THE POTENTIAL OF CHINA-JAPAN-KOREA FREE TRADE AGREEMENT

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Executive Summary

1. China, Japan and South Korea began the trilateral Free Trade Agreement (CJK FTA) talks on 26 March 2013 despite Japan's unresolved territorial issues with the other two.

2. According to a joint report, CJK FTA will increase China's GDP by 0.4%, Japan's by 0.3% and South Korea's by 2.8%. It will bring more pressure on China's domestic manufacturing sectors as well as Japan's and South Korea's agricultural sectors.

3. China has gone a step further in constructing a regional free trade network with the CJK FTA. A more unified regional market may minimize the impact from the US and Europe's slowdown on China's economy. A regional economic integration led by China will also augment China's political clout on the global stage.

4. South Korea has intended to prioritize bilateral negotiations with China because of its export potential. China is the largest export destination for South Korea, accounting for 24% of its total exports in 2012.

5. It is also concerned that a CJK FTA will lead to its further dependence on Japanese core components and technology and worsen South Korea's trade deficit with Japan, which had amplified from US$9 billion in 1991 to US$26 billion in 2012.

6. Japan has regarded South Korea's recent progress on FTAs, in particular with the US and European Union (EU), as a threat to Japanese export-oriented industries, especially for cars, home appliances and machinery. Japanese entrepreneurs urged the government to pursue Trans-Pacific Partnership (TPP) as an alternative to Japan-US FTA.

7. Both CJK FTA and TPP are equally important for Japan's export expansion. China is an especially important market for Japan's machinery and electrical machinery (45% of Japan's total exports to China in 2012) while the US is an essential market for Japanese motor cars (33% of Japanese total exports to the US in 2012).

8. Political factors, such as the historical issues and unsettled territory disputes, will continue to be uncertain variables in the development of a CJK FTA, which could become an important stabiliser for trilateral political relations in the future.

9. The three countries also joined members of ASEAN, Australia, New Zealand and India to form the Regional Comprehensive Economic Partnership (RCEP) and launch trade negotiation in 2013. Meanwhile, the US-led TPP negotiation among member states is still in progress.

10. While RCEP is a regional cooperation, the TPP is cross-continent with higher free trade standard. The stalled Doha negotiation implies that a US-led TPP may surpass the World Trade Organization in terms of promoting global trade and investment liberalization. As the world's second largest economy, China is unlikely to be excluded from the TPP.