, will contribute to the establishment of an attractive and predictable business environment. The current agreement should be

developed further. If member states are flexible enough to adopt new rules to address the region's current and future policy challenges, RCEP could produce even more significant and stable economic benefits.

4.1.3 Impact of RCEP for the ROK

On the 15th of November 2020, the ROK signed the RCEP free trade deal with 14 other Indo-Pacific countries. RCEP became effective in the ROK in February, 2022, one month later than the effective date agreed by most signatory states due to a delay in the domestic ratification process. In the middle of a heightened US-China trade war and supply chain disruptions due to the pandemic, the effectuation of RCEP was a silver lining in the clouded economic and trade outlook.

However, RCEP is regarded as a shallow free trade deal with a low level of liberalization compared to CPTPP, allowing each RCEP member tariff concessions to discriminate across members and sectors. RCEP also lacks chapters on the environment, labor standards, or state-owned enterprises. As a result, many members have decided to substantially vary their levels of commitment across trading partners.

With RCEP signatory membership, the ROK de facto joined multilateral free trade architectures and also became connected with Japan for the first time, despite the ROK's many existing bilateral FTAs that covered more than 75% of the global economy. The ROK can benefit immediately from an approximately 92% overall tariff reduction from RCEP trading partners. In particular, it has now gained new market access in Japan, with the tariff elimination rate set at 83% of tradable goods, excluding sensitive items related to automobiles and machinery. For agricultural products, the deal opened at the level of 46% in the ROK and 49% in Japan. For industrial products, the market opened at the level of 91.7% in the ROK and 94.1% in Japan (Oh, 2021 pp. 2-3)

In the service trade component of RCEP, the ROK enjoys expanded market access to ASEAN in the areas of cultural content, distribution, and logistic services on top of an already effective ASEAN-the ROK FTA. Japan opened up wholesale and retail services, online games, rice, tobacco, salt, and brokerage services (Oh, 2021 pp. 2~3). Regarding the service and investment chapters, RCEP countries with a positive list system are required to initiate the procedure for converting to a negative list within three years of entry into force. In the government procurement chapter, each ASEAN member country first introduced the rules of government procurement by disclosing the associated information through the internet. This information access is likely to help intra-RCEP trade and Foreign Direct Investment(FDI) increase.

Given RCEP's limited effectuation period, it would still be premature to attempt to discern the full impacts of RCEP on the the ROK economy and all other member states. The only available quantitative reference for the ROK is the data on import and export activities using RCEP tariff concessions, released in February 2023 by the Korea Custom Services as shown in Table 4 of ROK's trade under the RCEP concession tariffs. From February to November in 2022, the ROK's trade with RCEP partners using RCEP tariff concession rates were recorded as a mere USD 8.9 billion, amounting to only 0.68% of the country's total trade of USD 1.415 trillion in 2022.² The temporary impacts during the first 10 months of RCEP effectuation were thus almost negligible, but the full impacts of RCEP on the ROK's economy are likely to increase as the ROK's firms start to more widely utilize the various RCEP liberalization benefits.



2 See the data from the press release on the first year trade performance under RCEP concessions by the Korea Customs Service, 2023. The export figures cover only those items processed with official certifications of origin. If self-certification by approved exporters is included, the figures are likely to increase.

4.2 Implementation Status of RCEP

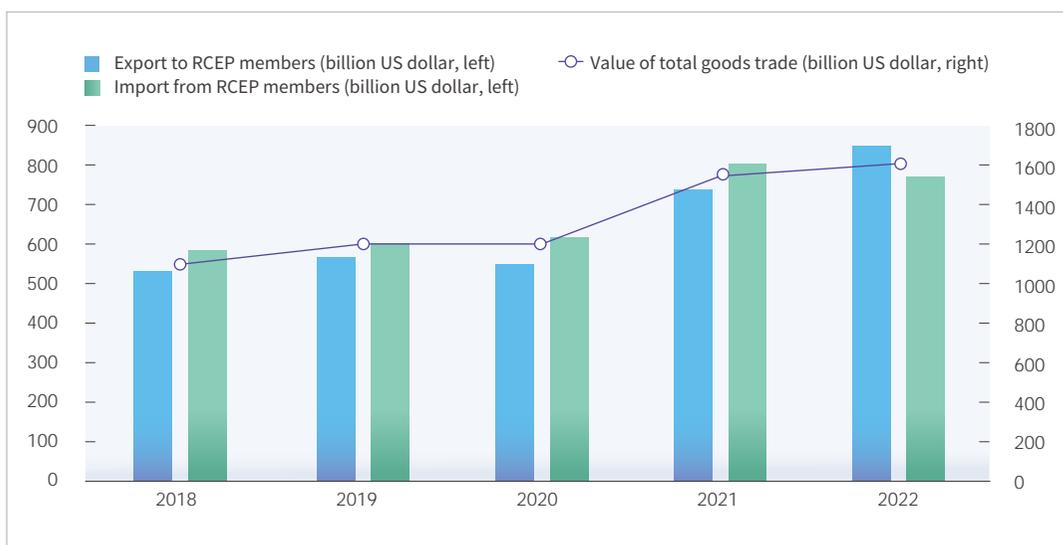
4.2.1 Implementation Status of RCEP in China

Significant Trade Creation Effect

Trade in Goods

After the RCEP came into effect, over 90% of intraregional goods trade gradually achieved zero tariffs. Several high tariff areas such as food, agriculture, consumer goods, and automobiles enjoy the greatest beneficiaries.

Figure 5 China's Trade with RCEP Members, 2018-2022



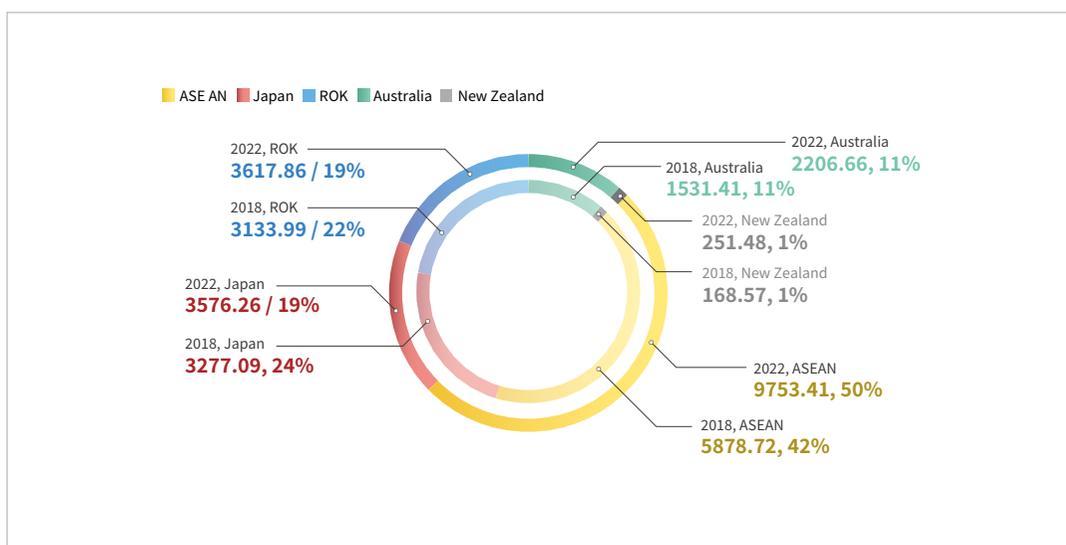
Source General Administration of Customs of China

In 2022, China's import and export with the other 14 member countries of RCEP reached USD 1940.57 billion, with an increase of 7.5%, accounting for 30.8% of China's total foreign trade import and export value. 8 countries contribute to intra-regional trade with growth rates over 10%. The trade creation effect is significant, increasing foreign trade by 8.55% on average, among which the average increase of export trade was 5.68%, while in import trade was 11.85%. According to the simulation results of RCEP Impact Assessment Report on Regional Economy, by

2035, RCEP will drive the cumulative increase in regional exports and imports to reach USD 857.1 billion and USD 983.7 billion.

Within RECP member countries, ASEAN accounts for 50.31% of China's import and export, with an increase of 15%, among which China's import and export growth rates to Indonesia, Singapore, Myanmar, Cambodia, and Laos have all exceeded 20%.

Figure 6 China's Goods Trade with RCEP Members, 2018 and 2022 (USD Billion)



Source: General Administration of Customs of China

Trade in Services

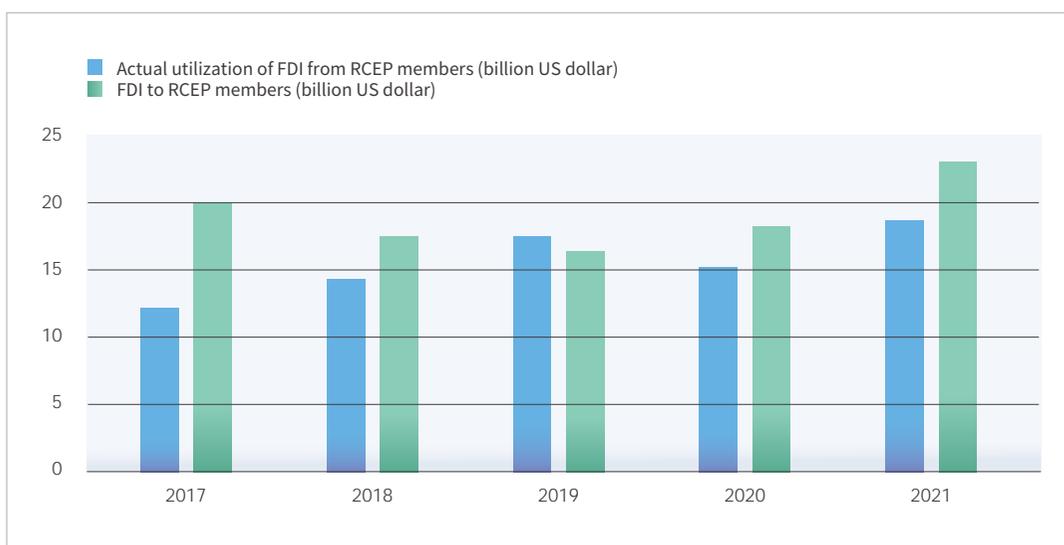
After the RCEP takes effect, China's service trade will shift from positive list (explicitly listing sectors that undertake Market Access and National treatment commitments) to negative list (listing sectors that are limited or excluded). The current management of the negative list has several disadvantages such as too many restrictions, complicated content, and disorganized methods. It should attach great importance to the construction of domestic free trade ports playing a leading and exemplary role in the implementation of RCEP rules.³

³ Hainan Free Trade Port has launched the first negative list of cross-border service trade making a fundamental change in the way service trade is managed.

Significant Investment Increase Effect

RCEP involves investment protection, investment promotion and liberalization measures, and has a significantly higher level of openness than existing bilateral FTAs. In 2022, China's non-financial direct investment in RCEP members rose 18.9% to USD 17.96 billion absorbing 23.1% increased direct investment of USD 23.53 billion from member countries. The ROK and ASEAN's investment in China increased by 64.2% and 8.2%, respectively.

Figure 7 Bilateral Investment Between China and RCEP Members, 2017-2021



Source National Bureau of Statistics of China

In 2022, China's execution amount of offshore outsourcing from RCEP member countries reached CNY 208.9 billion, accounting for 23.3% and increasing by 4.2%. Thereinto, the execution amount of offshore outsourcing from New Zealand and Singapore grew the fastest, with an increase of 78.8% and 39.0%, respectively. The industrial structure has shifted towards higher value-added types such as KPO (Knowledge Process Outsourcing) and BPO (Business Process Outsourcing).

Strong Promotion of Rules of Origin

In 2022, China's import and export of intermediate products to other RCEP member countries reached CNY 8.7 trillion, with an increase of 8.5%, accounting for 67.2% of China's total import and export value to other member countries during the same period. The corresponding origin standard for products is “40% regional value component” , and the product value can be accumulated, making it easier for exporting countries to enjoy tariff preferences. In line with a series of simpler customs procedures, trade facilitation, negative lists to promote investment liberalization, the integration of supply chains among member countries is further deepened.

Enterprises in China are able to apply for certificates of origin through the General Administration of Customs or China Council for the Promotion of International Trade. As the RCEP agreement was signed, the commerce department, the trade promotion system, many business associations, law firms, and accounting firms started to conduct a large amount of corporate publicity and training work, promoting enterprises to understand and use rules. In 2022, export enterprises in China have applied for over 673 hundred certificates of origin and statements of origin under RCEP in total. The value of goods export enjoying preferential treatment reached CNY 235.3 billion, while tariff reduction was CNY 1.58 billion. The value of goods import enjoying preferential treatment was CNY 65.3 billion with a tariff reduction of CNY 1.55 billion.

Implement Relevant Systems on High Level, Pilots of the Negative List in Service Trade

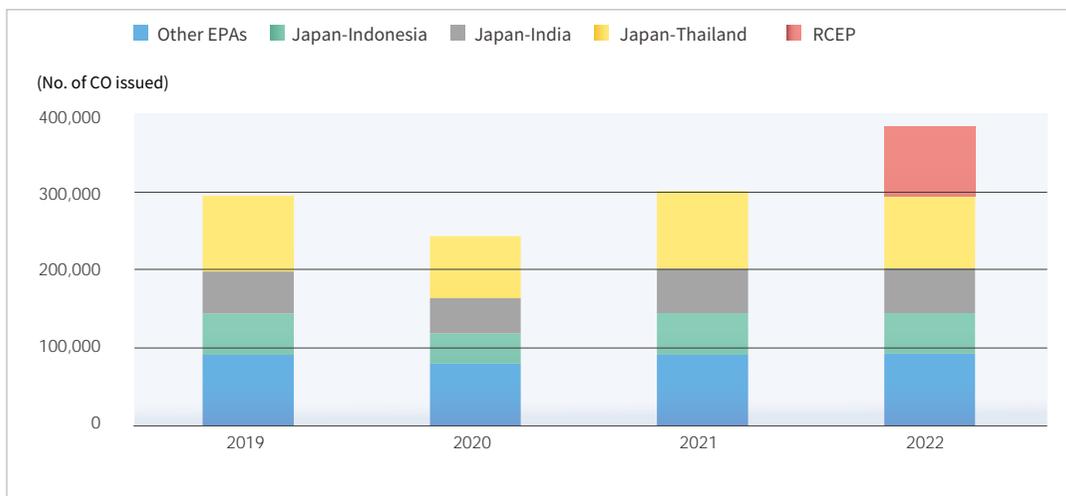
The chapter on RCEP intellectual property protection and e-commerce rules are being implemented in China. In terms of intellectual property rights, China granted more than 79,800 invention patents in 2022, reaching 9.4 high-value invention patents per 10,000 people. Research on data intellectual property protection rules and local pilot projects have been carried out orderly. In terms of e-commerce, the construction of logistics channels and cross-border e-commerce cooperation have become hot topics. The new land-sea-air channels have driven the formation of joint forces in the central and western regions, opening up new prospects for trade cooperation with RCEP partners such as ASEAN. China continues to improve the system of reducing tariffs, eliminating non-tariff barriers, expanding market access, and national treatments for foreign investment in RCEP. China has launched the first pilot service trade negative list in Hainan Free Trade Port, which is expected to be replicated and promoted nationwide soon.

4.2.2 Implementation Status of RCEP in Japan

In January 2022 RCEP entered into force for ten countries, including Japan. However, it will take a relatively long period for Japan to fully reap the benefits of RCEP in trade with China and the ROK as they eliminated only 25% and 41.4%, respectively, of their tariff lines vis-a-vis Japan immediately after the agreement’s enactment, and tariffs on the remaining items will be reduced progressively over a period of 21 years for China and 20 years for the ROK. Nevertheless, some evidence shows that Japanese firms started actively utilizing RCEP in 2022.

First, let us look at the utilization status of RCEP for exports from Japan. According to statistics published by Japan’s Ministry of Economy, Trade, and Industry (METI), in 2022, the total number of certificates of origin issued for all FTAs in Japan reached a record high of 387,000. Among them, the number of certificates issued for exports under RCEP reached 88,856, the second highest after the Japan-Thailand Economic Partnership Agreement (EPA) (Figure 8).

Figure 8 Number of Certificates of Origin Issued in Japan by FTA



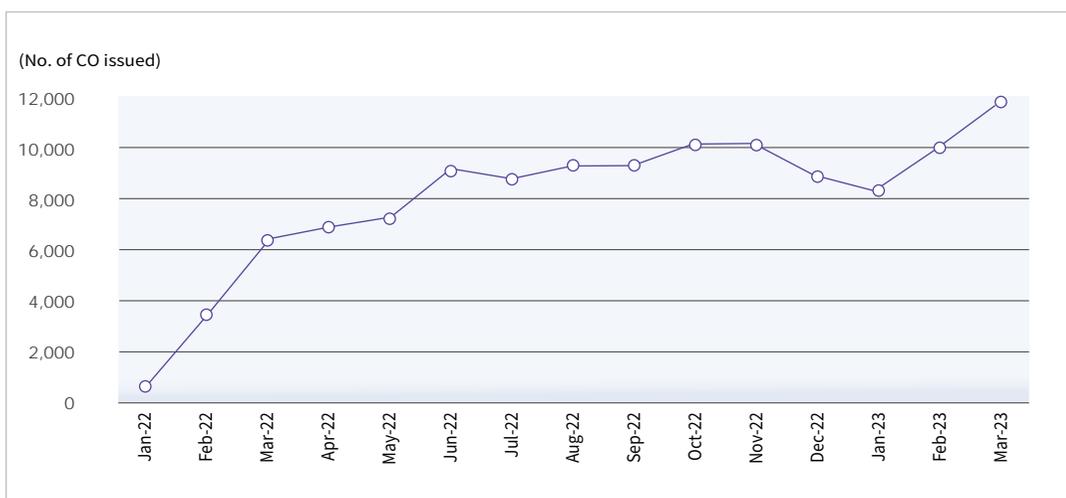
Source Ministry of Economy, Trade, and Industry (METI).

Of those, 59,630 certificates were issued for exports to China and 29,418 to the ROK, and these two countries accounted for 99% of the total number of certificates issued for exports to RCEP members (Nikkei, 2023, April 8). In other words, most of the exports for which RCEP preferential tariffs were used in 2022 were shipped to China or the ROK. However, for exports to other RCEP members, preferential tariffs under Japan’s existing FTAs, such as the Japan-Thailand EPA and

the Japan-Indonesia EPA, are still being used actively.

The number of certificates of origin issued under RCEP grew steadily in 2023 (Figure 9). In March, the number marked a new record post-January 2022, totaling 11,615 cases, and RCEP became the FTA with the highest number of certificates issued among all FTAs concluded by Japan. As preferential tariff rates in other countries decrease in the future, the utilization of RCEP preferential tariffs by Japanese exporters is expected to increase further.

Figure 9 Number of Certificates of Origin Issued for Exports Under RCEP



Source Ministry of Economy, Trade, and Industry (METI).

Second, Japan's imports under RCEP's preferential tariffs in 2022 amounted to approximately JPY 4.1 trillion (Figure 9). Imports from China accounted for 3.6 trillion (88.5%), followed by JPY 318.4 billion (7.8%) from the ROK, with the two countries accounting for 96.3%. Among other members, RCEP preferential tariffs were utilized for imports from Vietnam (JPY 117.6 billion, 2.9%) and Thailand (JPY 25.1 billion, 0.6%). However, existing FTAs still tend to be utilized for imports from members other than China and the ROK, such as the Japan-ASEAN EPA and other bilateral FTAs for imports from ASEAN countries and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) for imports from Australia and New Zealand.

Table 2 Japan's Imports from RCEP Countries in 2022

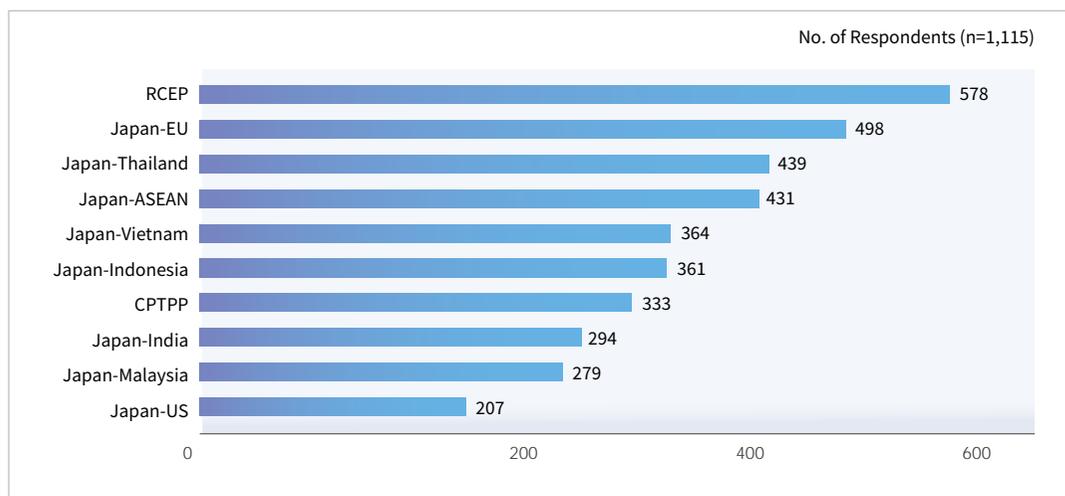
	Total Imports (1) (Billion JPY)	Imports under RCEP(2) (Billion JPY)	(2)/(1)
China	24,843.4	3,615.9	(88.5%)
The ROK	4,416.3	318.4	(7.8%)
Vietnam	3,478.4	117.6	(2.9%)
Thailand	3,502.4	25.1	(0.6%)
Other Members	17,352.7	9.0	(0.2%)
RCEP Total	53,593.1	4,086.1	(100.0%)

Note The import values in the table do not include data for countries where the agreement was not yet in effect with Japan in 2022 (Indonesia, the Philippines, and Myanmar).

Source Ministry of Finance (MOF).

According to a survey conducted by Japan Customs, RCEP was the most popular FTA utilized by respondent firms when importing to Japan, and the number of RCEP users has already exceeded those of the EU-EPA, Japan-ASEAN EPA, and CPTPP.

Figure 10 Number of Japanese Firms Utilizing FTAs



Note This survey was conducted from December 13, 2022, to January 31, 2023. The number of responding firms was 1,115. FTAs ranked 11th or lower are not shown.

Source Japan Customs (2023).

In 2022, imports from CJK under RCEP were highly concentrated in a few specific industries⁴. Textile, chemical, and plastic and rubber products accounted for more than 70% of imports from China, while chemical, plastic and rubber, and base metal products accounted for more than 80% of imports from the ROK (Table 3). These are product areas where Japan had maintained MFN tariffs before the creation of RCEP, and tariff reductions in the first year were very modest. This fact suggests how important tariff reductions are for firms engaged in trade within this region.

Table 3 Japan's Imports from China and the ROK Under RCEP in 2022

HS Sections	Japan's imports under the RCEP (Million JPY)			
	From China		From The ROK	
Textile Products	1,473.0	40.7%	26.7	8.4%
Chemical Products	770.4	21.3%	116.9	36.7%
Plastic and Rubber Products	376.8	10.4%	115.2	36.2%
Base Metal Products	241.5	6.7%	37.9	11.9%
Footwear, etc	220.4	6.1%	0.1	0.0%
Others	533.8	14.8%	21.7	6.8%
Total	3,615.9	100.0%	318.4	100.0%

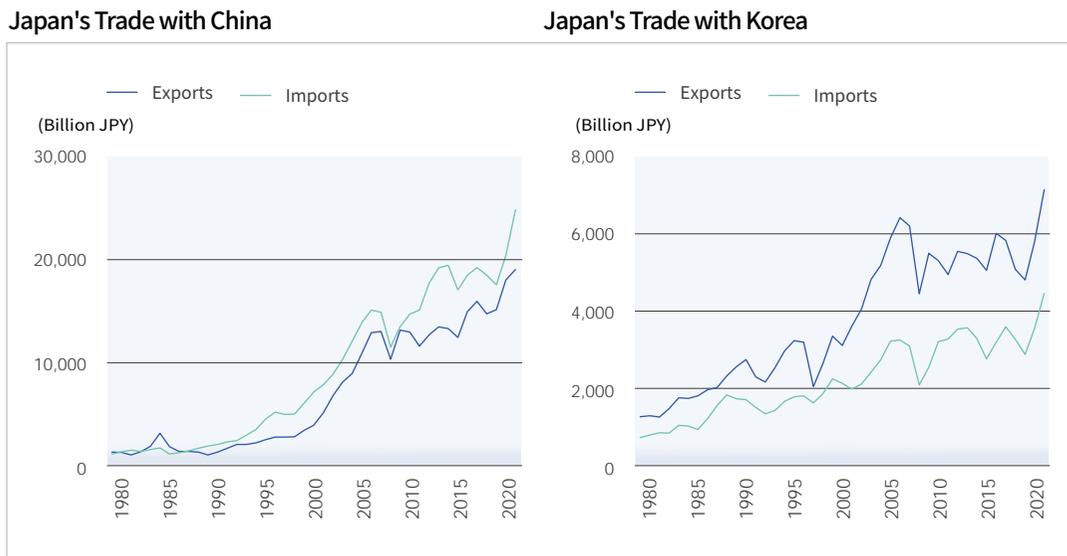
Source Ministry of Finance (MOF).

Meanwhile, the first RCEP Joint Committee meeting was held in April 2022 to discuss the implementation and operation of the agreement. At this meeting, it was agreed to establish four subsidiary bodies of the Joint Committee; a Committee on Goods, a Committee on Services and Investment, a Committee on Sustainable Growth, and a Committee on the Business Environment. Furthermore, at the RCEP Ministerial Meeting held in September 2022, the ministers discussed issues related to the implementation of the RCEP agreement and reaffirmed the necessity of not taking any RCEP-inconsistent measures to ensure free and fair economic order in the region.

Although the significant depreciation of JPY and global inflation may have contributed primarily, in 2022, JPY-based Japan's trade value with China and the ROK reached historic levels both for imports and exports (Figure 11). Trade liberalization and facilitation efforts under RCEP are expected to further expand trade between CJK in the long run.

⁴ Other industries; like frozen mixed vegetables, futon mattresses, thermos bottles, fishing rods, and seafood mixes were actively imported from China, while copper winding cables, distilled alcoholic beverages, eyeglass frames, dried krill and dried shrimp, and felt pens from the ROK took advantage of preferential tariffs under RCEP.

Figure 11 Trends in Japan's Trade with China and the ROK



Source Ministry of Finance (MOF).

4.2.3 Implementation Status of RCEP in the ROK

The RCEP agreement consists of a total of 20 chapters; coverage of trade in goods and services, the latest trade rules on investment, SPS, TBT, e-commerce, intellectual property rights, SMEs, and etc. Although tariffs concessions are relatively low compared to the other advanced mega deal in the Asia-Pacific, for example, the CPTPP, it is highly significant that the RCEP rules of origin integrate the various standards signed in members' bilateral FTAs into a unified system to avoid Spaghetti Bowl effects by allowing regional accumulation as well. Another great improvement in the RCEP deal allows self-certification of origin by approved exporters or producers in addition to concerned public and private organizations, which helps reduce time and related international transaction costs. It is also significant that the e-commerce chapter contains provisions for paperless trade, electronic authentication, and electronic signatures, which will facilitate cross-border e-commerce for big companies and SMEs in the RCEP community.

ROK's implementation of RCEP is clearly indicated by its trade performance under RCEP tariff concessions. Since RCEP effectuation, ROK's trading firms commenced using newly open market access to its RCEP trading partners. The Korea Customs Service released data on the ROK's trade activities within the RCEP bloc using RCEP tariff concessions (Table 4). Overall, the ROK's exports and imports using RCEP tariff concessions during the first ten months reached USD 3.3 billion and 5.6 USD billion respectively. ROK's RCEP-induced trades are concentrated with only four

RCEP economies, namely Japan, China, Thailand, and Vietnam. ROK's exports under RCEP tariff benefits amounted only to 0.4%, whereas the figure for imports was slightly higher at 0.7%. Thus, RCEP's immediate impacts on ROK's trade during the short run of ten months post-effectuation were marginal.

Table 4 ROK's Top Five RCEP Trading Partners Using RCEP Tariff Concessions From February, 2022 –November, 2022

Country	Exports (Million USD)		Imports (Million USD)	
	Amount	Ratio (%)	Amount	Ratio (%)
Japan	2,234	67.4	2,716	48.3
China	920	27.3	2,178	38.7
Thailand	81	2.5	649	11.5
Vietnam	48	1.6	27	0.5
Singapore	24	0.8	51	0.9
Others	12	0.4	7.1	0.1
Total	3,319	100	5,628	100

Source Korea Customs Service, Press Release on first-year trade performance under RCEP concessions, February 1, 2023

However, it is still significant that the ROK's traders have taken advantage of tariff reductions and/or elimination, and especially the unified rules of origin of RCEP. Given the positive contribution of the ROK's RCEP membership during the first 10 months, RCEP is expected to revitalize the ROK's intra-regional trade and subsequent cross-border investment for resilient supply chains in the RCEP bloc with maximum use of the liberalized measures contained in RCEP.

The ROK's traders used RCEP concessions most with Japan (Table 4). Japan is a top 5 trading partner for the ROK, and RCEP is the ROK's first free trade deal with Japan in a plurilateral regional framework. The ROK has benefited most in terms of the importation of battery materials from Japan. China was the second highest-ranking country with which the ROK used RCEP concessions, followed by Thailand and Vietnam, both with far smaller trade figures than Japan. Indonesia and the Philippines are not included in this computation because Indonesia made RCEP effective in January 2023, and the Philippines and Myanmar have not ratified the RCEP deal. Total trade with self-authentication is not included in the ROK's Customs Service data. Once all signatory members put RCEP into force and self-certification of origin is counted, the ROK's RCEP-induced trade figures are likely to rise significantly.

Approximately one-half of the ROK's total trade is associated with RCEP member states. Given the tariff concession benefits of RCEP, the ROK's central and local government agencies and business organizations including export-oriented SMEs are also increasingly interested in applications of RCEP rules of origin and tariff agreement-related information collection. According to the Korea Federation of SMEs (KBIZ), 85.3% of the ROK's SMEs hold the view that RCEP will be beneficial for their cross-border trade and 77.3% of them expect their exports will increase due to increased market access and tariff reductions or elimination. The most popular measures for the ROK's SMEs are unified rules of origin and simplified certification of origin procedure, and flexible use of e-commerce.

RCEP allows the ROK to increase zero tariff commodities from the 79.1-89.4% agreed in the ASEAN-the ROK FTA to 91.9-94.5%. At an industrial sector level, the ROK's auto sector is likely to benefit. The average tariff abolition rate under RCEP for passenger cars, trucks, and automobile-related parts such as airbags and automobile engines is expected to be more than 27.5% effective. The (average) RCEP tariff abolition rate for passenger cars and trucks is expected to be more than 35%, and the effect of this is expected to be remarkable. If the tariff rate is lowered further through RCEP's upgrading, further positive consequences for the ROK's automobile and auto parts export are anticipated.

Both accumulated rules of origin and simplified certification between RCEP signatory states are likely to help the ROK's SMEs reduce the burden of preparing certification of origin. Regional SMEs can also take advantage of differences in tariff rates across member countries and tradable goods. For example, a Japanese importer is likely to choose the ROK's zero-tariff synthetic filament fibers than Chinese fibers with 9.1% tariff. In the case of automobile safety glass, the ROK's tariff rate is zero but China applies a 3.5% tariff rate. RCEP also strengthened IPR (Intellectual Property Rights) to cover 83 items, which allows legal protection for K-Pop music and other such cultural contents.

The ROK's SMEs have been clumsy in taking advantage of various free trade deals. To help the ROK's SMEs acquire RCEP trade concessions, the country's central and local governments and business organizations have been undertaking public campaigns to diffuse various RCEP contents. The application of RCEP rules of origin and information collection on tariff agreements related to tradable commodities, plus related procedural methods, are being developed in various ways. KOTRA has published an RCEP Users' Guidebook for public consumption with a portal link (<https://unipass.customs.go.kr/clip/index.do>). The ROK's local governments, the Korea International Trade Association, the Korea Federation of SMEs, and Korea Chamber of Commerce have also begun tailor-made public campaigns for the ROK's firms under their jurisdiction to facilitate more effective utilization of RCEP benefits while monitoring companies' RCEP usage status with 1,380 call center consultations.

4.3 Trilateral Cooperation Under RCEP

4.3.1 Perspective of China

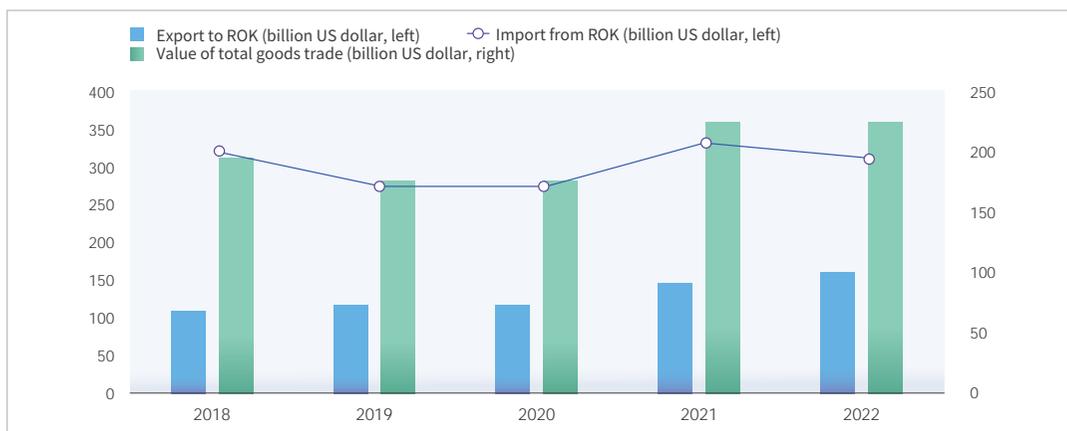
As the first FTA among CJK RCEP fills the gap in the past and promotes CJK to be an integrated market. According to the prediction of the Peterson Institute for International Economics, by 2030 RCEP will boost the national income of member countries by USD 186 billion per year, increasing their GDP by 0.2% per year on average. These will bring benefits to CJK of USD 85 billion, USD 48 billion, and USD 23 billion, respectively.

Continuously Deepening Economic and Trade Cooperation among CJK

CJK are important mutual trade partners. In 2022, the China-ROK trade volume reached USD 362.2 billion, with a YoY increase of 0.1%; the China-Japan trade volume was USD 357.4, with a YoY decrease of 3.7%. As a result, the ROK became China's fourth largest trading partner in 2022, rising one place higher from last year,, , while Japan slipped to fifth place.

Since 2018, China-the ROK trade has accounted for 20% to 25% of the ROK's international trade, and 6% to 7% of China's international trade. The annual export value of the ROK to China is USD 192.82 billion on average, the import value is USD 128.63 billion, and the trade surplus is about USD 64.2 billion. This means that China has been in a deficit in bilateral trade with ROK. During 2022, the China-ROK trade reached USD 362.2 billion, with a YoY increase of 0.1%.

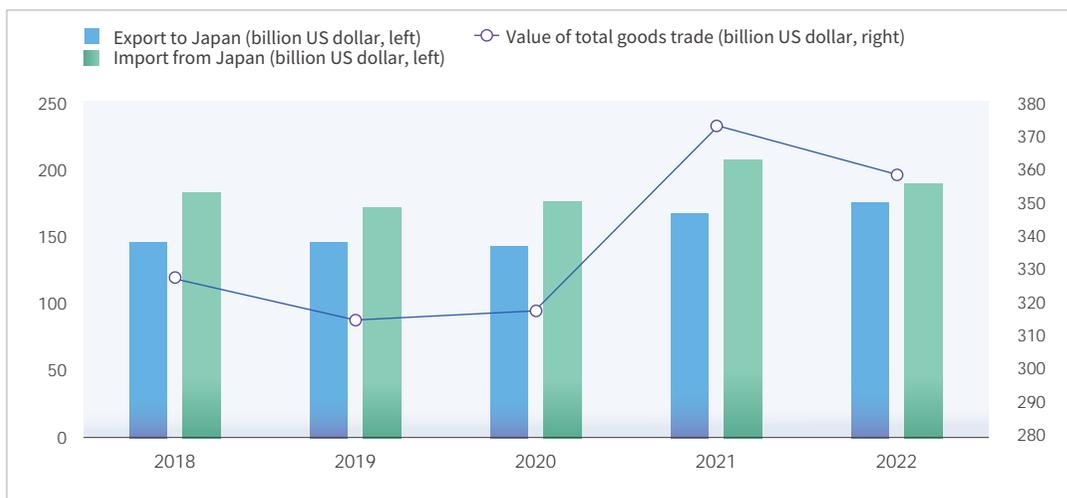
Figure 8 China's Goods Trade with ROK, 2018-2022



Source: General Administration of Customs of China

Overall, the China-Japan bilateral trade volume showed a good development trend from 2008 to 2018, increasing from USD 268.63 billion in 2008 to USD 317.53 billion in 2018 by nearly 18.2%. China's export to Japan increased by nearly 6% YoY, to approximately USD 173.5 billion; Japan's export to China increased by about 8% YoY, reaching nearly USD 144 billion. From 2018 to 2020, the bilateral trade volume exceeded USD 300 billion. In 2021, the China-Japan trade volume increased by 16.97% YoY, to USD 37.11 billion. In 2022, China's exports to Japan increased by 4.4% YoY, while the total trade volume decreased by 3.6% YoY.

Figure 9 China's Goods Trade with Japan, 2018-2022

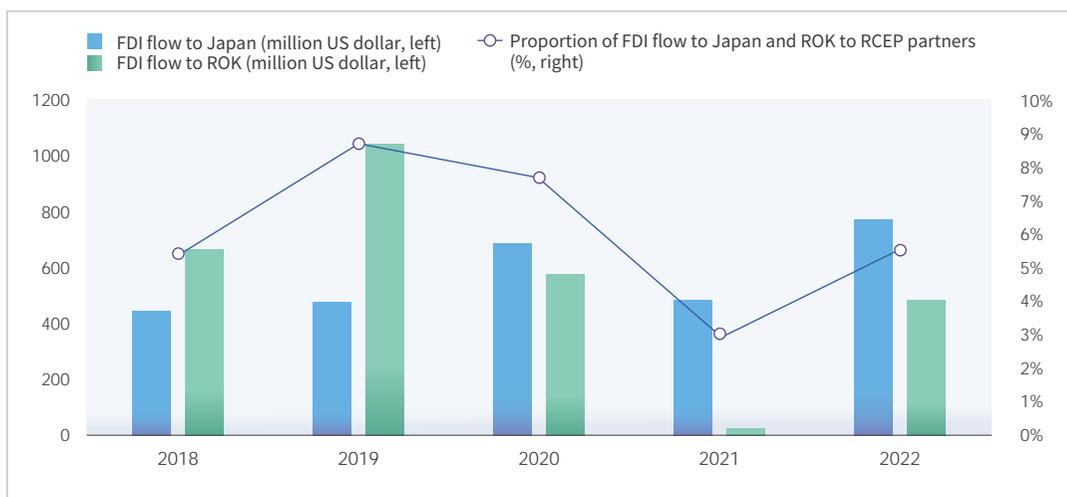


Source: General Administration of Customs of China

Stable and Improving Bilateral Investment among CJK

The implementation of RCEP will reduce investment transaction costs and promote the development of two-way investment among CJK. From 2017 to 2021, China's direct investment in Japan and the ROK showed a trend of first decreasing and then increasing, but the overall trend was stable and positive. There was a certain level of trough in direct investment to Japan and ROK from 2018 to 2020. In 2021, FDI in Japan expanded to USD 762 million, with a 241% YoY increase of FDI in the ROK, and the proportion of FDI in Japan and the ROK to RCEP partners expanded to 5.4%.

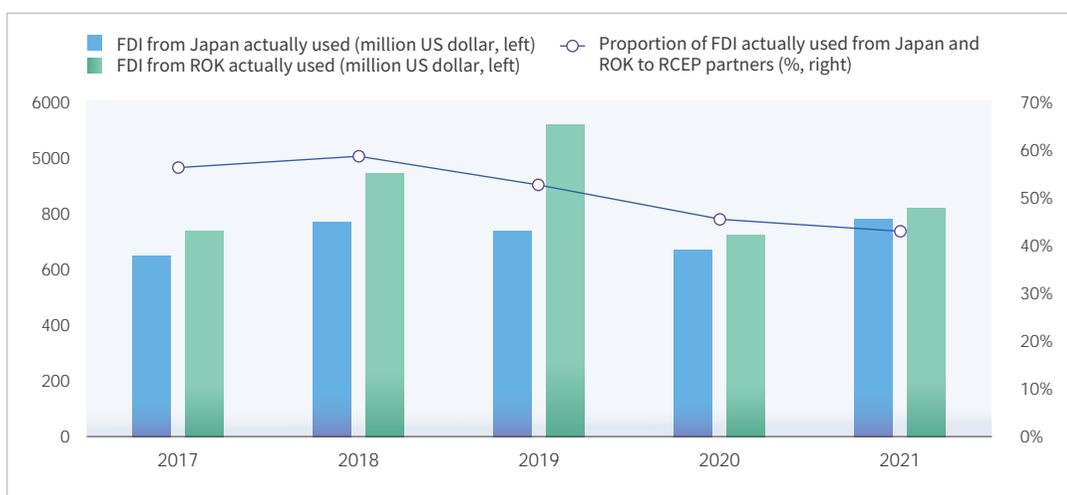
Figure 10 China's FDI Flow to Japan and the ROK, 2017-2021



Source National Bureau of Statistics of China

Under the RCEP framework, CJK have opened up their markets and improved their level of foreign investment access. China's actual utilization of foreign investment from Japan and the ROK in the past five years has been relatively stable. From 2017 to 2021, China's actual utilization of foreign investment from Japan and the ROK fluctuated from 56.3% to 42.2%, and has always remained at a high level. In 2022, Japan and the ROK's investment in China showed a high growth trend.

Figure 11 China's FDI Actually Used from Japan and the ROK, 2017-2021



Source National Bureau of Statistics of China

The Independent Degree of Industrial and Supply Chains of CJK Increases

Through long-term close trade and investment cooperation, CJK have formed famous East Asian production network system, gradually deepening mutual interdependence in the industrial and supply chains. With the implementation of RCEP, over 90% of the trade in goods among CJK will achieve zero tariffs, which will enable intermediate and manufactured goods with relative export advantages to enter each other's markets at lower costs more conveniently. In the past two decades, the proportion of intermediate products exported by China to Japan has been continuously increasing, while the proportion of intermediate products exported to the ROK has shown a downward trend; the proportion of intermediate products in Japan and the ROK's export to China is gradually decreasing, indicating that with the continuous improvement of China's export structure, China's position in the division of labor in the GVC has increased. This will enhance the resilience of the industrial and supply chains among CJK, achieving dual promotion of functional and institutional cooperation in the industrial chain.

RCEP Driving CJK Cooperation in Digital Economy

RCEP has a dedicated chapter on e-commerce, which plays an important role supporting the development of digital economy and trade in the three countries. CJK have strong innovation capabilities in the high-tech field, especially in ICT. China has well-known advantages in 5G technology, and there is significant cooperation among enterprises of the three countries. From a market and financial perspective, CJK each have different types of advantages. China has strong market and financial advantages, while Japan and the ROK have technological and financial advantages, making the digital economy field as the complementarity of CJK. Under the RCEP framework, the digital economy is an important area for deepening economic and trade cooperation between CJK, and can also have a strong leading and driving role in other fields.

4.3.2 Perspective of Japan

There is growing demand in some countries to prioritize economic security over free trade. With the weakening of the legislative and judicial functions of the WTO, countries are resorting to protectionist measures in the name of protecting national security. In this context, RCEP can and should play a crucial role in promoting economic integration and cooperation in East Asia, a center of global economic growth, and in establishing a predictable and stable economic order in the region.

To counter the ongoing wave of expanding protectionism, it is necessary to enhance the attractiveness of East Asia as a production base and market through the reliable implementation of RCEP, thereby boosting the number of beneficiaries of regional integration. CJK should further raise their relatively low levels of tariff elimination and accelerate the pace of liberalization. If the reduction in preferential tariff rates under RCEP is insufficient, firms operating in this region will have no choice but to continue using existing ASEAN+1 FTAs and other FTAs, and they will never be freed from the spaghetti bowl problem. Also, it is essential for RCEP to enhance the agreement's attractiveness swiftly as a shield against this wave of protectionism.

Furthermore, CJK should cooperate to further improve the user-friendliness of the agreement. Three countries should introduce the principle of MFN treatment for tariff reductions under RCEP. Currently, Japan applies different preferential tariff rates for the same products depending on whether they are imported from China or ASEAN countries. This means that there is discrimination in tariff treatment among RCEP member countries. Similarly, China and the ROK have not adopted the MFN treatment principle. Such tariff differentials not only artificially distort trade flows but also result in the inclusion of complicated “tariff differential rules” in the agreement to prevent tariff evasion, thereby reducing the user-friendliness of the agreement.

Lastly, CJK, and other member countries should leverage RCEP as a forum to initiate dialogue on economic security. It would be worthwhile to initiate discussions and joint research on the impact of measures related to economic security on trade and the economy in East Asia and to discuss better ways to balance free trade and economic security and to further strengthen supply chains in the region. RCEP can serve as a foundation upon which to seek practical solutions to these issues.

RCEP has provided the three countries with the most important and stable platform to enhance economic cooperation and continue dialogue on common policy challenges. Considering the possibility that the successful creation of RCEP may diminish the political momentum for concluding negotiations on a CJK FTA, the significance of RCEP as a platform for the three countries to engage in dialogue may increase even further.

4.3.3 Perspective of the ROK

Even without the RCEP during the past two decades, CJK have experienced highly deepening intra-regional connectivity in trade and cross-border FDI as China has successfully integrated into East Asia, especially after joining the WTO in 2001. This is clear evidence of the gravity model in action, emphasizing that the trade linkages between countries are proportional to the GDP size of

the trading partners and inversely related to the geographical distance between them.

It is significant that the CJK states are now formally and indirectly connected with each other under RCEP's newly added liberalization measures given the stalled CJK trilateral FTA negotiation. The CJK economies have been great beneficiaries of the liberal trading system, becoming a global manufacturing hub by taking advantage of naturally emerging regional value chains arising from geographical proximity and their inherent manufacturing competitiveness.

As long as the trilateral flow of essential materials between CJK is not “weaponized” for geopolitical reasons, cross-border FDI is well protected, and tourism remains unconstrained, the three countries' natural market value chains are likely to increase in mutual gains (Ahn forthcoming, 2023). With the effective RCEP mechanism, it is imperative that CJK leaders facilitate mutual gains in order to live up to the spirit of trilateral common prosperity as emphasized by the joint summit statement at the Chengdu Trilateral Summit in 2020 (Ahn, 2020).

The intra-regional shares of the CJK, ASEAN and RCEP economies have undergone various changes in the past two decades (Table 5) (Ahn, 2018). Both CJK and ASEAN's intra-RCEP trade shares increased during the period 2000-2010 but declined in the 2010s. However, overall intra-RCEP trade expanded its share by about 1.5%p over the period of 2000-2021. This suggests that trade linkages between CJK and ASEAN would have been on the rise due to sheer market forces and CJK's respective bilateral FTAs with ASEAN even without considering the impacts of RCEP. Now with the effective RCEP agreement, supply chain interactions between two groups, CJK and ASEAN, are likely to increase and give renewed momentum to an enhanced RCEP in the future (Ahn 2018, 2020).



Table 5 Share of Intra-Regional Trade by Different Sub-Groupings Over 2000-2021(Unit:%)

Year	CJK	ASEAN	RCEP	Year	CJK	ASEAN	RCEP
2000	20.3	22.8	27.2	2011	21.4	24.1	27.7
2001	21.2	22.2	26.7	2012	20.2	24.3	27.9
2002	22.4	22.7	27.2	2013	19.3	24.3	27.8
2003	23.7	24.5	27.4	2014	19.1	24.1	27.6
2004	24.1	24.4	27.4	2015	19.5	23.4	28.2
2005	23.7	24.8	27.4	2016	19.6	22.7	28.4
2006	22.9	24.8	26.9	2017	19.7	22.4	29.0
2007	22.2	24.9	26.7	2018	19.2	22.8	28.9
2008	21.5	24.9	27.1	2019	18.4	22.4	29.3
2009	22.3	24.3	27.6	2020	18.7	21.1	28.9
2010	22.1	24.6	28.0	2021	17.6	20.9	28.6

Source Author's calculation based on IMF Direction of Trade

According to an UNCTAD study by Nicita (2021), even before the RCEP deal, China's dependence on intra-RCEP imports and exports in 2020 was recorded at 39% and 27%, respectively. However, Japan's intra-RCEP dependence was 49% in imports and 43% in exports, respectively—significantly higher than that of China (Table 6). The ROK's intra-RCEP dependence in imports and exports exhibited a similar magnitude as that of Japan—far higher than China's. On average, RCEP members' imports and export dependence on the RCEP bloc was measured at 51% and 45%, respectively.

Table 6 RCEP Members' Intra-RCEP Trade in 2020

	Intra-RCEP Trade (USD billion)		Percentage of Trade with RCEP members	
	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>
Australia	122	206	56	73
Brunei Darussalam	3	7	52	88
Cambodia	22	9	85	33
China	738	688	39	27
Indonesia	115	101	67	57
Japan	355	321	49	43
Lao People's Democratic Republic	5	6	94	91
Myanmar	16	13	34	67
Malaysia	123	142	60	56
New Zealand	24	26	56	62
Philippines	79	37	68	49
the ROK	233	284	46	50
Singapore	168	222	47	54
Thailand	130	134	61	54
Viet Nam	179	117	72	42
RCEP	2,311	2,311	51	45

Source Key Statistics and Trends in Trade Policy 2020 (UNCTAD). The table is re-quoted from the UNCTAD study carried out by Nicita (2021)

Note figures refer to trade in goods.

RCEP is likely to boost members' incomes by 0.6%, adding USD 245 billion annually and 2.8 million jobs to regional employment (Park, Petri, and Plummer, 2021, p.9). These benefits are estimated to be more than double those projected for CPTPP. The largest percentage increase will be realized by the most trade-oriented economies such as Malaysia and Vietnam, and CJK which enjoy the largest on-going trade volumes and no prior trade agreements other than the shallow China-the ROK FTA.

To take advantages of free trade deals, CJK have pursued competitively bilateral, sub-regional, and regional mega deals in global FTA networks with many non-RCEP countries, such as the ROK-US FTA and Japan's anchor state role in CPTPP, in addition to bilateral FTAs with RCEP

countries (Figure 12). It should be noted that CJK have established their respective FTAs with ASEAN. However, China, as a global manufacturing hub, now the biggest trader in the world, has diversified its trade linkages more heavily with non-RCEP economies than both Japan and the ROK without engaging in a bilateral trade pact with Japan and without upgrading the bilateral trade pact with ROK.

Figure 7 Various FTAs Between RCEP Members

	Australia	China	Japan	ROK	New Zealand
ASEAN	AANZFTA	ACFTA	AJCEP	AKFTA	AANZFTA
Australia		ChAFTA	JAPEA, CPTTP	KAFTA	ANCERTA, CPTTP
China			-	CKFTA	NZCFTA
Japan				-	CPTTP
ROK					NZKFTA

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Regional Supply Chains

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Regional Supply Chains

5.1 Global Supply Chain Reconfiguration and Structural Changes

Over the past several decades, growing technological progress and the related complexity of production processes, trade liberalization, and lower transportation and communication costs have reshaped the global trade landscape. In particular, production has become increasingly fragmented because of growing regional and Global Value Chains (GVCs), with components and parts crossing numerous international borders as market forces dictate for efficiency and flexibility.

This trend has resulted in faster growth in intermediate inputs than in the trade of final goods. This new pattern of production has certainly been prevalent in Asia. The IMF (2015 p.73) has provided empirical evidence that, from 1995 to 2013, Asia's trade in intermediate goods grew by a factor of six, while trade in final goods grew almost four times over. This trend in Asia compared with fourfold and threefold increases of trade in intermediate and final goods, respectively, in the rest of the world.¹

As a result, the latest international trade involves increasingly complex interactions between people, firms, and organizations. Supply chains cross countries and regions. The components of a given product could now be made in multiple countries. Trade has become a round-the-clock business and, thus, good performance in trade requires good connectivity along not only roads, rail, and sea, but also in telecommunications, financial markets, and information-processing. Having inefficient or inadequate systems of transportation, logistics, or trade-related infrastructure can severely impede a country's ability to compete on a global scale.

In response to what is thus an inevitably complex system of interdependence, companies have embraced global supply chains, giving rise to a tangled web of production networks that weave the world economy together. This drive toward specialization sometimes has made substitution difficult, especially for unusual skills or products. And as production has gone global, countries have also become more interdependent, because no country can possibly control all the goods and components its economy needs. National economies have been subsumed into a vast global network of suppliers.

1 IMF (2015), "Regional Economic Outlook: Asia-Pacific, stabilizing and outperforming other regions", World Economic and Financial Survey, April 2015, p73

However, the global COVID-19 pandemic has altered the global economic landscape due to global supply chain disruptions. The pandemic has invoked de-globalization and inward-looking trade and investment policies due to continued lockdowns by major Covid-ridden economies. Indeed, the sudden halt in travel and commerce precipitated by the outbreak of COVID-19 has triggered the re-nationalization of some industries.

Given the borderless spread of the pandemic, hitherto existing supply chains are undertaking resilience-oriented restructuring through further diversification while minimizing the risks involved in excessive dependence on one or a few countries. As a result, regional and GVCs continue to proliferate, diversifying global outsourcing. For a robust economic revival to occur, countries with deeply linked cross-border supply chains must increase resiliency of the intra-regional connectivity of supply chains to ensure that growth and employment return to normal while jointly combating cross-border pandemic and natural disasters due to climate change.²

To ensure resilient supply chain networks, many countries have adopted multiple sourcing strategies for critical materials and moving from global to regional networks while pursuing supply chain digitalization. As the US-China rivalry continues to intensify, major economies have adopted reshoring, near-shoring, and even friendly shoring policies for the sake of supply chain resilience. This pattern tends to lead to geo-economic fragmentation of supply chains.

Yusuf and Leipziger (2022) provided several characteristics of the post-pandemic trade order mixed with the US-China rivalry. First, the reliability of supply chains was severely impaired by the COVID-19 pandemic and its consequences. Near-shoring or on-shoring became much more attractive than global supply chain management, and the cost of interruptions as compared with higher inventory levels has changed the production calculus.

Second, the continuation of a bitter economic rivalry between the United States and China has seen both nations trying to become more resilient in the procurement of inputs, with associated consequences for others such as ROK. Third, the nature of production has shifted with new technologies. Therefore, it is critical to secure essential minerals and metals needed for new products, such as electric car batteries and micro-chips, to avoid competitive disadvantages in the global marketplace.

2 For a potential collaboration to fight the corona pandemic and economic revival in Northeast Asia, see Choong Yong Ahn, "China, Japan, and South Korea can marshal a collaborative response to Covid-19," East Asia Forum, 13th April, 2020. (<https://www.eastasiaforum.org/2020/04/13/china-japan-and-south-korea-can-marshal-a-collaborative-response-to-covid-19/>)

On top of the impacts of the COVID-19 pandemic, the question of how the increasingly intensifying US-China rivalry will unfold has added another greatly uncertain factor to influence intra-regional supply chains through various trade and investment restrictions imposed by the super powers. As a consequence of protective measures resulting from the US-China rivalry, frequent application of the security-trade nexus argument is likely to significantly affect the intra-regional trade and investment pattern in East Asia. Especially security-sensitive products such as high-end semiconductors, batteries, and AI-intensive products, and strategic materials such as rare earth, manganese, lithium, and cobalt, will alter the global trade and investment landscape as well as regional integration patterns.

In this context, the effectuation of RCEP at the start of 2022 was highly significant in heralding a new sense of optimism for the liberal trade order amid increasingly rampant protectionism, supply chain disruptions due to the COVID-19 pandemic, and increasingly intensifying US-China rivalry in the global geo-political competition. As detailed in the previous section 4.2, RCEP's positive impacts are quite evident in the case of the ROK and are likely to be so for most members, as indicated by many RCEP-related studies (Nicita 2021, Park, Petri, and Plummer 2021). Therefore, effective coordination of domestic policies between RCEP members through the agreement's built-in consultation mechanisms is crucial to maximize the expected effects of RCEP.

However, the on-going zero-sum geopolitical fragmentation, primarily caused by the US-China rivalry over 21st-century technology leadership, will destabilize the productive supply chain system that prevailed in the past three decades or so. To counter the harmful consequences of geo-political fragmentation, RCEP needs to be upgraded in order to be more comprehensive and more liberalized to match the quality of the CPTPP especially in labor and environmental standard, intellectual property rights, subsidies, and investor-state disputes settlements. Provided that these reforms are done to meet the respective global standards, there will also be a need to pursue the strategic convergence of RCEP and CPTPP with the returning US and new entrants from key RCEP members including China and the ROK (Ahn, 2018). In this context, the full and transparent implementation of RCEP's scheduled tariff cuts and further elimination of non-tariff barriers will be also essential.

5.2 Supply Chain Trends and Management of China, Japan, and the ROK

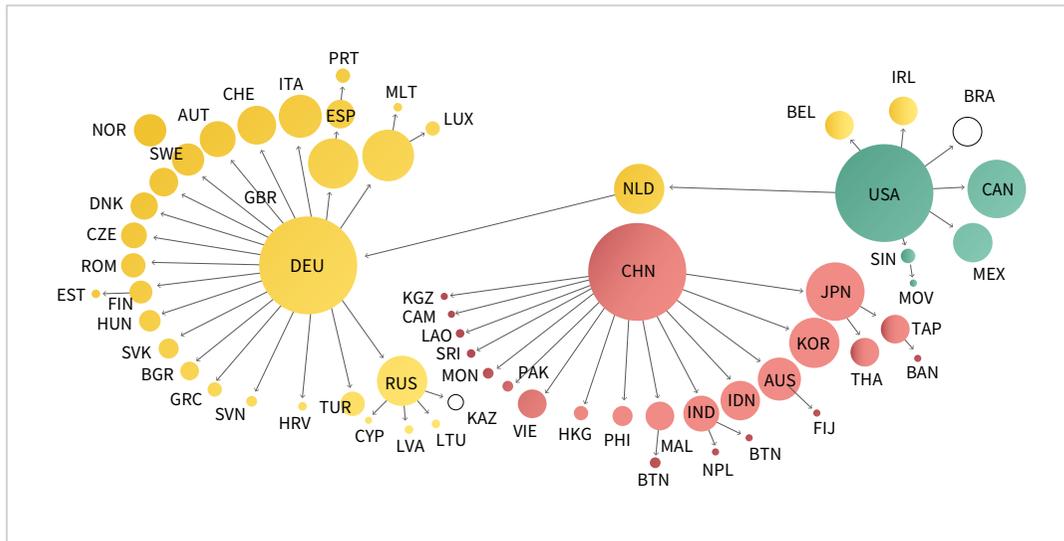
5.2.1 Supply Chain Trends and Management of China

With the rapid development of the Chinese economy and the continuous improvement of its innovative capabilities, China is gradually becoming one of the core countries in the global supply chain. The development of the supply chain is showing a trend towards digitization, intelligence, and collaboration. Against the backdrop of the regionalization of the global supply chain, based on the geographical advantages and industrial development of CJK, Japan and the ROK have become China's preferred partners in building regional industrial chains. Economic and trade investment cooperation between the three countries is becoming increasingly close, forming an Asia-Pacific regional supply chain with global influence. China will further expand the layout of the supply chain in more industries and regions, gradually deepening cooperation and collaboration, and promoting the global, digital, and innovative development of the supply chain.

China: One of the Core Countries in the Global Supply Chain

Currently, a highly dependent industrial division pattern on China's industrial and supply chains has been formed worldwide. China has deeply integrated into the global industrial division system and has become the center of the global trade network. China had a trade network centrality score of 98.55, ranking first globally, well ahead of the second-ranked US (88.41) and the third-ranked Germany (86.96)(UN Comtrade, 2020). Over two-thirds of global trade flows through the GVCs, which effectively reduces transportation costs, decreases trade barriers, creates employment opportunities for trading nations, and contributes to the economic growth of developing countries.

Figure 1 GVCs Network Map for 2019

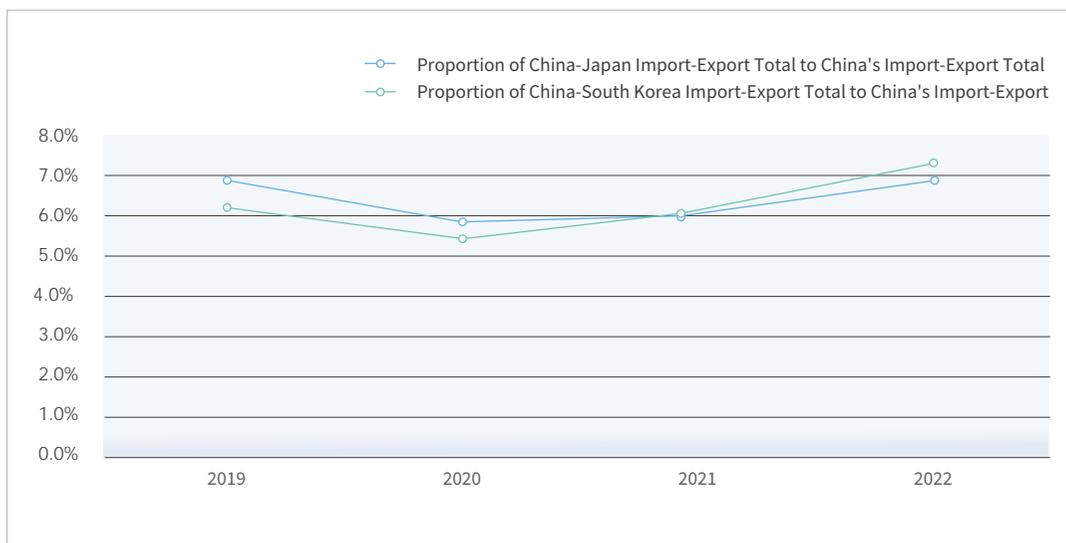


source World Trade Organization (WTO)

Expanding Scale of the Supply Chain in the New Paradigm

Over the past decade, China's supply chain has continuously expanded in terms of industry, space, sector, and form. China has become the largest trading partner for over 120 countries and regions. The vast scale of its industrial and supply chains positions “Made in China” as a significant player globally. In 2020, China was the largest export destination for 33 out of 186 countries and regions worldwide, and the largest import source for 65 countries (McKinsey Global Institute). China has close international trade cooperation and a massive supply chain with Japan and the ROK. In 2019, China's total imports and exports with Japan and the ROK accounted for 6.9% and 6.2% of its total trade, respectively. Japan and the ROK were the fourth and sixth largest trading partners of China, respectively. Despite the COVID-19 pandemic, Japan and the ROK maintained their enthusiasm and close cooperation in trade with China. In 2020 and 2021, Japan and the ROK remained the fourth and fifth largest trading partners of China, respectively. In 2022, trade between China and Japan, as well as China and the ROK, continued to grow. The ROK accounted for 7.3% of China's total imports and exports, becoming the fourth largest trading partner, while Japan accounted for 6.9% and became the fifth largest trading partner. The supply chain scale among the three countries is gradually expanding.

Figure 2 Trend of Japan-ROK Import-Export Total Ratio from 2019 to 2022



source General Administration of Customs of China

The Manufacturing Industry Maintaining the Main Position of the Supply Chain System

The manufacturing industry is the main component of China's supply chain system. China has the most complete industrial system in the world, but there are still a lot of links that need international cooperation and import, such as high-precision technology and links, materials for high-end manufacturing, etc. China is on the side of product cost advantage in the supply chain of CJK, while Japan and the ROK have a greater advantage in superior technology and high-end manufacturing components, etc.

From the trade perspective, the manufacturing industry accounts for a large proportion of the whole industry. Taking six representative industrial products such as chemical products (category 6), plastic products (category 7), metal products (category 15), audio-visual products (category 16), vehicles and other related equipment (category 17), and precision instruments and equipment (category 18) as examples, in 2022, Japan and the ROK will import a total of CNY 1.23 trillion and CNY 1.27 trillion of industrial products from China, accounting for 92.54% and 92.54% of total exports, respectively. In 2022, Japan and the ROK will import a total of CNY 1.23 trillion and CNY 1.27 trillion of industrial products from China, accounting for 92.54% and 92.23% of total exports, respectively; China will import a total of CNY 1.23 trillion and CNY 1.27 trillion of industrial products from Japan and the ROK, accounting for 92.5% and 92.2% of total imports, respectively.

From the perspective of investment, Japan's actual investment in China's manufacturing industry is CNY 28.64 billion, accounting for 70.4% of Japan's total overseas direct investment; the ROK's actual investment in China's manufacturing industry is CNY 39.2 billion, accounting for 80.3% of the ROK's total overseas direct investment. In the regional cooperation between CJK, the manufacturing industry always maintains the main position of the supply chain system

Table 1 China's exports of industrial products to Japan and the ROK in 2022 (unit: billion CNY)

	Category 6	Category 7	Category 15	Category 16	Category 17	Category 18	Total of six categories of goods	Total of all goods	Industrial Products Share
Japan	1680.2	874.40	1138.4	6354.9	1050.6	1206.8	12305.50	13297.99	92.54%
ROK	1553.7	976.00	720.32	8610.3	121.47	737.51	12719.40	13790.78	92.23%

source General Administration of Customs of China

Intermediate Goods Supply Chain Becoming a New Trend

The intermediate goods supply chain is an important support for foreign trade and has become a new trend to promote the development of the supply chain, reflecting the closeness of supply chain and industrial chain cooperation among different countries. In the regional supply chain of CJK, China is in the downstream position with a high proportion of intermediate goods imports; Japan and the ROK are in the upstream place with a high proportion of intermediate goods exports and relatively low imports. 2019, China's total imports of intermediate goods reached USD 1.58 trillion, accounting for 60.6% of goods imports, 14%p higher than the world average; Japan and the ROK's exports of intermediate goods accounted for 50.1% and 63.8% of goods exports in 2019, Japan and the ROK are China's third and fifth largest sources of imports, respectively; in 2021, the ROK and Japan are China's third and fourth most significant sources of imports respectively.

Blocking of Production Networks Becoming a New Driving Force for Industrial Synergy

Under the trend of global integration, the advantages of regional economic integration are highlighted, and industrial synergy development has become a new driving force. Global production networks gradually show blocking characteristics, and blocking of production networks has become a new direction and driving force for future industrial synergy. For example, in 2020, the U.S.-Mexico-Canada (USMCA) agreement, showing obvious regionalization characteristics, to enhance the ROO profit, to further raise the threshold of zero tariffs for auto parts, the amount of increase reached 12.5%. In 2021 year-end, the world's regional trade agreements in force have reached 353, more than double of 2007's 165 regional trade agreements. The global economic chain as a whole, with the development of industry refinement, each industry chain presents a close intertwined connection, and a large number of links in the chain need to be realized through cooperation between countries.

The block industry chain of CJK has formed new advantages under the promotion of industrial synergy. China still relies on imports in some of the high-precision links, while Japan and the ROK are important export sources of electromechanical and precision instrument component products. In 2022, China's total imports of electromechanical products from Japan and the ROK will be CNY 635.490 and CNY 861.036 billion; total imports of precision instruments will be CNY 120.683 billion and CNY 73.731 billion. In the future, China will become an important component of regional economic integration, and the production network will be characterized by blocking, which will become a driving force for industrial synergy.



5.2.2 Supply Chain Trends and Management of Japan

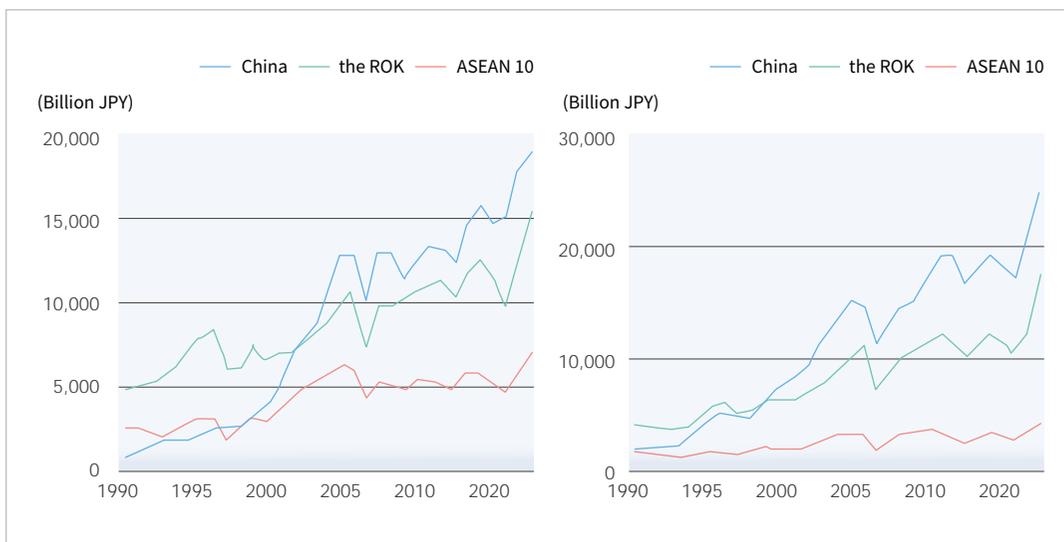
China and the ROK are crucial trading partners for Japan due to their geographic proximity and large market size. In 2022, China was Japan's largest export and import partner, accounting for about 20% of its total exports and imports (Table 2). Likewise, the ROK ranked as Japan's third-largest export partner and seventh-largest import partner. Considering these three countries as a single region, Japan's intra-regional trade dependency ratio is 26.6% for exports and 24.8% for imports, which represents approximately a quarter of its total trade.

Table 2 Japan's Major Trading Partners in 2022

Export Partners				Import Partners		
		Export Value (Billion JPY)	(%)		Import Value (Billion JPY)	(%)
1	China	19,004	19.4%	China	24,843	21.0%
2	USA	18,255	18.6%	USA	11,733	9.9%
3	the ROK	7,106	7.2%	Australia	11,612	9.8%
4	Chinese Taipei	6,857	7.0%	UAE	6,019	5.1%
5	Hong Kong	4,357	4.4%	Saudi Arabia	5,569	4.7%
6	Thailand	4,269	4.3%	Chinese Taipei	5,097	4.3%
7	Singapore	2,935	3.0%	the ROK	4,416	3.7%
	China + the ROK	26,110	26.6%	China + the ROK	29,260	24.8%

Source Ministry of Finance (MOF).

If we examine the long-term trends, Japan's trade in the region has experienced significant growth over the past three decades (Figure 2). Moreover, as highlighted in Chapter 4, both Japan's exports and imports with these two countries reached record levels in 2022. Despite facing significant external challenges during this period, such as the global financial crisis, the Great East Japan Earthquake, escalating trade tensions between the U.S. and China, a pandemic outbreak, and Russia's invasion of Ukraine, the upward trajectory indicates that the supply chains established in the region have demonstrated greater stability and resilience than anticipated.

Figure 3 Trends in Japan's Trade with China, the ROK, and ASEAN
Japan's Exports
Japan's Imports


Source Ministry of Finance (MOF).

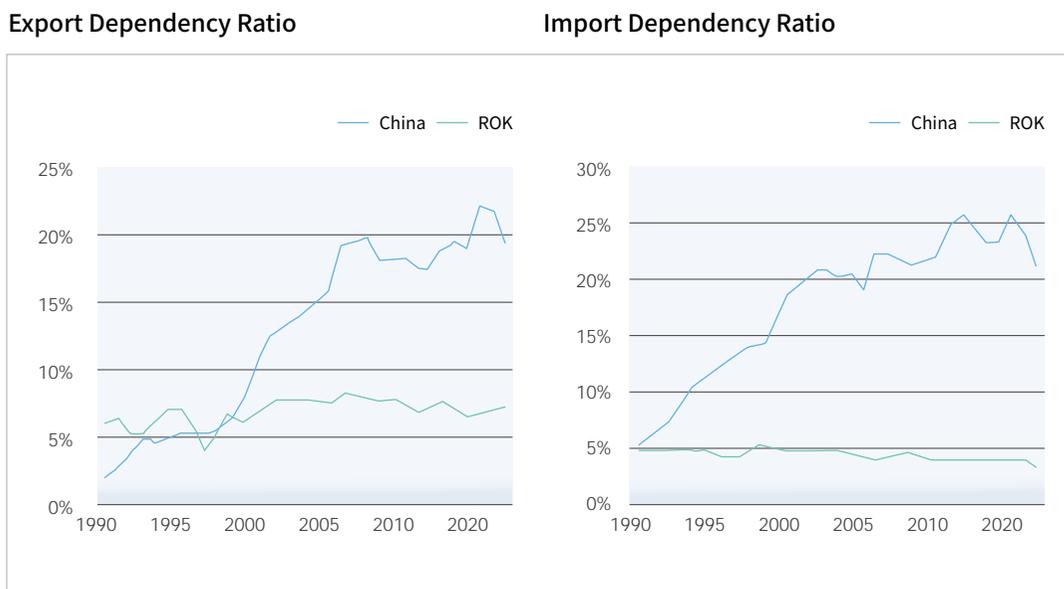
In particular, trade between Japan and China has experienced rapid growth since the 2000s. When comparing 2022 with the year 2000, just before China's accession to the WTO, Japan's exports to China increased by almost sixfold, while its imports from China nearly quadrupled. This remarkable expansion can be attributed not only to the implementation of open trade and investment policies by both countries but also to the enhanced quality of trade-related infrastructure, including customs clearance procedures, and the dramatic progress and diffusion of information communication and transportation technologies. These have played a crucial role in reducing the trade-related transaction costs faced by firms in the region.

Trade between Japan and the ROK peaked in 2007, coinciding with the global financial crisis, and has experienced sluggish growth in subsequent years. However, since 2021, the year following the outbreak of the pandemic, trade between the two countries has been expanding steadily. Over the past two decades, both exports and imports between Japan and the ROK have doubled. This positive trend is expected to continue, fueled by ongoing tariff reductions under RCEP.

As a result of this trade expansion in the region, Japan's intra-regional trade dependency ratio has increased over the past 30 years (Figure 4). Its export dependency on China was 10% in 2002, surpassed 20% in 2011, and peaked at 22% in 2020. Similarly, Japan's import dependency on China was 10% in 1994, exceeded 20% in 2003, and peaked at 25% in 2020. Several factors have

contributed to the recent decrease in dependence on China, including rising labor costs in China, the consequent relocation of production bases to other countries, an increase in local production and procurement within China, and the temporary economic slowdown caused by the pandemic outbreak.

Figure 4 Japan's Trade Dependency on China and the ROK



Source Ministry of Finance (MOF).

On the other hand, based on the findings of a survey conducted by JETRO in August 2022, approximately 94% of Japanese firms operating in China expressed their intentions to maintain or expand their business scale, while around 5% indicated they would downsize, and only 1.4% stated their plans to withdraw or relocate to a third country (JETRO, 2022, 9). This underscores the continued recognition of China as a promising market and production base by Japanese firms. Similarly, 95% of Japanese firms in the ROK responded that they would expand or maintain their operations, further highlighting the positive outlook for the ROK's market.

The claim that a sophisticated international division of labor exists in this region is supported by the fact that intermediate goods drive trade in the region. As depicted in Table 3, intermediate goods constitute over 60% of Japan's exports to both countries, indicating its role as a key supplier of goods that are essential for production activities in the region.

Table 3 Japan's Trade Value by Goods Type

Japan's exports to China Million USD

	Primary Goods	%	Intermediate Goods	%	Final Goods	%	Total
2000	523.6	1.3%	30,170.0	72.7%	10,807.4	26.0%	41,501.0
2010	4,375.7	2.6%	111,940.9	65.5%	54,696.4	32.0%	171,013.0
2019	1,573.1	1.0%	102,290.8	64.2%	55,426.3	34.8%	159,290.2
2020	1,445.5	0.9%	102,794.8	63.4%	57,769.8	35.7%	162,010.1

Japan's imports from China

	Primary	%	Intermediate	%	Final	%	Total
2000	3,231.4	5.9%	13,945.7	25.5%	37,480.4	68.6%	54,657.4
2010	2,837.0	2.0%	49,368.8	34.6%	90,412.3	63.4%	142,618.2
2019	2,232.1	1.4%	57,248.6	37.1%	94,840.7	61.5%	154,321.4
2020	2,002.1	1.3%	49,884.6	33.3%	97,882.1	65.4%	149,768.8

Japan's exports to the ROK

	Primary	%	Intermediate	%	Final	%	Total
2000	286.8	0.9%	22,289.9	70.0%	9,247.7	29.1%	31,824.3
2010	1,841.0	2.9%	45,500.1	71.8%	16,052.0	25.3%	63,393.2
2019	1,978.5	4.5%	31,471.6	71.1%	10,784.8	24.4%	44,235.0
2020	1,488.5	3.6%	29,144.0	70.5%	10,722.6	25.9%	41,355.1

Japan's imports from the ROK

	Primary	%	Intermediate	%	Final	%	Total
2000	233.5	1.2%	12,214.2	60.7%	7,684.7	38.2%	20,132.5
2010	746.2	2.8%	19,997.5	74.8%	6,005.9	22.5%	26,749.6
2019	559.7	2.1%	20,251.6	74.6%	6,326.2	23.3%	27,137.4
2020	581.7	2.4%	17,022.1	70.9%	6,417.0	26.7%	24,020.9

Note Intermediate goods include processed goods and parts and components, while final goods include capital goods and consumption goods.

Source Adapted from RIETI-TID (RIETI Trade Industry Database).

In contrast, over 60% of Japan's imports from China are final goods. However, the proportion of these goods has decreased over the past two decades, signaling the increasing significance of China as a supplier of intermediate goods to Japan. Similarly, over 60% of the ROK's exports to Japan are intermediate goods, indicating that trade between the two countries is driven by trade in intermediate goods in both directions.

Looking at the change in trade values from 2019 to 2020, it can be seen that exports from Japan to China increased for both intermediate goods and final goods, despite the pandemic. Conversely, Japan's imports from China during the same period saw a 3.2% increase for final goods but a 12.9% decrease for intermediate goods. Likewise, trade in intermediate goods between Japan and the ROK was also affected, with Japan's exports to the ROK declining by 7.4% and Japan's imports from the ROK decreasing by 15.9%. Although Japan's trade with China and the ROK has recovered since 2021, the three countries should explore measures to minimize the short-term negative impacts on regional trade when faced with external shocks.

Finally, if we look at the data on trade in value-added, it becomes evidently show that the structure of Japan's trade with China and the ROK has changed dramatically over the past two decades (Table 4). In 2000, the year before China joined the WTO, China and the ROK's value-added in Japan's exports had accounted for 0.6% and 0.3% respectively. However, by 2018, these figures expanded to 2.8% and 0.7%. This indicates that Japanese firms have actively developed their participation in regional supply chains. In particular, the share of China's value-added in Japanese exports has reached 4.5% in “computer, electronic, and optical products” , and it exceeds 3% in “automotive” and “machinery and equipment” . While the ROK's value-added share in Japan's exports has also gradually increased over the past two decades, it remains relatively low compared to that of China.

Table 4 Origin of Value Added in Gross Exports of Japan, China, and ROK
Japan's Gross Exports

	2000			2010			2018		
	Total			Computer, Electronic & Optical Products					
China's VA	0.6%	1.9%	2.8%	0.7%	2.6%	4.5%			
Japan's VA	92.5%	86.7%	82.8%	91.7%	86.5%	81.3%			
ROK's VA	0.3%	0.5%	0.7%	0.5%	0.6%	0.9%			
	Motor Vehicles			Machinery and Equipment					
China's VA	0.6%	2.4%	3.6%	0.6%	2.4%	3.4%			
Japan's VA	91.6%	86.4%	79.4%	93.3%	87.0%	83.0%			
ROK's VA	0.3%	0.6%	0.9%	0.3%	0.6%	0.9%			

China's Gross Exports

	2000			2010			2018		
	Total			Computer, Electronic & Optical Products					
China's VA	82.5%	80.8%	82.8%	68.4%	71.1%	72.9%			
Japan's VA	3.9%	2.6%	1.5%	8.7%	5.0%	3.2%			
ROK's VA	1.5%	1.7%	2.0%	2.9%	4.3%	5.8%			
	Motor Vehicles			Machinery and Equipment					
China's VA	87.3%	82.8%	85.9%	81.0%	79.1%	82.6%			
Japan's VA	3.1%	3.3%	1.6%	4.3%	3.1%	2.0%			
ROK's VA	0.8%	1.2%	1.0%	1.2%	1.2%	1.7%			

Korea's Gross Exports

	2000			2010			2018		
	Total			Computer, Electronic & Optical Products					
China's VA	1.4%	4.3%	5.2%	1.4%	6.0%	7.0%			
Japan's VA	5.9%	5.1%	2.7%	7.5%	6.1%	3.1%			
ROK's VA	70.8%	63.2%	68.0%	71.4%	65.5%	72.9%			
	Motor Vehicles			Machinery and Equipment					
China's VA	1.3%	4.8%	6.4%	1.2%	4.8%	5.9%			
Japan's VA	11.4%	6.2%	3.7%	8.1%	7.3%	4.0%			
ROK's VA	63.8%	67.6%	68.9%	72.2%	64.4%	71.2%			

Note "VA" stands for value added.

Source Adapted from OECD Trade in Value Added (TiVA) database.

Conversely, the share of Japan's value-added in China and the ROK's exports has declined over the past two decades. It is important to acknowledge that the value added generated by Japanese firms involved in production activities in China and the ROK is not counted as Japanese value-added. Furthermore, some Japanese firms have relocated their production bases from China and the ROK to ASEAN and other countries. Nonetheless, the share of the ROK's value-added in China's total exports has gradually increased, especially in computer, electronic, and optical products. This indicates a gradual decrease in the relative presence of Japanese firms within the Northeast Asian supply chain.

(Initiatives to Strengthen Supply Chains in Japan)

Since 2020, severe vulnerabilities in supply chains have been exposed in Japan, leading to a proliferation of calls within the country to resolve these issues. For instance, when the pandemic broke out, imports of Personal Protective Equipment (PPE) from China, a major supplier to Japan, suddenly came to a halt. Consequently, Japan faced a shortage of these essential products, triggering panic buying and a significant increase in prices. This situation prompted many citizens to acknowledge the risks associated with relying on other countries for products that protect people's lives and health.

During the pandemic, numerous countries implemented export restrictions to secure medical supplies for their own citizens. In principle, the WTO Agreement prohibits members from invoking quantitative export restrictions (GATT Article 11.1). However, as exceptions, the agreement permits members to temporarily restrict exports in order to prevent or relieve critical shortages of essential products for their domestic market, as well as to implement measures necessary for the protection of human life or health (GATT Article 11.2 (a) and Article 20 (b)). In response to the successive invocation of export restrictions by many countries, policymakers worldwide, including those in Japan, have recognized that the existing WTO rules do not necessarily offer a comprehensive solution for maintaining supply chains of vital goods like medical supplies which are crucial for protecting people's lives and health.

Supply chain vulnerabilities were also exposed in the electronics and automotive industries, both of which have sophisticated value chains established in East Asia. Since 2020, the pandemic and various natural disasters have caused disruptions in the supply of parts and components, resulting in bottlenecks and production delays in upstream industries. In a previous study conducted by Hayakawa and Mukunoki (2021), it was found that countries importing parts from countries heavily affected by the pandemic experienced a statistically significant decrease in their exports of machinery products.

As individuals have witnessed and experienced the potential vulnerabilities in supply chains, their concerns have grown. In response, the Japanese government has shifted its policy focus from solely pursuing economic efficiency to prioritizing the establishment of resilient supply chains (METI, 2020, p.76). To address supply shortages of medical supplies and semiconductors during the pandemic, the government has initiated subsidy programs aimed at supporting the relocation of production bases to Japan or the diversification of production across multiple countries. These measures are particularly targeted at items that have concentrated production bases in a few countries or those that directly impact the lives and health of the people.

On the other hand, it is worth noting that geographically dispersed supply networks offer enhanced resilience. When the supply sources for a specific item are spread across different countries, it becomes easier to substitute supplies from alternative sources, even in the event of disruptions caused by natural disasters or pandemics. Therefore, considering Japan's vulnerability to natural disasters such as earthquakes, volcanic eruptions, and floods, merely relocating production bases back to the country may not necessarily lead to risk minimization.

A study examining the factors influencing supply chain robustness and resilience during a pandemic also discovered, utilizing firm-level data sets from ASEAN and India, that firms with a greater diversity of suppliers and customers across different geographical locations exhibited greater flexibility in adapting with regards to their business partners when faced with supply chain disruptions. As a result, these firms were better equipped to mitigate the resulting damage (Todo et al., 2022).

In 2021, with the advent of the Kishida administration, the Japanese government embarked on a comprehensive endeavor to tackle various economic security concerns. In October 2021, a ministerial position dedicated to economic security was established, and preparations commenced to draft comprehensive legislation addressing these issues. In May 2022, the Economic Security Promotion Act was enacted, positioning measures to strengthen supply chains as one of the main pillars of the Act.

The law identifies critical products that exhibit high dependency on a few countries and are essential for economic activities or the lives and health of the population. Its objective is to bolster the resilience of supply chains for these products through government subsidies for associated industries and establishment of stockpiles. In December 2022, a total of 11 products, including semiconductors, storage batteries, critical minerals, and natural gas, were officially designated as key products. The government has already commenced providing support to ensure stable supplies of these products.

Furthermore, in recent years, Japan has actively engaged in collaborative efforts with other countries to strengthen supply chains. These initiatives encompass partnerships such as the Japan-US, Japan-EU, Quad (Japan-Australia-India-US), and Indo-Pacific Economic Framework (IPEF), which involves 14 countries, including Quad members, the ROK, and seven ASEAN countries.

In this manner, the Japanese government has initiated measures to reinforce supply chains through market intervention for critical products that face economic security risks. Conversely, for non-critical goods, continuous efforts have been made to maintain and enhance efficient and dynamic supply chains by adhering to rules-based trading systems such as the WTO and FTAs. Notably, since the mid-2010s, Japan has successfully concluded mega-FTAs, including the CPTPP, the Japan-EU-EPA, and RCEP, in addition to a trade agreement with the US and an EPA with the UK. As a result, the proportion of Japan's trade with its FTA partners has reached 78.8% of its total trade value (METI, 2022, p. 390).

A recent study utilizing firm-level micro data indicated that companies participating in global value chains experience a gradual increase in productivity over time, suggesting the importance of their continued participation in GVCs (Urata and Baek, 2022). To ensure that Japanese firms maintain their active involvement in the regional value chain, it is essential to ensure an open and stable trade and investment environment, with FTAs like RCEP continuing to play a critical role in achieving this objective.

To this end, efforts have been made in Japan to enhance the usability of existing trade agreements for businesses and further facilitate trade. These initiatives include the development and distribution of software to streamline the preparation of certificate of origin applications, the digitization of paper-based certificates of origin, and the implementation of seminars aimed at assisting SMEs in optimizing the utilization of EPAs (METI, 2022, p. 395).

5.2.3 Supply Chain Trends and Management of ROK

The ROK is a highly trade-dependent country with its trade volume over GDP reaching about 80%, compared to China's figure of 37%, Japan's 37%, the US' 25% and UK's 57% in 2021 according to the World Bank development indicators. As a consequence, the ROK is heavily integrated in international trade, but becoming highly vulnerable to external influences via its major trading partners, especially China and the United States. Table 5 shows that China is the ROK's the largest export partner, accounting for 22.7% of the ROK's total exports in 2022, followed by the United States at 16.0%, Vietnam at 8.9%, Japan at 4.4%, and Hong Kong at 4.0%, respectively. The ROK

imports 21% of its total imports from China, 11% from the United States, 3.6% from Vietnam, 7.4% from Japan, and 3.9% from Taiwan . Most notable is the relatively high share of ASEAN in the ROK's total trade with 18.2% in the ROK's total exports and 11.2% in the ROK's total imports.

Table 5 The ROK's Trade with Major Trading Partnering Countries in 2022

Economy	(USD million, %)						
	Exports	Ratio	Imports	Ratio	Balance	Total Trade	Ratio
China	155,789	22.7	154,576	21.1	1,213	310,365	21.9
United States	109,766	16	81,785	11.1	27,981	192,550	13.6
Vietnam	60,964	8.9	26,725	3.6	34,239	87,689	6.1
Japan	30,606	4.4	54,712	7.4	-54,106	85,318	6.0
Hong Kong	27,651	4.0	1,878	0.2	25,734	53,385	3.7
India	18,870	2.7	8,897	1.2	9,973	27,767	1.9
Singapore	20,205	2.9	10,348	1.4	9,857	30,553	2.1
Taiwan	26,198	3.8	28,275	3.9	-2,076	54,473	3.8
Australia	18,753	2.8	44,929	6.1	-26,176	63,682	4.5
Mexico	12,654	1.8	8,577	1.1	4,077	21,231	1.5
ASEAN	124,889	18.2	82,529	11.2	42,359	207,448	14.6
Global Total	683,585	100.0	731,370	100	47,785	1,414,955	100.0

Note Grand total refers to the ROK's total trade with all world trading partners.

Source Adapted from *Exports and Imports with Major Trading Partners*, by K-Stat of Korea International Trade Association (KITA). Retrived April 25, 2013, from <https://stat.kita.net/stat/world/major/KoreaStats06.screen>

According to a study by Petri and Plummer (2020, p.8), under the assumption of business as before, RCEP will add USD 186 billion to the world economy and 0.2% to its members' GDP permanently. These benefits will go largely to CJK, with gains of USD 85, USD 48 billion, and USD 23 billion respectively. They offered two basic reasons why the CJK states would gain so much from the RCEP agreement: first, their combined economic size is very large, accounting for 80 % of RCEP GDP; second, they are not jointly any member of other existing free trade deals, except for the shallow China-the ROK FTA (Petri and Plummer, 2020, p.10)

The ROK's supply chain integration with the world economy can be observed clearly by examining the ROK's export and import structures by processing stage. Table 6 shows that the portion of intermediate goods in the ROK's export structure consistently rose over the period of 2010-2022, increasing from 59.2% in 2010 to 74.2% in 2022. However the share of capital goods decreased from 29.2% in 2010 to 13.0% in 2022. Both primary and consumer goods exports remained almost constant over time at around 0.4% and 11% respectively. The trend implies that the ROK has increasingly been involved in forward linkage integration with RCEP economies, in particular ASEAN given its relatively high trade linkage with the ROK as suggested in Table 4, 5, and 6 of Chapter 4 and Table 5 of Chapter 5.

Table 6 The ROK Export Structure by Processing Stage (USD million,%)

Year	Primary	Consumer	Capital Goods	Intermediates	Other	Total
2010	2,075 (0.4)	52,039 (11.2)	136,052 (29.2)	275,896 (59.2)	321 (0.1)	466,384
2011	2,804 (0.5)	63,478 (11.4)	149,898 (27.0)	338,656 (61.0)	377 (0.1)	555,214
2012	2,383 (0.4)	65,056 (11.9)	133,994 (24.5)	346,002 (63.2)	435 (0.1)	547,870
2013	2,371 (0.4)	67,455 (12.1)	131,470 (23.5)	357,673 (63.9)	663 (0.1)	559,632
2014	2,289 (0.4)	69,237 (12.1)	133,233 (23.3)	367,341 (64.1)	565 (0.1)	572,665
2015	2,114 (0.4)	67,248 (12.8)	126,892 (24.1)	329,965 (62.6)	538 (0.1)	526,757
2016	1,931 (0.4)	66,198 (13.4)	109,273 (22.1)	317,163 (64.0)	860 (0.2)	495,426
2017	2,250 (0.4)	65,202 (11.4)	124,615 (21.7)	379,838 (66.2)	1,790 (0.3)	573,694
2018	2,391 (0.4)	64,388 (10.6)	103,851 (17.2)	432,140 (71.4)	2,089 (0.3)	604,860
2019	2,301 (0.4)	66,780 (12.3)	88,642 (16.3)	383,377 (70.7)	1,132 (0.2)	542,233
2020	2,481 (0.5)	64,728 (12.6)	82,041 (16.0)	361,511 (70.5)	1,737 (0.3)	512,498
2021	3,940 (0.6)	78,174 (12.1)	95,411 (14.8)	465,398 (72.2)	1,478 (0.2)	644,400
2022	4,412 (0.6)	80,957 (11.8)	89,139 (13.0)	507,325 (74.2)	1,751 (0.3)	683,585

Source Adapted from *Exports and Imports by Processing Stages*, by K-Stat of Korea International Trade Association (KITA) Retrieved April 25, 2013 from <https://stat.kita.net/stat/kts/use/Beclist.screen>.

However, the ROK's import structure by processing stage (Table 7) reveals quite a different pattern from the export structure. Having a paucity of natural resource endowments, the ROK's imports of primary products exhibited, on average, 24.6% of its total imports, compared to only 0.4% of primary exports during the years 2010-2022. The ROK's intermediary imports consistently shared an average of approximately 50%.

The trend suggests that the ROK has heavily involved itself in backward linkage integration with its trading partners, implying that it tends to import raw materials and low-end intermediate goods abroad to process them as middle- and high-end intermediate inputs and then exports them. Therefore, the circular supply chain links of the ROK are apparent from the varying structures of its exports and imports by processing stage. Combining the special features of the ROK's export and import structure, the ROK should maintain robust and resilient supply chain mechanisms with RCEP economies to ensure sustainable growth.

Table 7 The ROK's Import Structure by Processing Stage (USD million, %)

Year	Primary	Consumer	Capital Goods	Intermediates	Other	Total
2010	112,875 (26.5)	34,302 (8.1)	58,782 (13.8)	218,751 (51.4)	502 (0.1)	425,212
2011	163,480 (31.2)	42,675 (8.1)	62,556 (11.9)	255,326 (48.7)	376 (0.1)	524,413
2012	165,029 (31.8)	43,334 (8.3)	57,852 (11.1)	252,915 (48.7)	455 (0.1)	519,584
2013	149,588 (29.0)	46,777 (9.1)	56,395 (10.9)	262,506 (50.9)	320 (0.1)	515,586
2014	143,810 (27.4)	54,239 (10.3)	61,188 (11.6)	265,915 (50.6)	363 (0.1)	525,515
2015	93,271 (21.4)	57,302 (13.1)	60,786 (13.9)	224,687 (51.5)	453 (0.1)	436,499
2016	78,985 (19.4)	59,792 (14.7)	59,218 (14.6)	207,476 (51.1)	721 (0.2)	406,193
2017	105,020 (21.9)	59,694 (12.5)	79,180 (16.5)	232,289 (48.5)	2,295 (0.5)	478,478
2018	129,800 (24.3)	67,840 (12.7)	77,141 (14.4)	257,894 (48.2)	2,527 (0.5)	535,202
2019	116,764 (23.2)	69,025 (13.7)	65,258 (13.0)	249,869 (49.6)	2,427 (0.5)	503,343
2020	85,847 (18.4)	69,435 (14.8)	74,955 (16.0)	234,660 (50.2)	2,737 (0.6)	467,633
2021	127,993 (20.8)	80,735 (13.1)	90,861 (14.8)	313,015 (50.9)	2,489 (0.4)	615,093
2022	180,939 (24.7)	87,443 (12.0)	89,123 (12.2)	371,213 (50.8)	2,652 (0.4)	731,370

Source Adapted from Exports and Imports by Processing Stages, by K-Stat of KITA. Retrived April 25, 2013 from <https://stat.kita.net/stat/kts/use/Beclist.screen>

In terms of the ROK's trade dependence, and for that matter FDI, China has decisively been the largest trading partner (Table 6 and 7). A big question arises as to how the ROK should resolve any risks involved in excessive dependence on China, which is also shifting to a more self-sufficient system in order to minimize serious fallouts due to the US sanctions it faces in the area of strategic commodities while seeking multiple diversified sources of critical materials from the nations along its belt and road initiatives. In this context, the ROK is reassessing the risks to existing supply chains in order to come up with alternative outsourcing strategies.

To avoid harmful production halts and subsequent costly ripple effects on the entire economy due to the on-going pandemic or similar disease outbreaks in the future, natural disasters caused by climate change, and geopolitical confrontations, the ROK must diversify its supply chain connectivity with resource-rich economies elsewhere in the world. In this context, the ROK should seek out alternative strategic partners to obtain critical materials via deepening trade linkages and ODA programs as well. Four key ROK industries are particularly vulnerable to supply chain interruptions: semiconductors, large storage batteries, users of rare earths and lithium, and producers of medical supplies. The ROK should consider “just-in-case” policies for supply chain resilience including inventory accumulation, deviating from its previous emphasis on immediate cost factors (Yusuf and Leipziger 2022).

In order to ensure a resilient supply chain system, the ROK also needs to take a look at outbound and inbound FDI flows in connection with its trade patterns, given a salient trade and investment nexus. Cross-border investment and trade tend to reinforce each other, enhancing trade-investment liberalization and facilitation. As a result, most recent FTAs have typically been comprehensive and include an investment chapter to ensure FDI protection on a level playing field. The ROK's multi-track FTAs and active FDI promotion/aftercare services for international investors is likely to help elevate it into a highly competitive and attractive investment destination (Ahn chapter 2, forthcoming 2023)

Given the changing regional economic dynamics in Northeast Asia, basically referring to CJK, the ROK has developed the concept of a becoming Northeast Asian business hub to serve as a bridge between southbound Pacific Ocean economies and northbound continental economies. This was intended to help overcome natural resource limitations and to sway North Korea toward embracing an open door policy. This business hub strategy envisions the ROK as a competitive regional center in two particularly critical areas through a) a logistical hub using major port-centric sea ports such as Busan and Incheon, and b) a business finance hub located in Seoul that attracts the Asian headquarters of global financial companies (Ahn chapter 2, forthcoming).

In order to assess the ROK's supply chain management, it is necessary to review its interactions

with ongoing minilateral, multilateral, and regional architectures. Successive governments have been pursuing a business hub strategy by means of the New Southern and New Northern policy under the previous Moon Jae-in government and now an Indo-Pacific strategy under the Yoon Suk-yeol government. The ROK's Indo-Pacific strategy envisions “freedom, peace, and prosperity” in the region, which includes the RCEP bloc as a major regional component. The ROK added this “prosperity” component to the US-initiated notion of a “free and open Indo-Pacific.” Thus, the aim is basically to ensure a rule-based, inclusive, and prosperous Indo-Pacific without decoupling any other countries from the regional community.

Since starting to actively induce FDI in the late 1990s, it is true that the ROK has underperformed in attracting FDI relative to the size and sophistication of its economy (Ahn, forthcoming 2023). Before the COVID-19 Pandemic, the ROK attracted a yearly average of USD 13.2 billion on an arrival basis during the years of 2012-2019. The US Department of State highlights the ROK's complicated opaque and country-specific regulatory framework as one major culprit for its sluggish FDI inducement (USDS on Investment Climate Statements: South Korea, 2021). The ROK needs to proactively induce innovative MNEs that can collaborate with its domestic big-tech companies and venture startups so that they may remain competitive globally in sectors like semiconductors, hydrogen electric vehicles, automotive batteries, and LNG ships (Ahn, forthcoming).

In order to upgrade its high-tech industries and to ensure supply chain resilience for key intermediate inputs and strategic materials, the ROK is now undertaking a process of very comprehensive deregulation to adopt international best practices for attracting high quality FDI. For this purpose, a well-functioning aftercare service system called the Foreign Investment Ombudsman has been established to resolve a variety of grievances raised by MNEs doing their business in the ROK (Ahn, forthcoming).

In the highly uncertain and fragmented current trade landscape, the ROK is now very concerned about economic security, especially with regards to high-tech components and strategic materials. The country experienced a sudden disruption of supply chains during the height of the COVID-19 pandemic and also occasionally for other unpredictable geo-political reasons. Boosting the economic security architecture will certainly help reduce the risk of finding its export-dependence being subject to any economic coercion from the economic superpowers.

For this purpose, the ROK has made proactive interactions beyond RCEP with multiple multilateral initiatives such as the CPTPP, IPEF, Digital Economic Partnership Agreement, Chip 4 Act, and China-led AIIB. The ROK's recent much-touted global vision containing its Indo-Pacific manifesto aims to amplify economic diplomacy, enhance connections with lower- and middle-ranked economies, and embrace economic multilateral frameworks, while assuming greater

responsibility in regional and global geopolitics (Panda and Ahn, 2023). the ROK should be very active in safeguarding a rule-based liberal order in Asia-Pacific through a middle-power coalition with like-minded countries facing daunting risks due to unilateral protectionist measures by geoeconomic superpowers seeking to maintain their own national interests at the expense of smaller economies.

Against this backdrop, the ROK is working to align its R&D, innovation, and other strategic investments with those of the corporate sector in a better coordinated manner. There is a need to move from a typically “just-in-time” inventory management approach towards a “just-in-case” method that involves stockpiling of essential inputs to deal with increased uncertainty. The ROK government needs to take an active role in forging new alliances with countries in control of strategic inputs. It also needs to actively pursue an on-shoring policy by inducing inbound FDI through lucrative incentives and regulatory easing, while encouraging outbound FDI to build production capabilities abroad (Yusuf and Leipziger, 2022).



5.3 Strengthening Regional Supply Chain Linkages

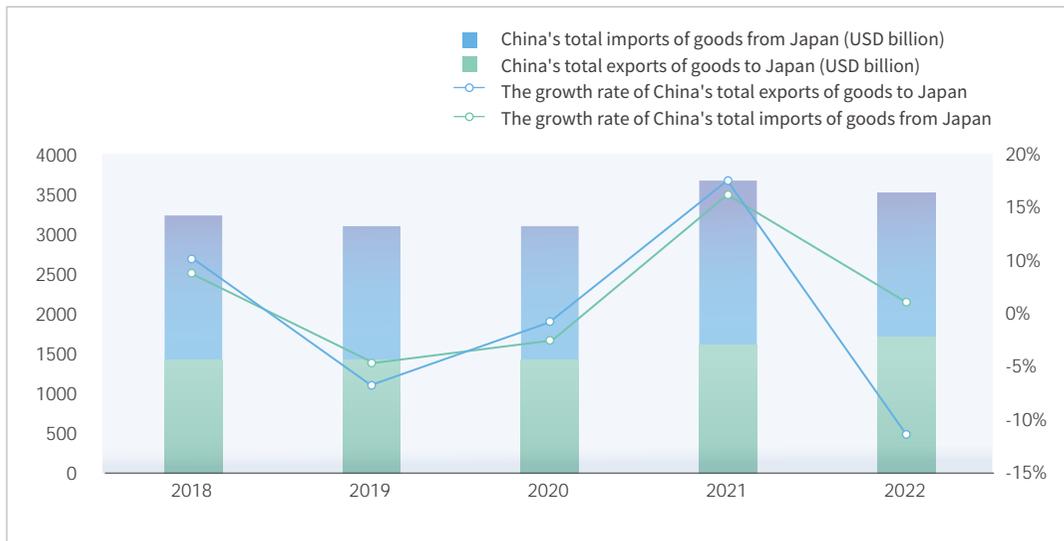
5.3.1 Strengthening China's Regional Supply Chain Linkages

Prior to the RCEP, trade cooperation relations among the RCEP member countries were more fragmented. For example, Japan, Australia and New Zealand were important parties to CPTPP; China established a strategic partnership with ASEAN in 2003, as well as a trade partnership with New Zealand in 2008 and trade partnerships with the ROK and Australia in 2015. However, China and Japan have not directly signed any FTA, nor have Japan and the ROK directly signed any FTA. Under the influence of factors such as politics and industrial structure, bilateral trades are carried out in accordance with WTO tariff standards without special preferences and trade arrangements. The signing of RCEP indirectly formed the China-Japan-ROK Free Trade Area, strengthened regional supply chain ties, and enabled CJK to form mutually open markets for the first time.

RCEP has promoted trade facilitation process between RCEP member countries at different levels, such as comprehensive tariff reduction or even zero tariff arrangements at the national level, ROO and preferential guidance at the enterprise level, and trade facilitation measures in goods at the customs level. These initiatives streamline the trade process and improve collaboration, bringing tangible benefits to importers/exporters and consumers across China. In the first year of RCEP's entry into effect, the total value of China's exports to Japan was USD 172.9 billion, a year-on-year increase of 4.4%; the total value of China's exports to the ROK was USD 162.6 billion, a year-on-year increase of 9.5%.

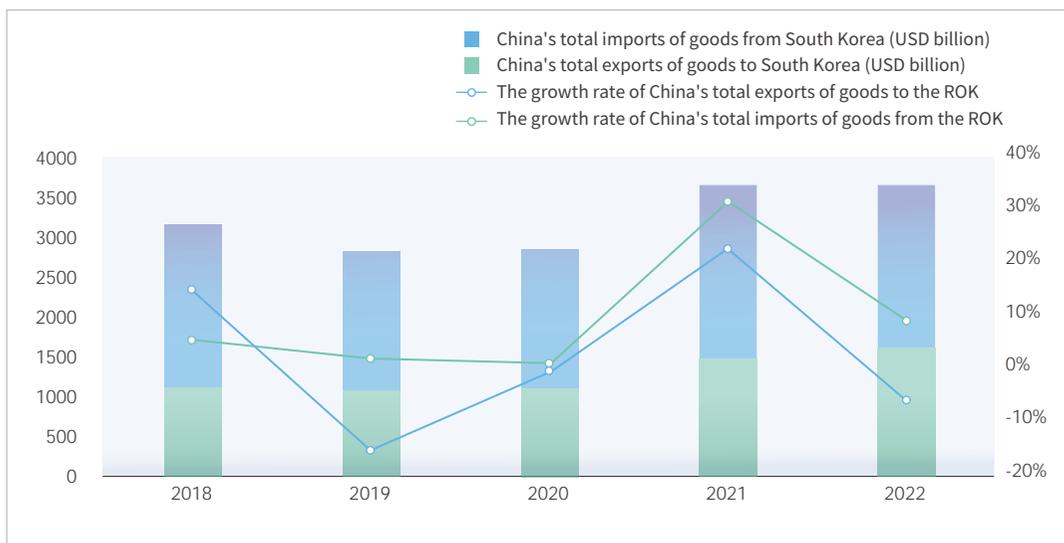


Figure 3 Import and Export Trade Volume between China and Japan from 2018 to 2022



source General Administration of Customs of China

Figure 4 Import and Export Trade Volume between China and the ROK from 2018 to 2022



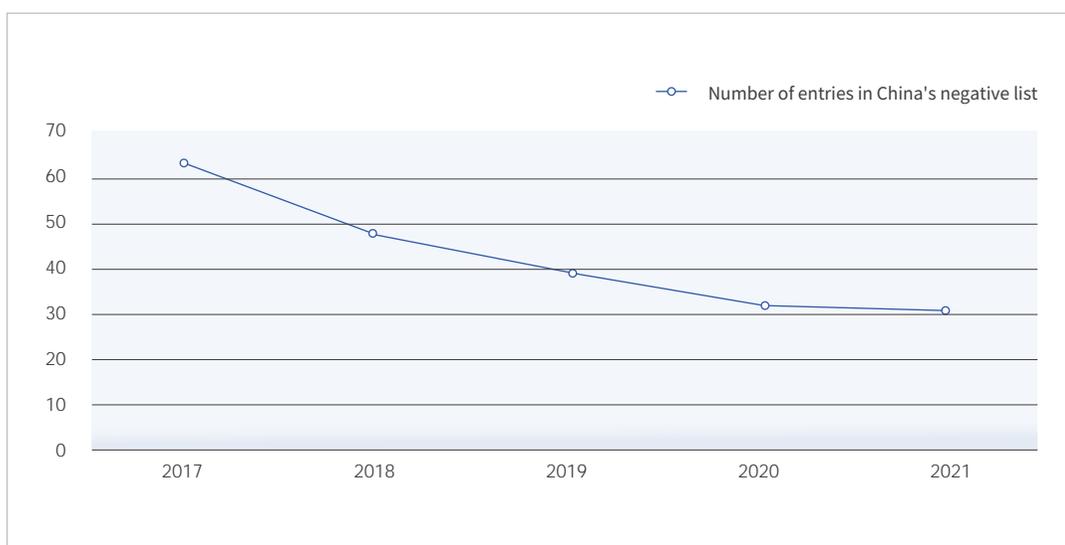
source General Administration of Customs of China

In order to build a global industrial and supply chain system that is secure, stable, smooth, efficient, open, inclusive, mutually beneficial, and able to reduce trade costs and maximize value, China established specific policies and measures, which include:

1. Promote the construction of the “Belt and Road” . China proposed the Belt and Road Initiative in 2013 to promote economic cooperation and connectivity among countries and regions along the route. As of early 2023, China has signed more than 200 cooperation documents with 151 countries and 32 international organizations to jointly build the Belt and Road. Promote the connection and coordinated development of regional supply chains by building a land-sea transportation network, promoting trade and investment liberalization and facilitation, and strengthening people-to-people exchanges.

2. Actively promote the implementation of FTA. China has signed FTA with a number of countries and regions, jointly built Free Trade Area (such as China-Australia Free Trade Area, China-ASEAN Free Trade Area, etc.), announced the overall plan for the construction of Hainan Free Trade Port, completed the signing of the RCEP, reduced the negative list for foreign investment access, further optimized the port business environment, and strengthened regional supply chain ties.

Figure 5 Number of Entries in China's Negative List from 2017 to 2021

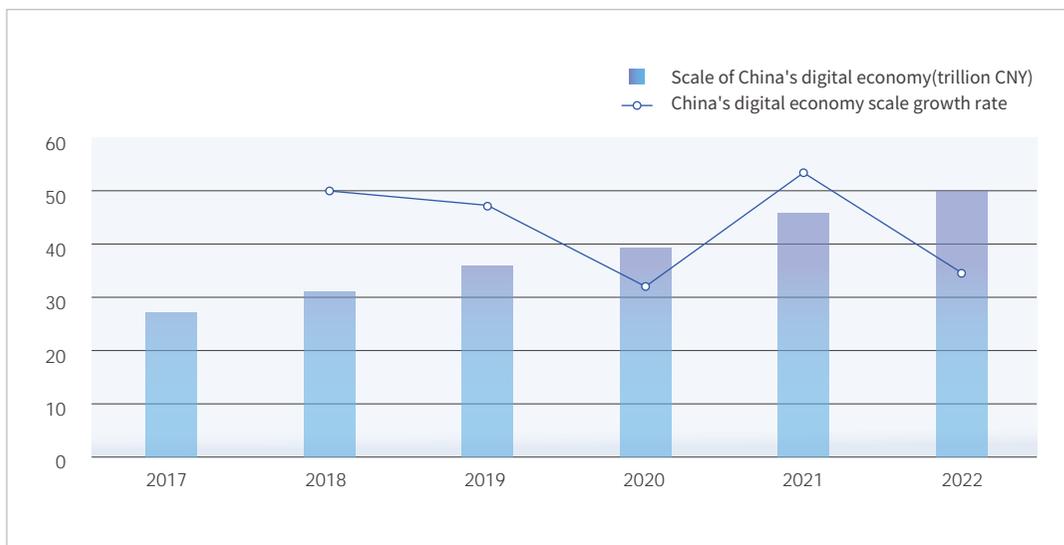


source Wind

3. Build a comprehensive pilot zone for cross-border e-commerce. China has set up cross-border e-commerce comprehensive pilot zones in many cities to promote cooperation and development between domestic and foreign e-commerce enterprises through the establishment of a series of facilitation policies and services, open up the “last mile” of cross-border e-commerce, and strengthen regional supply chain connections. For example, SF Group has established China’s first professional cargo hub airport, enabling more than 95% of domestic cities to connect with the rest of the world within 12~24 hours.

4. Promote the development of the digital economy. China has continuously strengthened digital infrastructure construction and digital technology research and development, and developed emerging fields such as e-commerce, cloud computing, and the Internet of Things, providing support and guarantee for the digitalization and intelligence of regional supply chains. In 2022, the scale of China’s digital economy reached CNY 50.2 trillion.

Figure 6 Scale and Growth Rate of China's Digital Economy from 2017 to 2022



source Wind

5. Strengthen talent training. China actively cultivates and introduces talents in supply chain management, trade, logistics and other aspects to provide a strong talent guarantee, and support for the coordinated development of regional supply chains.

5.3.2 Strengthening Japan's Regional Supply Chain Linkages

With the increasing concerns regarding vulnerability to natural disasters, pandemics, and geopolitical tensions, it is crucial for the three countries to address economic security concerns while working simultaneously to uphold a free and predictable rules-based trade regime. These policy objectives are essential in strengthening regional supply chains. And neglecting either aspect will preclude any fundamental solution to the problem from being found.

Therefore, it is imperative for the three countries to seek realistic and innovative solutions to pursue both objectives in a balanced manner, utilizing frameworks such as RCEP and trilateral dialogues. In so doing, it is crucial to avoid falling into the extreme dichotomy of “Free Trade or Economic Security.” To achieve this, the three countries should adopt an approach that categorizes goods into two groups: critical and non-critical goods. Critical goods are those whose sources of supply are concentrated in a few countries and whose supply chain disruption would cause significant losses to the economy and society of a region or a particular country.

Regarding critical goods, it is crucial to initiate discussions on granting countries certain rights to adopt measures that mitigate the risk of supply chain disruptions. The definition and scope of critical goods will vary among countries, depending on natural resource endowment, industrial structure, trade structure, and other factors. At the same time, the three countries should engage in discussions to establish the criteria for identifying goods as critical, while ensuring that the scope remains minimal to prevent the misuse and expansion of protectionist measures under the guise of supply chain strengthening. Moreover, the three countries should consider collaborating to provide each other with critical goods within the region in the event of supply chain disruptions, whenever feasible, and mutually refrain from imposing export restrictions.

Critical goods for which supply chains should be strengthened from the economic security perspective should be limited to a small portion of the numerous goods traded between the states, and most other goods should be classified as non-critical goods. When it comes to non-critical goods, there is limited justification for imposing trade and investment restrictions in the name of economic security. Excessive intervention in the market would undermine the dynamism of regional businesses, including small- and medium-sized enterprises, and hinder regional economic growth.

Therefore, it is desirable to encourage free trade in these goods and to further enhance the attractiveness of regional supply chains by upgrading existing agreements such as RCEP. An open trading system also plays a vital role in facilitating the swift exploration of alternative sources of supply and export markets in the event of supply chain disruptions. In this regard, the three

countries should take initiatives to further expand the amount of duty-free items in RCEP.

There are other areas in which the three can collaborate to strengthen intra-regional supply chains, such as improving the efficiency and resilience of customs procedures in the region. This would help minimize the negative impact on supply chains in the event of unforeseen external shocks including natural disasters and pandemics. Examples of related initiatives could include the digitization of customs procedures, providing 24-hour response capabilities to inquiries and consultations using AI, leveraging big data for customs screening, and offering technical assistance and capacity building to introduce these technologies to other RCEP member countries.

5.3.3 Strengthening the ROK's Regional Supply Chain Linkages

The RCEP economies are already integrated with each other based on different factor endowments, different stages of development, and a web of already effective bilateral FTAs. The smaller economies of RCEP are relatively dependent on RCEP, whereas big economies, especially the three largest economies, CJK, are much less dependent on it than the average RCEP economy. However, the collective trade volume of CJK dominates the entirety of intra-RCEP trade.

As an RCEP without India could be seen as half-baked, RCEP would be more robust with India's membership. India has shown rapid economic growth in recent years, being the most populous country and one with global economic power potential as the third largest economy in this decade. Fortunately, India has not withdrawn acrimoniously, so the door is still ajar for its signature. Some members might feel uneasy about a China-dominant RCEP without India. China needs to be more responsive to India's concerns. With India's RCEP membership, RCEP16 would likely become a highly formidable, more liberalized regional bloc and the largest entity of its kind in the world.

If RCEP continues to upgrade its quality to the level of the CPTPP with a reentering U.S., the two mega-deals could be converged strategically into a wider Asia-Pacific FTA in the future. This would likely constitute an instrumental building block for multilateralism, as envisioned by APEC's long-cherished goal of creating an Asia-Pacific Free Trade Area (Ahn, 2018). Therefore, RCEP members must demonstrate first that the liberalization of tariffs and NTBs must be implemented on schedule, and then they should move on upgrading the current agreement by introducing missing chapters that are covered by the CPTPP and liberalizing existing chapters further.

In the long term, many experts claim that a CPTPP without the US and China is doomed only

to limited success given the inevitably interdependent economic linkages between the two states. Fortunately, China has submitted a formal membership application to CPTPP. In order to cross over the entry threshold built into the CPTPP, China should carry out very comprehensive domestic reforms to embrace the required labor and environmental standards and resolve subsidy issues surrounding its vast state-owned enterprises. The ROK should also submit its CPTPP membership application as early as possible as the necessary domestic process is completed.

To facilitate a convergent path embracing RCEP and the CPTPP, CJK FTA negotiations, underway since 2012 but stalled after the 16th round in November 2019, need to be reactivated to provide new momentum for RCEP and Asia-Pacific-wide economic integration. All the negotiating members of both the CPTPP and RCEP constitute the Asia-Pacific Economic Cooperation (APEC) entity. Although the APEC process has been slow and non-binding, the US, China, Japan, and the remaining APEC member states have been fully committed to APEC's ideal for an Asia-Pacific community, specifically a Free Trade Area of the Asia-Pacific (FTAAP). It is critically important to sustain this vision and to see it realized via the amalgamation process outlined above.

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ASEAN+3 Regional Financial Cooperation: Past, Present, and Prospects

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ASEAN+3 Regional Financial Cooperation: Past, Present, and Prospects



6.1 Evolution of ASEAN+3 Regional Financial Cooperation

6.1.1 Regional Financing Arrangement

The Asian Financial Crisis (AFC) of 1997-98 was a defining moment in the evolution of ASEAN+3 financial cooperation. The crisis devastated the banking and corporate sectors and caused deep economic stagnation in Thailand, Indonesia, Malaysia, and the ROK.¹ These crisis-hit countries had major macroeconomic and financial weaknesses in the pre-crisis period: large short-term private external debt in foreign currencies, de facto pegged exchange rate policies, and weak banks and regulatory oversight. They were exposed to the so-called “double mismatch” problem—mismatches in currency and maturity—as corporates borrowed short-term funds from abroad in foreign currency, while making long-term investments in real assets in local currency. With weak regulatory oversight, their financial systems developed vulnerabilities which eventually led to banking crises. Following the AFC, regional authorities overhauled their policy and regulatory frameworks to strengthen macroeconomic fundamentals and financial systems and embarked on regional financial cooperation to avoid a repeat of similar crises. ASEAN+3 finance ministers launched a new regional policy dialogue process, the Chiang Mai Initiative (CMI), and the Asian Bond Markets Initiative (ABMI).

The Global Financial Crisis (GFC) of 2007-09 affected ASEAN+3 economies moderately, although it induced capital outflows from the ROK, Indonesia, and a few other ASEAN countries and caused some turbulence.² Following the GFC, ASEAN+3 authorities strengthened the regional financial safety net (Figure 1). In 2010, the CMI was upgraded to the Chiang Mai Initiative

- 1 The AFC was caused by excessive foreign-currency borrowing by the banking and corporate sectors, followed by a sudden stop of capital inflows, massive capital flow reversals, and crisis contagion spreading across the region (Khor, Guinigundo, and Kawai, 2022).
- 2 The ROK faced a mini-currency crisis in the aftermath of the Lehman shock, and decided to obtain a bilateral currency swap line from the U.S. Federal Reserve (Fed). Immediately after this currency swap arrangement was made, the currency and financial market stabilized (Kawai, 2015). If a precautionary arrangement of the CMI had been available with a sufficiently large amount, the ROK (and Indonesia) might have used it.

Multilateralization (CMIM) Agreement with an initial fund size of USD 120 billion.³ In 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was established as an independent surveillance unit. Central bank governors joined the finance ministers' cooperation process in 2012, when the CMIM's fund size was expanded to USD 240 billion and a precautionary facility was introduced in addition to the crisis resolution facility. The CMIM and AMRO formed a regional financing arrangement for crisis prevention and resolution.

Figure 1 Development of the CMIM and the AMRO



Note IMF = International Monetary Fund; MF-DLP = IMF-delinked portion; IMF-LP = IMF-linked portion.

Source Author's compilation of joint statements of ASEAN+3 finance ministers and central bank governors.

3 The CMI was a combination of the ASEAN Swap Arrangement among all ASEAN countries and a network of bilateral currency swaps among several ASEAN countries and CJK, while the CMIM is a multilateral currency swap arrangement among all ASEAN+3 economies governed by a single contractual agreement to provide financial support to members in need of short-term liquidity.

The CMIM is linked to an IMF program in the sense that if a member country wishes to withdraw more than 40% of the maximum amount of the CMIM,⁴ the country must be under an IMF-supported program. To use the precautionary CMIM, the requesting country must pass qualification criteria and the program is also subject to the same IMF-link rule.

The AMRO conducts surveillance on individual member economies and the ASEAN+3 region. During peace times, it analyzes macroeconomic performance and policy, capital flows, and exchange rates and implements an early warning system to detect vulnerabilities. During crisis situations, it prepares recommendations on any CMIM request based on a macroeconomic analysis of the requesting member and monitors the use and impact of the funds disbursed and the requesting member's compliance with policy conditions. The AMRO has also conducted 13 test runs on its own as well as with the IMF.

6.1.2 The ABMI: Local-Currency Bond Market Development

ASEAN+3 financial authorities launched the ABMI with the belief that the expansion of local-currency (LCY) bond markets would help remedy their financial systems' excessive reliance on domestic banks and foreign short-term loans and reduce the “double mismatch” problem. With the two wheels of the financial market (i.e., the banking sector and the LCY bond market), the region would become more resilient to external or home-grown shocks. There were additional reasons for developing LCY bond markets. First, the region's dynamic economic growth would create further funding needs for corporate investment and infrastructure investment. Second, multinational corporations would have considerable need to secure LCY funds for their current operations. Third, the rising middle class would demand LCY bonds for wealth accumulation and diversification. Fourth, pension funds, insurance firms, and other institutional investors would be keen to hold LCY bonds for investment purposes.

ASEAN+3 authorities have worked together to develop and integrate national LCY bond markets by promoting bond issuance, facilitating bond demand, improving the regulatory framework, and strengthening bond market infrastructure. They established the Credit Guarantee and Investment Facility (CGIF) and promoted the issuance of LCY corporate bonds in member economies.⁵

4 The IMF-delinked portion was initially set at 10% and raised to 20% in 2005, to 30% in 2014, and further to 40% in 2021. The IMF link was introduced on the grounds that the CMI (and CMIM) would supplement IMF financing, and was considered a stopgap measure to ensure that the use of the CMI (and CMIM) would not lead to moral hazards.

5 Since its inaugural bond issuance guarantee in April 2012 until January 2023, the CGIF has guaranteed 57 bonds issued by 39 companies from 12 economies in 9 currencies with total cumulative notional guarantees of USD 2.8 billion. See ASEAN+3 FMCGs (2023b).

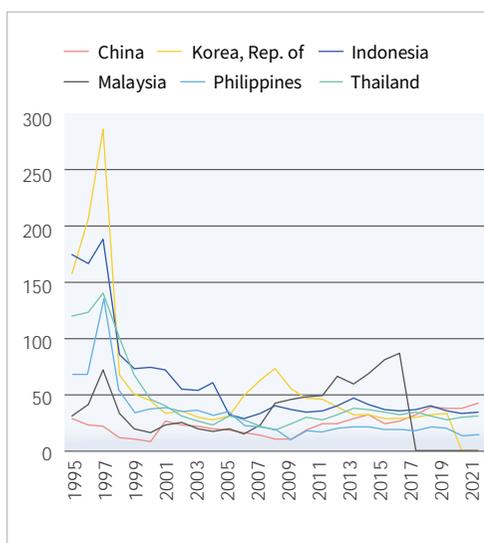
6.2 Financial Market Health and Development

6.2.1 Restoration of Financial Health

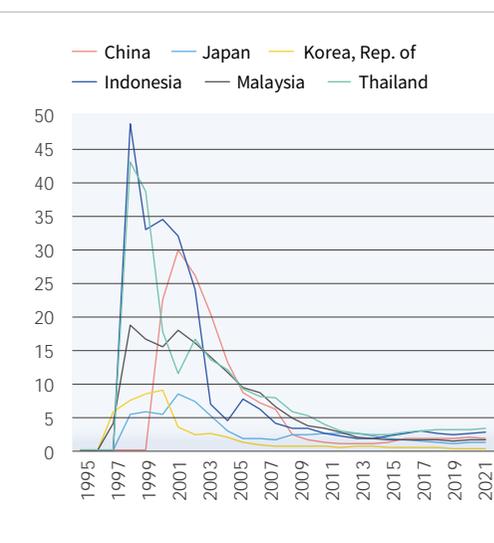
After the AFC, the crisis-hit countries improved their external position with a rapid swing to large current account surpluses and a significant build-up in foreign exchange reserves, while reducing short-term external debt. The foreign exchange reserves of the four crisis-hit countries declined initially from USD 119 billion in 1996 to USD 86 billion in 1997, but bounced back to USD 187 billion in 2000 and further to USD 891 billion in 2022. The four countries successfully reduced the ratio of short-term external debt to foreign exchange reserves from an average of 172% in 1997 to 45% in 2000 and 2017 (Figure 2A). In addition, public sector debt, which rose sharply in the crisis-hit countries because of exchange rate depreciations and bank recapitalization, started to gradually stabilize, falling to below 60% of GDP in subsequent years.

Figure 2 Short-Term External Debt and Non-Performing Loans of Selected ASEAN+3 Economies

2A. Short-Term External Debt as a Ratio of Foreign Exchange Reserves (%)



2B. Non-Performing Loans as a Ratio of Total Loans (%)



Source Adapted from *World Development Indicators* and *Global Financial Development Database*, by the World Bank. <https://www.worldbank.org/en/publication/gfdr/data/global-financial-development-database>

The ratios of non-performing loans (NPLs) to total loans by the banking systems in the crisis-hit countries also dropped significantly from extremely high levels in 1998 (with the NPL ratios recorded at 49% and 43% in Indonesia and Thailand, respectively) to below 4% in 2010 (Figure 2B).⁶ The GFC did not lead to any visible increase in the NPL ratio in the ASEAN+3 region. This meant that the ASEAN+3 banking systems had restored their financial health by the time the GFC struck.

6.2.2 Financial Market Development and Deepening

Table 1 summarizes the state of financial market development and deepening of ASEAN+3 economies. The table demonstrates that the banking sector remains the most dominant part of the financial market for some economies (China, the ROK, Malaysia, Thailand, and Vietnam), while the stock market is the most dominant for others (Japan, Hong Kong, Indonesia, the Philippines, and Singapore). The domestic debt securities market has expanded in CJK, Malaysia, and Thailand partly thanks to the efforts at developing LCY bond markets under the ABMI, although its market size is still smaller than those of the banking sector and stock market.



⁶ The NPL ratio of Japan, which also experienced a banking crisis in 1997-98, peaked at 8.4% in 2001 and began to decline to 2.5% in 2010.

Table 1 National Financial Structure of ASEAN+3 Economies, 2000-2020

	Private credit by deposit money banks			Stock market capitalization			Outstanding domestic private debt securities			Outstanding international private debt securities		
	2000	2010	2020	2000	2010	2020	2000	2010	2020	2000	2010	2020
China	111.0	126.6	182.9	38.1	66.2	83.2	7.6	33.6	73.2	1.2	1.2	8.1
Japan	181.7	99.2	118.3	63.5	66.5	133.3	46.4	73.8	68.7	5.5	6.5	14.2
ROK	70.2	89.4	164.4	29.7	95.4	132.9	50.7	63.3	77.6	7.7	11.1	13.3
Hong Kong	150.4	185.6	258.9	363.1	1,185.9	1,777.3	17.1	14.3	(45.6)	17.2	37.2	63.9
Brunei Dar.	50.3	36.6	38.8	--	--	--	--	--	--	--	--	--
Cambodia	6.4	27.5	142.8	--	--	--	--	--	--	--	--	--
Indonesia	19.4	24.3	33.2	16.2	47.7	46.9	3.7	7.6	4.7	5.9	2.1	7.9
Lao PDR	7.9	20.9	--	--	--	--	--	--	--	--	--	5.6
Malaysia	126.7	107.0	134.1	120.6	160.3	129.5	32.8	61.1	57.6	13.7	14.5	20.2
Myanmar	8.9	5.1	27.2	--	--	--	--	--	--	--	--	--
Philippines	35.6	28.3	52.1	31.1	75.5	75.4	0.2	1.1	(9.2)	10.8	6.3	8.3
Singapore	96.0	94.9	132.7	159.1	269.9	189.0	16.5	11.6	(35.0)	15.0	22.6	--
Thailand	105.1	90.7	125.6	23.1	81.4	108.7	0.0	51.0	52.8	8.7	2.5	--
Vietnam	35.3	8	7	25.0	54.2	(0.0)	(2.8)	(3.5)		0.2	0.5	

Note “—” means data are not available. Figures in parentheses are ratios of corporate bonds to GDP.

Source Adapted from *Global Financial Development Database*, by the World Bank, July 2018, October 2019, and August 2022. <https://www.worldbank.org/en/publication/gfdr/data/global-financial-development-database>; and AsianBondsOnline Data Portal, by the Asian Development Bank. <https://asianbondsonline.adb.org/data-portal/>

6.3 Regional Cooperation for Financial Stability

6.3.1 Challenges for the CMIM and AMRO

Although the ASEAN+3 region has established a solid regional financing arrangement, the CMIM and AMRO face challenges in improving their effectiveness. The most serious challenge is that the CMIM (or its predecessor, the CMI) has never been used. Second, the amount of financing available to each member remains small and there is a need to increase the financial resources available to individual members. Third, the objectives of the CMIM are narrowly defined,⁷ and there is a case for expanding them and making the facility more readily available for members in need of financing, as in the case of the IMF and other regional financing arrangements (Table 2). Fourth, the AMRO has not maximized its full potential.

Table 2 Functional Differences among the IMF and Regional Financing Arrangements

	Financing entity	Legal status	Funding sources	Reserve management	Surveillance	Lending instruments	Lending conditionality
IMF	IMF	Legal entity	Quota, NAB, bilateral loans	Centrally managed	Surveillance (publicly available)	SBA (SCF), EFF (ECF), RFI (RCF), FCL, PLL, SLL	Set by IMF
ESM*	ESM	Legal entity	Paid-in capital from fiscal budget; bond issuance	Centrally managed	Limited participation in surveillance by EC & ECB	Macroeconomic adjustment, market purchases, bank recapitalization, PCCL, ECCL	Set by ESM, EC and IMF
FLAR*	FLAR	Legal entity	Paid in-capital; capital market borrowing	Centrally managed and invested	Surveillance (not publicly available)	Liquidity facility, BOP support, foreign debt restructuring, contingency line	No conditionality
CMIM	ASEAN+3 countries (+ Hong Kong)	Not a legal entity; a set of contracts	A set of bilateral currency swaps	Self-managed by each member	Surveillance by AMRO (publicly available)	CMIM-PL, CMIM-SF	Set by AMRO (for IMF-DLP) or AMRO & IMF (for IMF-LP)

Note ESM = European Stability Mechanism; and FLAR = Fondo Latinoamericano de Reservas (Latin American Reserve Fund).

Source Adapted from IMF Lending Arrangements, by the IMF (<https://www.imf.org/en/About/Factsheets/IMF-Lending>); and Han (2022).

⁷ The objectives of the CMIM are: (i) to address actual and potential balance-of-payments and short-term liquidity difficulties in the region; and (ii) to supplement existing international financial arrangements (particularly the IMF).

First, the CMIM has never been utilized despite the occurrence of various types of financial shocks, i.e., the GFC, taper tantrum, and COVID-19. One interpretation of this is that ASEAN+3 economies have been successful in avoiding balance-of-payments (BOP) difficulties and liquidity shortages, so they have not needed financial assistance⁸. The second interpretation is that the CMIM is designed to address short-term liquidity shortages in a very narrow way. The third interpretation is that the CMIM is still tied to IMF programs, with the IMF-delinked portion standing at 40%, and some member economies are reluctant to take the risk of eventually having to go to the IMF by using the CMIM. To address this “IMF stigma” issue,⁹ the CMIM's IMF-link could be reduced over time, ultimately to zero.

Second, at USD 240 billion, the CMIM's resources remain small relative to the resources available under IMF financing or other regional financing arrangements such as the European Stability Mechanism (ESM). One approach to address this issue is to redesign the CMIM in a way to increase financial resources available to individual members. Another option is to expand the overall size of CMIM resources by 100% or so. A more fundamental approach would be to introduce a large fund, with paid-in capital subscriptions or quota contributions, not only to increase the resource size but also to ensure that the CMIM becomes a solid safety net.

Third, to meet the narrow objectives of the CMIM, it has only two instruments, i.e., crisis resolution and precautionary arrangements. There is a case for interpreting the objectives more flexibly and making the facility more readily available for members in need of financing, as in the case of the IMF and other regional financing arrangements. Also, the CMIM has no concessionary lending program for poorer members, while the IMF does. The CMIM could expand its menu of financial instruments to meet the needs of member economies.

Fourth, to maximize the AMRO's potential, it is urged to do more sectoral or functional surveillance and boost its capacity to design lending programs and policy conditions, particularly when activating the IMF-delinked portion of the CMIM. For this purpose, the AMRO requires greater financial and human resources. Overall functions of the CMIM and AMRO could become more effective if the AMRO were to serve as the permanent secretariat for the CMIM.

8 Myanmar obtained IMF financial assistance of USD 700 million to address the COVID-19 pandemic, while the country did not approach the CMIM. The IMF believed that its support would help the country in meeting the urgent BOP needs arising from the pandemic. Similarly, the CMIM could have been mobilized in a more flexible way to address the country's BOP needs.

9 There are three types of IMF stigma: (i) economic stigma, whereby a request for an IMF program could be viewed by markets as a sign of weakness and prompt capital outflows; (ii) conditionality stigma, whereby conditionality, even when optimally designed, could create a sense of intrusiveness and lack of ownership over IMF programs; and (iii) political stigma, whereby the negative image that opinion leaders, NGOs, and the general public have with regards to the IMF could prevent some policymakers from approaching it (IMF, 2017).

It is thus highly welcome that the ASEAN+3 Finance Ministers and Central Bank Governors have agreed to: (i) explore possible financing structures for the CMIM, including a paid-in capital structure; (ii) consider the creation of new financial instruments to meet urgent BOP needs arising from pandemics and natural disasters as well as rapid digital capital outflows; and (iii) urge the AMRO to mainstream emerging and structural issues, such as financial digitalization, climate change, population aging, and supply chain reconfiguration, in its surveillance work (ASEAN+3 FMCG 2023a). In addition, it would be useful to transform the CMIM and AMRO into a single institution forming a de facto Asian monetary fund, with integrated functions of financing and surveillance. This institution would have legal status, centrally manage the contributed fund, lock all member countries into financial commitments without opt-out possibilities, and could issue bonds to obtain additional funding for lending purposes.

6.3.2 Responding to Future Crises

The CMIM and AMRO should be ready to respond to future crises in any of the ASEAN+3 economies. Once a financial crisis breaks out in the region, the CMIM needs to be mobilized quickly. If the crisis were a small-scale one, the CMIM and AMRO could handle it, and this would be a good opportunity to test the effectiveness of the CMIM's IMF-delinked component and the AMRO's crisis management capacity. If the crisis were a large-scale one and/or one involving multiple countries, the CMIM and AMRO would be advised to work with the IMF. In this case, forming an Asian Troika, including the IMF, the CMIM/AMRO, and the Asian Development Bank (ADB), would be useful to provide Asian inputs to crisis management, drawing lessons from the Euro Area financial crisis in which the IMF, the European Union, and the European Central Bank formed the European Troika. The reason to include the ADB as an Asian Troika member is that it has a long history of providing financing during past periods of financial crises and turmoil and has been supporting the ASEAN+3 finance process as a partner offering analytical skill and financing capacity.

6.4 Regional Financial Cooperation in Bond Markets and Emerging Areas

ASEAN+3 financial authorities have been broadening the nature of their financial cooperation to address emerging challenges and opportunities. New areas include financing sustainable and resilient infrastructure investment, disaster risk financing, and financial digitalization including fintech.¹⁰ The authorities are also exploring new directions for LCY bond market development under the ABMI.

6.4.1 Further Development and Integration of LCY Bond Markets

Although regional LCY bond markets have developed rapidly, several challenges remain. First, the LCY bond market is still underdeveloped in several ASEAN countries, such as Brunei Darussalam, Cambodia, Lao PDR, and Myanmar, and efforts are needed there to develop LCY government bond markets. Second, even in countries where government bond markets are relatively well-developed, such as Indonesia, the Philippines, and Vietnam, the LCY corporate bond markets are still small and can be expanded. Third, LCY bond markets have not been well-integrated in the ASEAN+3 region where the share of USD instruments is much higher for intraregional financial transactions. Fourth, the region has very limited financial instruments to support environmentally friendly, natural disaster-resilient, and sustainable economies.

ASEAN+3 Finance Ministers and Central Bank Governors have agreed to focus on five pillars during 2023-2026: (i) promoting sustainable finance regionally; (ii) improving regulatory frameworks and market infrastructures and creating a better foundation for cross-border transactions; (iii) promoting digital transformation to integrate the ASEAN+3 financial markets; (iv) promoting LCY liquidity provision to mitigate risk in cross-border transactions; and (v) continuing and further tailoring support for LCY bond market development (ASEAN+3 FMCG 2023a).

¹⁰ Ito and Kawai (2021) explore the promotion of regional currency use for international transactions as another area of regional financial cooperation.

6.4.2 Financing Sustainable and Resilient Infrastructure Investment

ASEAN needs an annual infrastructure investment of USD 210 billion (climate-adjusted estimate) until 2030 (ADB, 2017). This does not include the additional expenditure associated with natural disasters that increasingly impact existing infrastructure, or the additional infrastructure investment needed to vigorously promote climate transition. It is difficult to meet the widening infrastructure financing gap through traditional sources of financing, i.e., public sector funding and the existing models of public–private partnerships.

ASEAN+3 members have been exploring innovative financing mechanisms to leverage public funds to catalyze financing from the private and institutional sectors in multiples far beyond the current average of 1:3, by reducing risk, creating an enabling investment environment, and providing an opportunity for sustainable outcomes (ADB, 2023). The regional economies need to work together to identify effective financing models¹¹ that combine public, private, institutional, and other forms of capital and upgrade public–private infrastructure partnerships.

6.4.3 Disaster Risk Financing

Without sufficient financial planning, ASEAN+3 governments could be forced to spend public financial resources for disaster response and recovery purposes, which would squeeze investment in education, health, infrastructure, and industrial development. Due to the underdevelopment of private disaster insurance markets, ASEAN+3 economies need to offset a significant share of government contingent liability through cooperative arrangements. The region has developed initiatives such as the ASEAN Disaster Risk Financing and Insurance (ADRFI) and the Southeast Asia Disaster Risk Insurance Facility (SEADRIF), to manage public finance risks due to disasters. ASEAN+3 finance authorities have also launched a new regional initiative on Disaster Risk Financing (DRF). The main objectives of the initiative are to: (i) support the implementation of DRF solutions; (ii) lay the foundation for DRF solutions; and (iii) increase access to affordable financial instruments to secure adequate financing for pre- and post-disaster efforts (ASEAN+3 FMCG 2023a). The most realistic approach would be for all ASEAN+3 members to join the SEADRIF and make it an ASEAN+3 DRF mechanism.

11 A candidate model includes blended finance, asset recycling, asset securitization, converted debt structures, municipal bonds, green bonds, and green and transition funds.

6.4.4 Financial Digitalization

The digitalization of financial services, including the expansion of fintech, has created new business opportunities and policy challenges. Regional authorities wish to promote financial digitalization to leverage its benefits while minimizing attendant risks. Financial digitalization has improved the quality of financial services, including payment services, by accelerating transaction speed, reducing transaction costs, and expanding financial inclusion. Digital innovation in financial services, however, carries domestic and international risks (Morgan and Huang 2021, AMRO 2023). Domestically, a combination of digital banking and social media can create a rapid depositor run, as in the case of the recent Silicon Valley Bank failure in the US. The widespread use of crypto assets and stablecoins can challenge a country's monetary sovereignty. Regulatory and competition issues arise as new technologies enable non-bank entities to provide financial services, compete against banks, and build financial risks outside the traditional regulatory perimeter. Internationally, a growing volume of unrecorded cross-border digital transactions could undermine the authorities' ability to monitor money laundering and terrorism financing and manage international capital flows, with consequences for a country's external vulnerability. The introduction of central bank digital currencies (CBDCs) can make cross-border currency substitution easier and expose countries to currency crises.

Thus, financial digitalization can have serious cross-border implications and require financial authorities to coordinate their policies and practices, particularly at the regional level. ASEAN+3 financial cooperation may focus on harmonization of legal, regulatory, and supervisory frameworks to allow fintech firms to enjoy a level playing field for financial services providers; facilitation of cross-border payments and settlements for digital currencies; safeguarding regional financial stability against cross-border digital transactions (such as crypto asset flows, digital bank runs, and digital currency substitution); concerted efforts at anti-money laundering and countering the financing of terrorism; and mutual learning from each other's digital experiences (e.g., on the promotion of SMEs' fintech adoption, consumer and privacy protection, and enhancement of cybersecurity).

There are also other emerging areas that ASEAN+3 finance authorities may wish to work on jointly, such as macro-structural frameworks and instruments, sustainable and transition finance, LCY transactions in cross-border payments, corporate debt and household debt, and financial market developments in an aging society.

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Policy Recommendations



7.1 China Perspectives

7.1.1 CHEN Wenling

The Asian region must maintain the strong momentum of economic growth. CJK have a population of over 1.5 billion and a combined economy of more than USD23 trillion. In 2022, China's total trade volume with Japan and the ROK was about USD720 billion, accounting for 11.4% of China's total foreign trading. The three countries have close economic and trading ties, are important economic and trade partners, and target markets for each other. China-Japan-the ROK trade contributes 70% of the growth of the Asian economy and 36% of the growth of the world economy, which is considered a stable growth foundation of the world and international economy and trading cooperation. After the RCEP is put into operation, China and Japan will make a free trade arrangement for the first time, bringing the three major economies, i.e., CJK into the same framework for the first time. In 2021, CJK ranked as the second, third, and ninth economies in the world, and the total economic volume of the three countries far exceeds that of the Eurozone and is comparable to that of the North American Free Trade Area, which is already a veritable global economic center. Within the RCEP, CJK account for more than 82% of the total economic volume and have a pivotal influence. After implementing the Global Development Initiative announced by President Xi Jinping in Singapore for one year, the number of countries and international organizations supporting the initiative has increased to more than 100, and the Group of Friends of Global Development Initiative established on the United Nations platform has developed more than 60 members, and has strongly forged a consensus on promoting common global development. It is more important for Asian countries to make development their top priority. They must unite and work together to maintain macroeconomic, financial resilience, and stability.

7.1.2 ZHANG Jianping

In Northeast Asia, based on geographical adjacency as well as differences in economic development and resource endowment, CJK have strong potential complementarities in the fields of resources, labor, capital, technology and other production factors. The scale and development potential of the regional market is huge.

CJK Should Lead Implementing the RCEP Rules

Given that CJK takes over 80% of the GDP and trade volume in RCEP, CJK is crucial in promoting regional economic integration in East Asia and Northeast Asia. CJK need to take the lead in fully implementing the opening commitments and rules of RCEP. CJK are the key to promoting regional economic integration in East Asia. It will take more than 20 years for CJK to achieve the goal of 90% “zero-tariff” commodities. CJK needs to negotiate as soon as possible and gradually increase the coverage of “zero-tariff” goods and shorten the transition period for tariff reduction. CJK should uphold the principle of openness, continue to refine RCEP rules and improve the mechanism, and promote the gradual implementation of RCEP rules and standards in the fields of service trade, e-commerce, and competition policy. Keeping in line with CPTPP, CJK should speed up the negotiation process of the CJK Free Trade Agreement and promote the regional economic integration of East Asia and Northeast Asia to a new level.

Utilize RCEP Rules of Origin, Exert Complementary Advantages, and Tap the Potential of Tripartite GVC Cooperation

Under the background that the economies of are still highly complementary and highly dependent on the market, CJK need to make full use of RCEP rules to ensure the supply of raw materials, commit the trade circulation of parts and intermediate products, and promote the liberalization and facilitation of trade and investment. With 40% cumulative rules of origin, exert their respective advantages, strengthen GVC cooperation, promote the further integration of manufacturing, industrial chains, and supply chains among the CJK, to improve the cooperation level and efficiency of East Asian production networks. Under the RCEP framework, CJK can take the lead in formulating and implementing a China-Japan-ROK capacity-building list focusing on the development of professional services and a list of economic and technological cooperation in the fields of equipment manufacturing and digital transformation of the manufacturing industry. Guided by openness, inclusiveness and sharing, it will attract ASEAN companies to

further integrate into the CJK supply and industrial chains, driving the improvement of the overall competitiveness of the manufacturing industry in the region and reducing the risk of decoupling and broken chains. In addition, based on RCEP, the governments of CJK should also promote high-level practical cooperation in specific fields when eliminating interference and enhancing mutual trust, to release the positive effect of mutual promotion between “small multilateral” and “large multilateral” .

CJK have Great Potential for Low-carbon and Green Development Cooperation, which Needs to be Further Explored

In 2022, the carbon emissions of CJK rank first, fifth, and eighth in the world. It is the common interests of CJK to strengthen low-carbon and green development cooperation, so there is huge potential for cooperation. First, it is necessary to promote cooperation in new and renewable energy. CJK have broad space for cooperation in the fields of wind energy, solar energy, tidal energy, biomass energy, and hydrogen energy. Especially in hydrogen energy, CJK have own advantages separately. Second, coordinate the promotion of green and low-carbon energy technology innovation and the formulation of international standards. Finally, carry out in-depth cooperation in energy conservation and environmental protection, as well as in the supply chain of the green and low-carbon industrial chain. CJK have broad cooperation potential and complementary space in the fields of construction, transportation, and industry energy use. In addition, only by establishing an effective cooperation mechanism can the stability and durability of cooperation be guaranteed. Regional energy and climate governance cooperation can be promoted by relying on existing platforms and mechanisms such as the East Asia Summit, the ASEAN 10+3 Energy Ministers Meeting, and the CJK Environment Ministers Meeting.

Development Room for CJK Service Trade Is Huge, Breakthrough Is Urgently Needed

CJK have the conditions to achieve breakthrough in free trade under certain service items under the RCEP framework. First, make full use of RCEP to build an upgraded version of China-ROK Free Trade Area with a focus on service trade, start China-Japan service trade negotiations as soon as possible, and promote the unification and docking of CJK service trade rules, regulations, management, and standards. Secondly, “early harvest” should be achieved as soon as possible in key areas of modern service industry such as the digital economy and finance and insurance. For example, to adapt to the general trend of industrial transformation led by the

digital economy, under the framework of RCEP e-commerce rules, CJK jointly explore the large digital economy market in the region and carry out in-depth cooperation under the intelligent manufacturing industry. Finally, promote cooperation in life service industries such as tourism, medical care, culture and entertainment. Actively promote the process of free trade in tourism, education, cultural entertainment and other industries. In addition, facing the common challenge of population aging, CJK need to actively promote free trade in industries such as medical care, health care, and elderly care.



7.2 Japan Perspectives

7.2.1 KAWAI Masahiro

ASEAN+3 economies have deepened their regional financial cooperation over the past 25 years, focusing on the regional financing arrangement, i.e., the Chiang Mai Initiative Multilateralization (CMIM) and the ASEAN+3 Macroeconomic Research Office (AMRO), as well as the Asian Bond Markets Initiative (ABMI). These crisis-driven cooperation efforts have served the region well by promoting financial stability and enabling it to weather various external shocks, such as the global financial crisis, the taper tantrum, the COVID-19 economic crisis, and the war in Ukraine and sanctions. While maintaining financial stability should remain the core component of ASEAN+3 financial cooperation, the region could benefit even more by broadening the scope of regional financial cooperation to address emerging challenges and opportunities.

Policy recommendations can be divided into three parts: (i) strengthening the regional financing arrangement (the CMIM and AMRO); (ii) expanding the scope of local-currency (LCY) bond markets under the ABMI; and (iii) broadening regional financial cooperation to address emerging challenges and opportunities.

Strengthening the regional financing arrangement (the CMIM and AMRO)

- Increase the maximum amount of CMIM financing available to individual members;
- Reduce the CMIM's International Monetary Fund (IMF)-link over time, ultimately to zero;
- Change the mode of CMIM financial contributions into a system of paid-in capital subscriptions or quota contributions;
- Expand the CMIM mandate and introduce new financial instruments to allow for flexible responses to shocks (such as pandemics, natural disasters, and rapid digital transactions) affecting members' balance-of-payments needs as well as concessional lending;
- Enable the AMRO to function as a permanent secretariat that handles surveillance, all aspects of the CMIM, and technical assistance;
- Form an Asian Troika comprising the IMF, the CMIM/AMRO, and the Asian Development Bank in the event of future financial crises; and
- Integrate the CMIM and AMRO into a single institution with legal status.

Expanding the scope of LCY bond markets under the ABMI

- Continue to support LCY bond market development by focusing on country-specific challenges;
- Facilitate cross-border transactions of LCY bonds and integrate the ASEAN+3 bond markets through improved regulatory frameworks, efficient market infrastructures (including for cross-border settlements), financial digitalization, and risk mitigation; and
- Promote sustainable and disaster-resilient finance through the development of green and transition bonds, insurance-linked products, and debt-for-climate or nature swaps.

Broadening regional financial cooperation on emerging areas

- Leverage public funds to catalyze the financing of sustainable and resilient infrastructure investment from the private and institutional sectors through effective financing mechanisms and improved public-private partnerships;
- Encourage all ASEAN+3 members to join the Southeast Asia Disaster Risk Insurance Facility (SEADRIF) so as to form an ASEAN+3 Disaster Risk Financing (DRF) mechanism which supports members in implementing DRF solutions and secures adequate financing for pre-and post-disaster efforts;
- Promote financial digitalization to maximize its benefits while minimizing attendant risks, particularly those associated with rapid cross-border digital transactions; and
- Explore financial cooperation in other emerging areas such as macro-structural frameworks and instruments, sustainable and transition finance, LCY transactions in cross-border payments, corporate debt and household debt, and financial market developments in an aging society.

CJK have assumed leadership roles in promoting regional economic integration forward with the recent implementation of the RCEP Agreement. Further regional financial integration would call for greater cooperation among the financial authorities, led by the three countries, toward a more integrated and stable financial system as a foundation for achieving dynamic, sustainable, and resilient regional economies.

7.2.2 KUNO Arata

The geopolitical and geoeconomic landscape surrounding the three countries has dramatically shifted over the past several years, with growing strategic competition between the US and China, the outbreak of the pandemic, Russia's invasion of Ukraine, and the resulting disruptions in global supply chains. However, as mentioned in Chapter 5, Japan's respective trade values with China and the ROK reached an all-time high in 2022 following the creation of RCEP. Moreover, firms in this region actively utilized RCEP's preferential tariff system in the same year. These facts imply that the supply chains established in Northeast Asia have demonstrated remarkable flexibility in response to external shocks and have become essential infrastructure for the business sector in the region.

On the other hand, the three countries must face the reality that concerns about further promoting economic interdependence with other states and demands for protectionist measures have rapidly increased in some countries due to the abovementioned environmental changes. To promote economic integration in Northeast Asia amid these headwinds, the CJK leaders should seek a path to achieve a better balance between an open trading system and economic security without falling into a 'false dichotomy' between the two policy goals.

During the initial stages of the pandemic, there was a tendency in many countries, including Japan, to engage in discussions based on an extreme dichotomy of 'fighting against the coronavirus or resuming economic activities.' However, after months of trial and error, the importance of simultaneously balancing these two policy goals has been gradually recognized, leading many countries to succeed in breaking free from this dichotomous trap. Likewise, a transition to pragmatic policies that balance free trade and economic security will be possible to achieve in the region if the CJK leaders do not fall into such a trap, although a certain transition period will be necessary.

While the three countries have traditionally maintained economic interdependence, they have not succeeded in consistently sustaining political momentum for promoting economic integration due to various political and diplomatic challenges. For the three to advance their economic integration amid escalating geopolitical uncertainties, it is crucial to maintain a wide range of communication channels, including multilateral, regional, trilateral, and bilateral platforms, and to continue dialogue and cooperation by utilizing all available avenues.

Firstly, WTO rules have been serving as vital international public goods for fostering stable economic relations between the three states. Unfortunately, the WTO's dispute settlement mechanism has been dysfunctional since December 2019 due to US vetoes of the appointment of

judges. To maintain the ‘rules-based international order,’ the CJK leaders should collaborate closely to promote WTO’s dispute settlement system reform. Simultaneously, the three should agree to utilize the Multi-Party Interim Appeal Arbitration Arrangement (MPIA) as a provisional measure for resolving disputes until the WTO’s Appellate Body becomes fully functional. In this regard, the ROK, the only non-MPIA member among the three countries, should consider participating in this arrangement to facilitate dispute settlement between them.

Secondly, to effectively counter the growing wave of protectionism, the CJK leaders should further enhance the attractiveness of the region’s supply chains and broaden the base of beneficiaries of economic integration by upgrading the existing RCEP agreement. Specifically, the three countries should consider increasing the level and pace of tariff reductions, adopting the most-favored-nation (MFN) principle within RCEP to eradicate any remaining tariff discrimination among them and improve its user-friendliness for the business sector. Furthermore, in preparation for unforeseen external shocks in the future such as a new pandemic, discussions should be initiated within the RCEP framework to evaluate the impacts of prior protectionist measures taken in the name of economic security and to find better strategies to mitigate the adverse consequences of potential supply chain disruptions in the region.

Thirdly, within the trilateral cooperation framework, the CJK leaders should endeavor to hold a summit meeting at the earliest opportunity and sustain dialogue and cooperation to address common policy challenges, as proposed during the Trilateral Finance Ministers and Central Bank Governors’ Meeting held on May 2, 2023. Furthermore, the CJK leaders should expedite negotiations to finalize a CJK FTA, building upon the achievements made in RCEP negotiations.

Lastly, the realization of stable economic development in the Northeast Asian region hinges on the establishment of constructive and trust-based bilateral relations. It is crucial for the CJK leaders to uphold and broaden bilateral dialogue and exchange at all levels, encompassing the governmental, business, academic, and grassroots spheres.

7.3 ROK Perspectives

7.3.1 AHN Choong Yong

RCEP follows the consensus-based “ASEAN way” of consultation to manage its implementation through a combined agenda of implementation and built-in provisions for making gradual progress in trade liberalization. This approach is contrasted with firm commitments adopted at the outset and contained in the CPTPP text. To orient RCEP toward successful implementation, CJK need to play a critical role to reinforce the “ASEAN way” and ensure that RCEP members with different factor endowments and development stages adhere to the agreed RCEP disciplines.

RCEP's effectuation now longer than a year, RCEP secretariat needs to be established rather swiftly to ensure RCEP function smoothly. RCEP member states are urged to accelerate the pace of talks on critical minerals supply chain, digital and green trade, and domestic green growth, which are key areas of their economic cooperation. The RCEP secretariat must conduct regular reviews of liberalization commitments by its member states and continue to pay attention to the agenda, including a full switch to the negative list system for FDI and introduction of investor-state dispute systems(Ahn, forthcoming 2023). RCEP members must share online platforms to update on their implementation progress for each chapter. RCEP also needs to establish a well-coordinated mechanism of knowledge sharing in terms of agenda implementation and progress. After achieving confidence building in fulfilling the commitments to RCEP clauses, the quality of RCEP should be upgraded by introducing new chapters on labor, the environment, and subsidy issues to SOEs to match the content of the CPTPP.

The ROK has decided internally to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which was signed by 11 Asia-Pacific countries in March 2018(Ahn, 2022). The ROK's barely one year-old Yoon Suk-yeul Government is now weighing on when to submit an official application to CPTPP given the expected protests by farm organizations and other vulnerable sectors for additional market openings during the early period of the new administration.

Asia is one of the most vulnerable regions to climate change risks yet emits the largest volume of carbon dioxide. The continent is likely facing more extreme precipitation occurrences such as storms, floods, and landslides, having experienced almost 40 percent of total disasters worldwide in the past two decades (ADB, 2023 p13). In connection with the environmental risks, RCEP's coverage and depth of environment and climate change provisions needs to be raised or a separate chapter added that incorporates climate change mitigation regardless of likely

geopolitical fragmentation.

In this context, the CJK leaders must realize that at the root of indispensable cooperation among the CJK states are unavoidable ecological connectivity. The problems of transborder fine dust, marine plastic litter, and the ongoing terrifying spread of the novel Coronavirus must be tackled urgently and collectively. This requires a concrete and quickly implementable action agenda that can contribute to deeper confidence building for the CJK economies to implement the RCEP agreements (Ahn, 2020).

Mutual trust among CJK can only be deepened through an unwavering commitment to a rules-based regional and global trade order while respecting each other's economic systems. Geographically inseparable, CJK must look forward and work responsibly to create a peaceful, prosperous, and inclusive regional community—a building block towards much-needed multilateralism. The CJK leaders, at their eighth trilateral summit in December 2019, in Chengdu have already committed to a 'free, nondiscriminatory, transparent, predictable, and stable trade and investment environment' and to keep markets open, in addition to maintaining durable peace and security in the region (Ahn 2018, 2020).

The CJK economies have been great beneficiaries of the liberal trade system of the past four decades and have become a global manufacturing hub by taking advantage of naturally-emerging regional value chains arising from geographical proximity and inherent manufacturing competitiveness. Some see RCEP as so unambitious as to be largely symbolic (The Economist, Nov 15, 2022). To realize a sustainable and robust RCEP bloc, CJK must look forward and work responsibly to upgrade RCEP as a continuing process and to reactivate the CJK FTA negotiations, building the foundations for much-needed multilateralism. To follow up the Indo-Pacific manifesto (Panda and Ahn, 2023), the ROK should work together with like-minded countries to upgrade RCEP towards eventual convergence with CPTPP.

7.3.2 KWAK Soojong

The two issues of regional fragmentation and regional integration are expected to become important subjects for ROK, China, and Japan. In fact, the trilateral relationship between ROK, China, and Japan is a critical factor in post- industrial 21st century civilization. In the past, relationships between countries were focused on expansion of territory, values or ideologies, or national wealth. These days, however, the expansion of national wealth is generally centered on integration and harmony, as well as the pursuit of mutual prosperity, rather than the plundering or exploitation of others. China regards its relationship with the Korean Peninsula and the ROK as

important. China seeks peace and stability on the Korean Peninsula and promotes dialogue and cooperation between the PROK and the ROK. China aims to strengthen bilateral and multilateral cooperation with the ROK, pursue mutual interests, and support joint efforts for regional security and prosperity. Likewise, Japan has had a complex view of its relationship with China. Historical, political, and economic conflicts have affected the two states' relationship in the past. However, there have been recent movements to enhance dialogue and cooperation between the two. Japan seeks mutual interests through bilateral and multilateral cooperation with China, and aims for regional security and economic prosperity. Most of all, the ROK seeks to mediate conflicts and support peaceful dialogue and resolution between China and Japan. While valuing economic exchange and cooperation with China, the ROK also maintains close relations with Pacific-regime countries. Japan understands China and the ROK from various perspectives. However, due to historical, political, and economic issues, its relationship with these two countries is often viewed as complex. Japan seeks to develop a harmonious relationship with China and the ROK, pursuing mutual understanding and cooperation for regional security and prosperity as well.

The most important motivation is for these three countries to strengthen trilateral exchange and cooperation through governmental, private, and various other channels to achieve trilateral understanding and sustainable economic growth and development. Mobility and communication are key factors. The economic growth of the three states has stagnated as the pandemic caused disruptions in global supply chains and communication between people. Each country has pursued its own policies without close communication, and there has been little discussion on the impacts of fiscal and monetary policies on the regional economy. There has also been a lack of in-depth discussion of the collapse of value chains and supply chains in the market, and the potential impacts on the regional economy due to unilateral policy decisions. The regional leadership of the ROK, China, and Japan is expected to play a crucial role in the future of the Asian economy in the 21st century, and it is not an exaggeration to emphasize this. These three countries carry significant economic importance and influence in the Asian region, and they are recognized as major players that have a significant impact on the global economy. If they exercise regional leadership and strengthen cooperation, it is expected to have a positive impact on the economic growth and development of the Asian region. These countries are expected to promote economic cooperation, trade, investment, and technological development in the region, actively address various regional issues through cooperation, and foster sustainable development of the regional economy.

The present situation is such that everything is intertwined with both positive and negative aspects, whether one desires them or not. The governments of each country must maintain closer political, economic, and social relationships considering this perspective. Therefore,

the following three points need to be emphasized. Firstly, the ROK, China, and Japan should hold regular, immediate, realistic, and substantive annual summit meetings. As there is a G7 centered on the West, it is envisioned that a G4 centered on Asia could be possible in the very near future. Important economic forums in Asia, similar to the Davos Forum in the West, should also be considered, as the center of the global economy in the 21st century is shifting across the Pacific to Asia. Secondly, businesses should transparently maintain and develop closely interconnected value and supply chain systems. The importance of stable maintenance of value and supply chains has been emphasized once again in the global economy throughout the recent pandemic. While the value and supply chains of the past were centered around petroleum-based manufacturing industries, it is anticipated that the chains of various financial services industries such as cryptocurrencies, central bank digital currencies, and derivatives, will become more important in the era of new capitalism. There will undoubtedly be many obstacles and challenges in this process, but what is clear is that the emergence of those various forms of capital could, would, and should disrupt the global economy more than petroleum.

Lastly, the ROK, China, and Japan should deeply embrace leadership and assume responsibility for economic development and political stability in Asia. Throughout history, it has been possible to summarize the progress of civilization in terms of war, disease, and technological advancement. While war and disease can sometimes hinder human civilization, they can also create turning points for new technological developments. In particular, when obstacles such as diseases arise rather than war, true leadership will be demonstrated through the sharing of knowledge and vaccines not only within one's own country but also with neighboring countries through new technologies. Rather than the logic of economic wealth and poverty, it is more important for the shared values of freedom and democracy to be exchanged and communicated among those who interact with each other. Instead of simply focusing on what we have, shouldn't we strive to share what we have and make greater efforts when there are shortages?

7.4 ASEAN Perspectives

RCEP is expected to bring significant gains for AMS, building on the previous ASEAN-centered regional integration process and the established IPN/GVC between AMS and East Asian countries. However, there are challenges to overcome before members can necessarily benefit from the agreement. The following section outlines several policy recommendations from the perspective of ASEAN and its member states.

The first and foremost is for AMS to embark on the path of systematic and well-designed structural reform across various policy areas covered by RCEP. There are still gaps at the borders and behind-borders. A gap analysis is the first step, which will identify the distances between domestic regulations and RCEP commitments as well as the potential gains from implementing the agreement.

Second, related to the first, it is important for all RCEP members to enjoy seamless but robust coordination at the national level. Given that RCEP is progressive in some areas, such as liberalization of services, customs reform, and trade facilitation, there could be adjustments in various policy areas and some of these could be significant. Also, delays in commitment implementation are commonly associated with weak or lacking coordination between government agencies. RCEP members may therefore consider establishing an RCEP national secretariat or assigning an existing FTA unit to better utilize RCEP and at the same time ensure its own and others' compliance with the agreement (Pambagyo and Gultom, 2022).

Third, liberalization of services under RCEP encompasses a negative-list approach. This has become a challenge especially for AMS that are mostly adopting positive-list approaches. Transition to a negative-list therefore becomes an immediate point of reform for many of these member states. In this respect, conducting regulatory audits would be a good starting point, which should then be followed by reforming laws and regulations to meet the requirements of a negative-list approach. In addition, strengthening regulatory frameworks to ensure compliance and removal of trade barriers is equally important, at the same time as providing information to the private sector in order to increase domestic service sector capacity.

Fourth, and further in terms of liberalization of services, it is important for AMS to start building a coherent and trade-facilitating policy framework to facilitate digital transformation, which is likely to accelerate in the near future. As noted, the current commitments in the e-commerce chapter of RCEP are still rather underdeveloped in terms of allowing trade in digital products and services, despite RCEP members' vision of gradually opening up the e-commerce sector under the agreement.

Fifth, one salient feature of RCEP is the notion of trade-enhancing ROOs that should deepen and

widen the currently established IPN/GVC. In addition, RCEP supports the agenda on ROOs by committing on implementation of a self-certification scheme for certificates of origin (CO), which provide proof of origin for traded products. It is critical for members to immediately implement self-certification mechanisms. Here, AMS can leverage from the same initiative at ASEAN level, which started much earlier, albeit while remaining in the initial stages.

Above are some recommendations that could be useful for AMS. Certainly, there are other recommendations to be made for member states, but these can be very detailed and possibly differ between members.¹

At this point, there is an important recommendation to make at the agreement level, and this is to immediately realize institutional apparatus to facilitate implementation of the agreement. The most urgent component at this point is to realize the presence of an RCEP secretariat. This allows more effective implementation and, more importantly, it paves the way for the realization of RCEP as a ‘living agreement’ that enables it to always remain relevant at any point in time.

¹ These are typically covered by other country-specific studies such as Thangavelu et al. (2022) and Damuri and Friawan (2022).

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