# Joint Report and Policy Recommendations
# on
# Towards a CJKFTA: Visions and Tasks

**November 28, 2005**

**Trilateral Joint Research**

**by**

**Development Research Center of China**
**National Institute for Research Advancement of Japan**
**Korea Institute for International Economic Policy of Korea**

## Executive Summary

Since 2003, a joint research project on the "Economic Effects of a Possible FTA between China, Japan and Korea" has been undertaken by the three representative institutes of the three countries. The Research in 2003 focused on the impact of the CJKFTA on the macro-economies of the three countries. Following an overall analysis of this subject, the three research teams conducted a joint research on the "Sectoral Implications of a China-Japan-Korea FTA" in 2004, analyzing cross-sector impacts in general, and the three sectors of agriculture, automobiles and electronics in details.

Based on the research of the last two years, the theme of joint research in 2005 is "Towards a CJKFTA: Visions and Tasks". The research is mainly concerned with the following three sectors: fishery, textile and steel. A general analysis on implication of the FTA on the services industries of the three countries has also been initiated.

After three years of cooperation, the joint research on the CJKFTA has achieved some significant results. The three representative institutions participating in the joint research project hereby jointly submit a comprehensive report of the current phase to the leaders of China, Japan and Korea, and would like to put forward the following policy recommendations:

***CJKFTA should comply with WTO Rules.***

China, Japan and Korea account for a large share in global trade. Especially in the areas of automobiles, steel, electronics, textiles and agricultural products, the proportion of imports and exports of the three countries in the global market is even higher. Therefore, the establishment of a free trade relationship between the three countries should pursue not merely the maximization of mutual interests, but also jointly promote the multilateral trade liberalization process. CJKFTA in the future should follow WTO rules concerning the regional trade agreements (RTAs), promote comprehensive and substantial liberalization and facilitation in such fields as trade in goods, trade in services and investment, and strengthen the economic and technological cooperation in broad areas. While opening markets to one another, the three countries need to consider opening markets to other East Asian countries and participating actively in the feasibility study on East Asia Free Trade Area (EAFTA), so as to play constructive roles in achieving the long-term goal of establishing an "East Asian Community".

***Accelerating structural adjustment in sensitive sectors through external pressure and setting timetables.***

Although all three countries have sectors with weak international competitiveness such as agricultural, manufacturing and services industries, long-term dependence on market protection is likely to slow down the pace of structural adjustment and miss out the huge economic benefits brought about by trade liberalization. For those sensitive sectors (namely, sectors that are likely to suffer from competition and relatively high costs of structural adjustment in employment after losing protection), it is necessary to reduce the social costs by such means as compensation schemes, job training and social safety net, etc. On the other side, to counter pressures from the interest groups in the vulnerable sectors, there is a necessity to propose plans for structural readjustment and timetables for market opening in an effort to accelerate the structural readjustment in these sectors.

***The CJKFTA Should Be Set as the Mid-Term Goal.***

Most of the East Asian countries are APEC members, according to the trade liberalization timetable of APEC, trade liberalization shall be realized before 2020. ASEAN FTA plans to reduce the tariff rates to zero among member states before 2015. China, Japan and Korea have signed or have been negotiating FTA or EPA with ASEAN countries respectively and all of them will be implemented within next 5 to 10 years. However, as the three largest economies in East Asia, China, Japan and Korea are relatively lagging behind in forging mutual free trade relationship. Without substantial progress in this aspect, the process of regional economic cooperation in East Asia would be slowed down. Since the EAFTA is being studied as a long-term goal, it is necessary to set CJKFTA as a medium-term objective and implement it before the establishment of EAFTA. In order to show the political will of the three countries to actively promote the establishment of CJKFTA, it is recommended that the Tri-Party Committee should hold serious dialogues over the official joint research on CJKFTA.

***The active participation of the business community and the support of governmental officials are beneficial for The Joint Research.***

Model simulation and statistical analysis are obviously insufficient for analyzing such a complicated issue, the possible implications of the CJKFTA. The opinions from the business community are invaluable for perfecting the joint research. It would be a good trail to make interaction between the two mechanisms, the joint research and the trilateral business forum, by introducing the progress of the joint research on CJKFTA to the business forum and inviting the forum's organizers of the three countries to attend the workshops of the joint research. During the process of the trilateral joint research, if the governments of the three countries could provide more support with necessary information, consultation and constructive opinions, it would be of great benefits to the trilateral research teams to pursue the ways towards the CJKFTA and put forward positive and pragmatic joint policy recommendations. At the same time, it is recommended that China, Japan and Korea should disclose its information regarding the FTA they have concluded as much as possible.

***The trilateral research teams shall continue to conduct joint research on the CJKFTA.***

Mutual trust, cooperation and win-win aspiration built among the three representative research institutions in the past three years has laid down a sound foundation for the joint research of the next stage. The Joint Research on CJKFTA shall continue to be policy-oriented. Based on the analysis of the sectoral implications of tariff cuts for trade in goods of the three countries, the contents of the CJKFTA research shall be expanded further to the cost and benefits of trade liberalization. Trade in services including producer services, non-tariff barriers, protection of IPR, investment, the framework of CJKFTA and implementation steps, will also be important research topics.

## Introduction

Since 2003, a joint research project on the “Economic Effects of a Possible FTA between China, Japan and Korea” has been undertaken by the three representative institutes of the three countries. The Research in 2003 focused on the impact of the CJKFTA on the macro-economies of the three countries. Following an overall analysis of this subject, the three research teams conducted a joint research on the “Sectoral Implications of a China-Japan-Korea FTA” in 2004, analyzing cross-sector impacts in general, and the three sectors of agriculture, automobiles and electronics in details.

Based on the research of the last two years, the theme of joint research in 2005 is “Towards a CJKFTA: Visions and Tasks”. The research is mainly concerned with the following three sectors: fishery, textile and steel. A general analysis on the implication of the CJKFTA on the services industries in the three countries has also been initiated.

After three years of cooperation, the joint research on the CJKFTA has achieved some significant results. The three involved institutions hereby jointly submit a comprehensive report of the current phase, along with policy recommendations, to the leaders of China, Japan and Korea.

## I. The Rationales of Accelerating the Process of CJKFTA

Since the 1990s, regionalism has become a worldwide phenomenon alongside economic globalization. Most industrialized and developing countries have adopted regionalism, of which, many belong to several regional trade agreements (RTAs). As of July 8$^{th}$, 2005, there are 180 RTAs in force notified to the World Trade Organization (WTO). It is estimated that over half of the global trade is conducted between members of RTAs.

Among the numerous RTAs, the European Union (EU) and the North American Free Trade Agreement (NAFTA) arouse special attention. In Europe, the EU accepted 10 new member states in May 2004, enlarging to 25-member. In America, encouraged by the success of NAFTA established in 1994, 35 countries have been pursuing a Free Trade Area of the Americas (FTAA). Two mega-trade blocs are forming in Europe and America, respectively.

After the Asian Financial Crisis, the process of regional economic integration in East Asia has also been accelerated. Many East Asian countries and regions, including China, Japan and Korea, have signed several RTAs and more bilateral FTAs are under negotiation and consultation.

The Japan-Singapore New-Age Economic Partnership Agreement (JSEPA) signed in 2002 has already been in force. After this, Japan reached agreement in principal with Thailand, Malaysia and the Philippines respectively on major elements of their bilateral EPA. Japan has also made progress in bilateral negotiations with Korea and Indonesia. In 2002, China signed the Framework Agreement on Comprehensive Economic Cooperation with ASEAN. Following the conclusion of the bilateral talks on trade in goods, the China-ASEAN Free Trade Area (CAFTA) came into effect in July 2005. Trade liberalization will be realized between China and the Old Six ASEAN members by 2010, and the FTA between China and all the ASEAN members will eventually be established by 2015. The FTA negotiation between Korea and Singapore has been substantially completed. In addition, Japan and Korea are also holding FTA negotiations with ASEAN as a whole, respectively.

However, as one of the major economic regions in the world, East Asia has not yet formed a regional trade agreement covering the whole area. At the ASEAN-China-Japan-Korea (10+3) Summit Meeting in 2003, Chinese Premier Wen Jiabao put forward a proposal to conduct a feasibility study on an East Asian FTA (EAFTA), which won favorable responses from the leaders of other nations. In April 2005, the East Asian countries have established an Expert Group to carry out academic researches on the feasibility of an EAFTA.

According to the Bogor Declaration of APEC, members of developed countries will realize trade liberalization by 2010, and developing members will achieve trade liberalization by 2020. As most of the East Asian countries are APEC members, they shall realize trade liberalization by 2020 according to the timetable of APEC. The

AFTA plans to reduce the intra-regional tariffs to zero by 2015. Furthermore, China, Japan and Korea have signed or have been negotiating FTAs or EPAs with the ASEAN countries respectively. As a result, a network of free trade relationships shall be formed in East Asia in the coming decade. However, as the three largest economies in East Asia, China, Japan and Korea are lagging behind in forging free trade relationship among each other. If no substantial progress is made in this aspect in the medium-term, it could slow down the process of regional economic cooperation in the entire East Asia.

In terms of economic size, China, Japan and Korea represent 90% of the East Asian economy. Without free trade among the three countries, trade liberalization within the whole East Asia could not be realized even with the formation of three "ASEAN + 1" FTAs. Therefore, it is necessary to set the establishment of a China-Japan-Korea FTA (CJKFTA) as a med-term objective so that the three countries could play their due roles in the process of East Asian regional economic integration. The formation of an FTA covering all countries in East Asia is not only consistent with the tendency of the worldwide regionalism, but also conducive to promoting trade liberalization under the multilateral framework.

## II. Simulation Results of the Macro-economic Effect with Updated Data

Two years ago, the Trilateral Joint Research Teams adopted a multi-country and multi-sector Computable General Equilibrium (CGE) model to simulate the likely macro-economic effects generated by a CJKFTA. According to the simulation results, the establishment of CJKFTA will bring great macro-economic benefits in terms of production, trade and economic welfare for the three countries. In this sense, establishing a trilateral FTA will be a win-win-win situation.

This year, the Joint Research Team entrusted the Japanese experts to carry out the econometric analysis for the second time, using the updated database of the Global Trade Analysis Project (GTAP). The simulation was conducted assuming a trilateral

FTA, which means zero bilateral tariff rates between any combination of the three countries. The new simulation results (see Table 1) indicate once again that CJKFTA will bring huge economic benefits to the three countries. Compared with the basic scenario, Korea benefits the most in terms of GDP growth, while Japan benefits the most in terms of welfare gains. Compared with the simulation results two years ago, China's gains in economic growth and welfare gains seem to have diminished. This is because the new simulation results have excluded the benefits obtained by China from its accession to the WTO in 2001, which has promoted economic structural optimization through tariff reductions. The other countries may suffer from small loss of GDP and economic welfare by the CJKFTA. This reflects trade diversion effects, that is, China, Japan and Korea are likely to replace some imports from other countries with imports from each other. Despite the above marginal negative effects, the total welfare in the world will increase indicating once again that the CJKFTA is a win-win-win strategy.

**Table 1: Macro-economic Effects of CJKFTA**

| | GDP Growth (%) | Economic welfare gains (million US $) |
|---|---|---|
| China | 0.30 | 3349 |
| Japan | 0.37 | 16760 |
| Korea | 3.55 | 12446 |

Source: Calculated by Dr. Kazutomo Abe.

Because of the nature of the model simulation, one should note the following constraints. First, the simulation results are not forecast of the economy. The model only measures the net effects of the policies that reflect of eliminating all tariffs. Therefore, other important changes that affect the economic growth are ignored. Secondly, the simulation results also ignored the policy effects that could be generated by the tariffs cut on FDI. In fact, according to the experiences of China and NAFTA, trade liberalization would not only stimulate intra-regional investment, but would also attract more FDI inflow from outside the region. Therefore, the positive effects of trade liberalization are probably greater than the simulation results.

## III. Cross-Sector Industrial Impacts of CJKFTA

In the research report of last year, we analyzed initially the advantageous industries of each country and the sensitive industries that may be disadvantaged in competition after China, Japan and Korea eliminated tariffs based on the Revealed Comparative Advantage (RCA) Index and Tariff Structure by industries of the three countries in 2003. Since there are complex input-output relations, trade and FDI within and outside the region, and industrial policy, as well as a relationship of upper-stream and down-stream industries, we still need to analyze in-depth the cross-sector impacts of trade liberalization through model simulations.

Based on simulation results by the CGE model, with reference to the research results of the previous year and the specific industrial analyses of this year, Table 2 describes briefly the cross-sector industrial impacts brought about by elimination of tariffs between China, Japan and Korea. Due to the assumption that, if trade liberalization is realized, the countries will import cheaper products, an substitution effect will be brought about to the output of disadvantaged industries in those countries, and the resources will be concentrated into sectors with comparative advantages, the output of some sectors will decrease compared with the basic scenario while others will grow. Table 2 shows the major benefited sectors in China are agriculture, textiles and electronics, while the automobile industry will be subjected to greater losses. The major benefited sectors in Japan are chemicals and general machinery, while the agriculture sector may suffer the most. The major benefited sectors in Korea are textiles, chemicals and electronics with agriculture sector subjected to major losses.

It is worth noting that the reduction of outputs in some sectors is merely in comparison with the basic scenario, rather than reductions in absolute quantity. Moreover, within a certain sector, situations may be quite different depending on upstream or downstream industries. Even for those sectors that may experience reductions in absolute quantity, such as the food processing sectors in Japan and Korea as well as the heavy and chemical industries in China, the governments are mainly faced with pressures for structural adjustment. If the adjustment of industrial structures can be gradually completed through such measures as establishing compensation mechanism and adopting a phasing-out period for tariff reductions, the overall economic gains are likely to be huge as more and more resources are allocated into those high-profit industries.

**Table 2: Cross-sector Industrial Impacts of the CJKFTA**

| | China | Japan | Korea |
|---|---|---|---|
| Agriculture | + | - | - |
| Fishery | + | / | - |
| Textile | + | - | + |
| Electronics | + | / | + |
| General Machinery | - | + | - |
| Steel | / | + | / |
| Automobiles | - | + | / |
| Chemical | - | + | + |

Note: + means the output increases, - means the output decreases, and / means the impact is quite small.

## IV. Assessment of the Impacts of CJKFTA on the Fishery, Steel and Textile in the Three Countries.

### 1. Fisheries

Fisheries production of China, Japan and Korea rank first, fourth and twelfth respectively in the world and accounts for 40% of the world total. The fisheries production structure in the three countries differs markedly. Firstly, the percentage of inland freshwater fisheries products in China is approximately 40% of all products, while the percentage is less than 2% in Japan and Korea. Secondly, direct catch is the main mode of production in Japan and Korea, with a percentage of 70%, while aquaculture in China accounts for about 50% of all sea surface fisheries products. These structural differences indicate that there exist complementarities between the three countries in terms of fisheries resources and mode of production. Working population in fishing industry is 1.6 % in China, higher than 0.27 % in Korea and 0.2 % in Japan.

*The Main Characteristics of Trade in Fisheries Products in the Three Countries*

First of all, Japan is a net importer of fisheries products and the biggest fisheries importer in the world. China is the largest fisheries producer, with an export scale ranking second in the world. Korea turned from a net exporter into a net importer in 2002, ranking 11$^{th}$ importer and 14$^{th}$ exporter in the world fisheries market.

Secondly, the three countries are mutually important trade partners in fisheries products. In 2004, Japan and Korea were the main markets for Chinese exports, Japan was the most important market for Korean exports (more than 60%), while China was the most important source of import for Korea (36.4%). Between 2000 and 2004, China experienced an increase in both import and export of fisheries products with Japan and Korea. Japan's exports to Korea increased rapidly, while its imports from Korea decreased significantly.

Thirdly, China has maintained trade surplus in fisheries with Japan and Korea, while Japan continues to run trade deficit with China and Korea. Korea has a trade deficit with China and a surplus with Japan.

*The Competitiveness and Complementarities of Fisheries Products between the Three Countries*

Because of product differentiation and prices or quality difference of fisheries products in Japan and Korea, complementarities between the two are more obvious. China has lower level of complementarities with Japan and Korea in fisheries products.

A comparison of the competitiveness of the three countries in the global fisheries products market by adopting the RCA index reveals that Japan and Korea do not compete in the world export market, neither do Japan and China, but China and Korea may compete in live fish, fresh and refrigerated fishes, crabs and other fisheries products for export to the global market. However, judging from ESI (Export Similarity Index), Export competition among China, Japan, Korea turn out to be very low generally in international market.

*The Tariff and Non-tariff Measures on the Fisheries Trade between the Three Countries*

China and Korea still remain high level of tariff rates in fisheries. Japan is the lowest (4.5%), followed by China (12.8%), and Korea (17.5%). Japan maintains several species-specific import quotas and Korea also uses adjustment tariffs on fisheries products.

Non-tariff measures are also reported to be prevalent in the import of fisheries products, such as customs and administrative procedures, inspection and quarantine, product quality and packing standards. Non-tariff measures are an important factor that restricts the trade of fishery products between the three countries.

*The Impacts of CJKFTA on Fishery Industry*

Due to the fact that China has the most competitive edge in fisheries among CJK in terms of low production cost and huge aquaculture production capacity, China would be the most beneficiary in case of the realization of CJKFTA in the short term. China, Japan and Korea share common sea area as well as fisheries resources. Japan and Korea have similar fisheries capabilities, while China is less competitive in this field.

In the long run, domestic demand in China, especially demand for the saltwater fisheries products, are expected to rise in the future and will challenge the supply capacity of its fisheries industry. The fisheries industries in Japan and Korea could benefit more from investment in the field of aquaculture and processing in China and from expanding export of saltwater fisheries products to China.

2. **Steel**

*Steel Trade between China, Japan and Korea*

China, Japan and Korea play important roles in the world production and trade of steel. The crude steel produced by the three countries in 2003 accounted for 38.9% of the world total, of which China accounted for 22.7%, Japan accounted for 11.4% and Korea accounted for 4.8%. In 2004, CJK's steel exports and imports reached 20% and 19.7% of the world total.

The degree of interdependence in steel trade between China, Japan and Korea is very high. In 2004, exports to Korea and China accounted for 26% and 23.6% of Japan's total steel exports respectively. China and Japan accounted for 32.1% and 15.3% of Korean exports respectively. Korea and Japan accounted for 22.1% and 10.1% of all Chinese exports of steel respectively.

According to RCA Indices, most of China's exported steel products with comparative advantages are raw processed and low value added products. Japan enjoys comparative advantage mostly in products with high technological level. Korea enjoys comparative advantage in between Japan and China.

Judging from the Export Similarity Index (ESI, see table 3), between 2001 and 2004, ESI between Japan and Korea was the highest and decreased slightly. Both the ESI between China and Japan and that between China and Korea rose significantly, showing a substantial rise of international competitiveness of China's steel products.

**Table 3: Export Similarity Index (ESI) of Steel Products in the Three Countries**

| | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|
| Japan-Korea | 58.45% | 57.39% | 58.66% | 53.85% |
| China-Japan | 23.55% | 35.93% | 32.53% | 37.74% |
| China-Korea | 19.45% | 31.38% | 26.53% | 31.46% |

Source: Calculated according to HS 6-digit code statistics in the UN Database.

*Tariff Structure of the Three Countries*

The tariff rates in China are the highest, while those in Korea and Japan are relatively low. In 2004, the average tariff level of China on steel products was 5.06%, while those for Korea and Japan were 0.61% and 0.01% respectively. In terms of weighted average tariff rate, China still levies the highest duty, while Japan and Korea are quite low (Table 4).

**Table 4: The Weighted Average Tariff Rate of Imported Steel Products by China, Japan and Korea**

| | All Products | Products from Korea | Products from Japan | Products from China |
|---|---|---|---|---|
| China | 4.63% | 5.25% | 5.36% | —— |
| Korea | 0.73% | —— | 0.26% | 1.01% |
| Japan | 1.20% | 0.02% | —— | 0.74% |

*The Impacts of CJKFTA on the Steel Industries of the Three Countries*

If the three countries eliminate tariff between each other, China's imports of steel products from Japan and Korea would grow considerably in the short term. In particular, those products with quite high tariff rates (e.g. more than 10%) will probably pose greater competitive pressure on local enterprises. Since Japan and Korea apply zero tariffs on most of steel products, CJKFTA may have no direct impact on the steel trade between the two and relatively small on China's export to Japan and Korea.

Considering the adjustment of the development direction for the steel industries in the three countries, the static effects mentioned above may be changed. In order to restrain the exports of products with highly energy consumption and serious environmental pollution, China has taken measures to restrict the exports of many raw processed steel products. In the case of Japan and Korea, both limit the development of steel industry to some extent with emphasis laid on controlling the energy consumption and promoting the recycling of resources. Therefore, Japan and Korea may not considerably expand steel production capacity and are likely to adjust the structure and destination of their exports.

## 3. Textile

### *Main Characteristics of the Textile Industries in China, Japan and Korea*

The textile industry can be divided into two categories, namely the textile and the apparel. Generally speaking, textile industry is more capital intensive and automated than that of the apparel industry. According to product characteristics, the apparel industry can again be classified into two types: the high quality and high value added clothing sector, and the low quality and mass-production clothing sector. While the former is knowledge and technology-intensive, the latter is relatively labor-intensive. On the whole, the textile and apparel industry is characterized by high proportion of small- and medium-sized enterprises.

The three countries' share of export of textiles and apparels in the world totaled 24.8% and 30.3% in 2003. China is the largest textile and apparel producer as well as exporter of apparels in the world with rapidly increasing trade surplus. Japan is one of the major net-importers of apparels in the world. Korea is an exporter of textile and apparels, but its trade surplus has been decreasing gradually in recent years.

China, Japan and Korea are important trading partners with a interdependent relation in textile and apparel trade. In 2004, the proportion of intra-regional trade in textile products among the three countries stood at 34.8%, much higher than that of intra-regional trade in goods (24.1%). China accounted for 74.2% and 50.5% of the textile imports by Japan and Korea, and Japan and Korea accounted for 20.8% and 15.5% of the textile imports by China respectively. China has been maintaining a textile trade surplus with Japan for a long time, and the magnitude of surplus is rising. Since 2002, China's textile trade with Korea has turned into a surplus. The bilateral trade in textile and apparel between Japan and Korea is relatively small, and Korea enjoys a marginal trade surplus.

*Comparisons of Market Openness and Competitiveness of the Textile Industries in the Three Countries*

In 2004, Japan's tariff rates for textile and apparels are relatively low on the whole (6.4%). The corresponding figures are 10% for Korea and 15.4% for China, which will be reduced significantly to 11.4% in 2005.

In 2003, RCA Index of China's textile industry was as high as 2.97, followed by 1.37 for Korea and merely 0.28 for Japan. This indicates that the competitiveness of China's textile and apparel industry is very strong, while that of Japan is relatively weak, and Korea is in between and relatively strong. In terms of specific sectors, China enjoys apparent competitive edge in labor-intensive, low value added and mass-production sectors, such as fibers and yarn made from natural materials and apparels. Japan and Korea are exporters of high value added products with comparative advantages in capital- and technology- intensive sectors such as filaments, staple fabrics, as well as in design and marketing of high-quality apparels. Korea specialized in processed textiles and knit fabrics among three countries with competitiveness in the world market in terms of quality and price.

**Table 5: Competitiveness of the Textile and Apparel Industries in China, Japan and Korea（TSI）**

| | China-Japan | China-Korea | Korea-Japan |
|---|---|---|---|
| Natural silk | 0.49 | 0.59 | 1.19 |
| furs like wool | -0.20 | 0.31 | -1.58 |
| cotton | -0.45 | 0.13 | -0.30 |
| other plant fibers | -0.07 | 0.79 | -11.59 |
| Chemical Fiber, Continuous Filament | -0.85 | -0.68 | 0.80 |
| Chemical Fiber, Staple Fiber | -0.77 | -0.25 | 0.33 |
| Adhesive-Bond Fabrics | -0.44 | -0.45 | 1.04 |
| carpets | 0.90 | -0.15 | -0.16 |
| special woven fabrics | -0.65 | -0.51 | 0.80 |
| Textiles | -0.63 | -0.70 | 1.12 |
| Knitwear and Crocheted Fabrics | -0.88 | -0.91 | 1.04 |
| Knitted or Crocheted Garments | 0.98 | 0.96 | 0.97 |
| Garments Not Knitted or Crocheted | 0.97 | 0.93 | 0.97 |
| other textile products | 0.98 | 0.82 | 0.84 |
| **Total for Textile and apparel** | **0.62** | **0.17** | **0.28** |

Source: Calculated according to customs statistics of the three countries.

Note: The TSI ranges between -1 and 1. The closer to 1, the stronger the competitiveness is.

*Impacts of CJKFTA on the Textile and Apparel Industries of the Three Countries*

If the tariffs are eliminated among the three countries, the competitive advantage in terms of price of China's products will be greater leading to continued growth of exports to Japan and Korea. However, judging from large export flow to date, trade intensity in low value-added and mass-production products, the room for export growth is quite limited. In addition, since labor costs only accounting for a small share in high value-added products, China's export of apparels to Japan and Korea may not increase so rapidly by removal of tariff.

It is conceivable that Japan's export of man-made filaments and fibers to China increases. The same situation applies to Korea's export of knitted fabric, man-made fibers and other processed textiles. Japan and Korea also has a potentiality to increase export of apparels to China. It is conceivable that China will become more and more a large market for high value added apparels from Japan and Korea.

On the whole, through the elimination of tariff and non-tariff barriers and the enhancement of specialization, there is room to increase regional trade among three countries by a CJKFTA. But, for Japan and Korea, the primary pressure results from accelerating the adjustment of employment structure in textile industry. In recent years, the textile enterprises of the two countries have stepped up transferring production bases to China, which accounts for 64% and 42% respectively of their overseas investments. It is conceivable that the vertical intra-industry trade relations have been formed by FDI among three countries. As a result, Japanese and Korean textile enterprises will be the major beneficiaries of CJKFTA.

## V. A General Analysis on the Impacts of CJKFTA on the Service Industries of the Three Countries

In 2004, service industries accounted for 33.2%, 68.8% and 62.6% of China, Japan and Korea's GDP respectively. Compared with countries with similar levels of economic development, however, the service industries in the three countries are relatively underdeveloped than the manufacturing industry.

In recent years, trade in services of the three countries has been growing rapidly. According to WTO's statistics, all three countries saw an increase of over 20% in services trade in 2004. However, the performances of China, Japan and Korea in services trade are not as good as those of trade in goods. In 2003, the three countries' total export and import in services accounted for only 8.5% and 11.2% of the global total. Furthermore, the proportion of intra-regional trade in services among China, Japan and Korea has been very low, standing at 6%-7% by estimation in 2004, which is much lower than the proportion of intra-regional trade in goods (24.1%). All of the three countries have been running trade deficit in services over past ten or more years.

*An Analysis on the Liberalization and Competitiveness of Services Trade in China, Japan and Korea*

In terms of GATS/WTO market access commitments for trade in services, Japan is the most liberalized among the three countries and has made commitments to 73.5% of the 155 service sub-sectors, and the corresponding figures for Korea and China are 67.7% and 54.2% respectively.

**Table 6: RCA of CJK and the Top Four in Global Trade in Services**

| | China | Japan | Korea | USA | UK | France | Germany |
|---|---|---|---|---|---|---|---|
| Services | 0.48 | 0.74 | 0.71 | 1.49 | 1.63 | 1.07 | 0.70 |
| Communications | 0.37 | 1.15 | 1.69 | 1.07 | 1.06 | 1.08 | 0.75 |
| Tourism | 0.63 | 0.30 | 0.40 | 1.46 | 0.88 | 1.40 | 0.46 |
| Telecommunications | 0.33 | 0.31 | 0.53 | 1.39 | 1.83 | 1.35 | 0.74 |
| Insurance | 0.12 | 0.13 | 0.06 | 0.89 | 4.06 | 0.84 | 1.43 |
| Patent and Royalty Fees | 0.02 | 2.33 | 0.57 | 4.72 | 2.24 | 0.88 | 0.49 |
| Other Commercial Services | 0.81 | 0.77 | 0.65 | 1.42 | 2.25 | 1.18 | 0.82 |
| Finance | 0.03 | 0.67 | 0.31 | 1.76 | 5.01 | 0.24 | 0.47 |
| Computer & Information Services | 0.36 | 0.32 | 0.02 | 0.84 | 2.65 | 0.43 | 1.18 |
| Labor, Culture and Entertainment | 0.03 | 0.10 | 0.13 | 2.79 | 1.92 | 1.57 | 0.37 |
| Construction | 1.46 | 0.00 | 0.08 | 1.47 | 0.40 | 3.34 | 4.40 |

Source: Calculated by Dr. Yoon Chang-In based on IMF, *Balance of Payments Statistics*

*(2005).*

Through a comparison of sector composition of services trade in the three countries' balance of payments, as well as an analysis of RCA indices, it is clear that China enjoys comparative advantages in tourism; Japan enjoys comparative advantages in receiving royalties and license fees, while Korea enjoys comparative advantages in the field of transportation.

*Impacts of Further Liberalization on Service industries of the Three Countries*

In order to develop trade in services to satisfy the demands caused by the trade in goods among the three countries, it is necessary to consider including services trade into the framework of CJKFTA. Further liberalization in services trade will promote competition in the regional services market. The stronger competition associated with regional services trade, can reduce costs and prices, increase efficiency and innovation, and broaden the range of services being offered. It can also reduce the fragmentation of services markets. More productive services sector can also be the foundation for the better performance of the manufacturing sector, as this increasingly relies on support and inputs from efficient producer services.

Competition may also bring about some negative effects. When the supervisory institutions' capabilities lag behind the requirements by liberalization, market risks will grow in the short term, particularly in finance sector. For those sectors that provide public and business services simultaneously, liberalization will challenge the supply of comprehensive services to the public. In order to make the most of merit of services trade, it is important to enhance domestic deregulation for increase of trade. From the standpoint of improvement of productivity of domestic service sectors, progress of domestic deregulation also needed.

The preferential arrangements on market access between the three countries are likely to constitute discrimination against service suppliers from other countries, thus causing welfare losses to local consumers. Therefore, the three countries should vigorously push forward the liberalization process under the multilateral framework while further opening up their services market to each other.

## VI. Joint Policy Recommendations

***CJKFTA should comply with WTO Rules.***

China, Japan and Korea account for a large share in global trade. Especially in the areas of automobiles, steel, electronics, textiles and agricultural products, the proportion of imports and exports of the three countries in the global market is even higher. Therefore, the establishment of a free trade relationship between the three countries should pursue not merely the maximization of mutual interests, but also jointly promote the multilateral trade liberalization process. CJKFTA in the future should follow WTO rules concerning the regional trade agreements (RTAs), promote comprehensive and substantial liberalization and facilitation in such fields as trade in goods, trade in services and investment, and strengthen the economic and technological cooperation in broad areas. While opening markets to one another, the three countries need to consider opening markets to other East Asian countries and participating actively in the feasibility study on East Asia Free Trade Area (EAFTA), so as to play constructive roles in achieving the long-term goal of establishing an “East Asian Community”.

***Accelerating structural adjustment in sensitive sectors through external pressure and setting timetables.***

Although all three countries have sectors with weak international competitiveness such as agricultural, manufacturing and services industries, long-term dependence on market protection is likely to slow down the pace of structural adjustment and miss out the huge economic benefits brought about by trade liberalization. For those sensitive sectors (namely, sectors that are likely to suffer from competition and relatively high costs of structural adjustment in employment after losing protection), it is necessary to reduce the social costs by such means as compensation schemes, job training and social safety net, etc. On the other side, to counter pressures from the interest groups in the vulnerable sectors, there is a necessity to propose plans for structural readjustment and timetables for market opening in an effort to accelerate the structural readjustment in these sectors.

***The CJKFTA Should Be Set as the Mid-Term Goal.***

Most of the East Asian countries are APEC members, according to the trade liberalization timetable of APEC, trade liberalization shall be realized before 2020. ASEAN FTA plans to reduce the tariff rates to zero among member states before 2015. China, Japan and Korea have signed or have been negotiating FTA or EPA with ASEAN countries respectively and all of them will be implemented within next 5 to 10 years. However, as the three largest economies in East Asia, China, Japan and Korea are relatively lagging behind in forging mutual free trade relationship. Without substantial progress in this aspect, the process of regional economic cooperation in East Asia would be slowed down. Since the EAFTA is being studied as a long-term goal, it is necessary to set CJKFTA as a medium-term objective and implement it before the establishment of EAFTA. In order to show the political will of the three countries to actively promote the establishment of CJKFTA, it is recommended that the Tri-Party Committee should hold serious dialogues over the official joint research on CJKFTA.

***The active participation of the business community and the support of governmental officials are beneficial for The Joint Research.***

Model simulation and statistical analysis are obviously insufficient for analyzing such a complicated issue, the possible implications of the CJKFTA. The opinions from the business community are invaluable for perfecting the joint research. It would be a good trail to make interaction between the two mechanisms, the joint research and the trilateral business forum, by introducing the progress of the joint research on CJKFTA to the business forum and inviting the forum's organizers of the three countries to attend the workshops of the joint research. During the process of the trilateral joint research, if the governments of the three countries could provide more support with necessary information, consultation and constructive opinions, it would be of great benefits to the trilateral research teams to pursue the ways towards the

CJKFTA and put forward positive and pragmatic joint policy recommendations. At the same time, it is recommended that China, Japan and Korea should disclose its information regarding the FTA they have concluded as much as possible in order to avoid unexpected cost and losses of the business sectors of their countries.

***The trilateral research teams shall continue to conduct joint research on the CJKFTA.***

Mutual trust, cooperation and win-win aspiration built among the three representative research institutions in the past three years has laid down a sound foundation for the joint research of the next stage. The Joint Research on CJKFTA shall continue to be policy-oriented. Based on the analysis of the sectoral implications of tariff cuts for trade in goods of the three countries, the contents of the CJKFTA research shall be expanded further to the cost and benefits of trade liberalization. Trade in services including producer services, non-tariff barriers, protection of IPR, investment, the framework of CJKFTA and implementation steps, will also be important research topics.