

**Japan, China and South Korea have much to gain from regional partnership accord  
Trilateral economic pact expected to propel both competition and cooperation,  
Infrastructure building to be facilitated and growth spurred**

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**Summary**

Japan, China and South Korea, differently developed economically, can contribute to the growth of one another by competing in the markets for goods and services on the one hand and, on the other, cooperating in the construction and operation of broadly defined infrastructures that can be regarded as quasi-international public assets. To this end, an economic partnership agreement, incorporating a free trade agreement, will provide an effective means.

**Joint study foresees rich economic benefits in Asian EPA with FTA as its core**

Japan, China and South Korea, differing from one another in stage of economic development and industrial structure, will likely be able to increase their respective competitiveness by promoting various exchanges and cooperation among them. The efforts, moreover, will help create an environment beneficial for the growth of all three economies.

In order to identify ways of cooperation conducive to the economic growth of Japan, China and South Korea, and propose policy measures to stimulate such cooperation, international joint research was undertaken under the auspices of the Japanese Ministry of Foreign Affairs bringing together Japan Center for Economic Research, Renmin University of China, Shanghai Academy of Social Sciences, and Samsung Economic Research Institute of South Korea.

The project examined the competitive strengths of the three countries not only as nations but on the levels of cities, industrial sectors and individual businesses, studied possibilities of cooperation in the areas of broadly defined economic infrastructures with major influence on growth, such as energy supply, information technology, logistics and finance and currency, made projections about future

industrial structures, and analyzed expected effects of a trilateral free trade agreement (FTA), the centerpiece of the project's proposals, on the three economies.

Regarding future industrial structures, input-output tables were used to estimate, industry by industry, the average annual rates of growth in real output from 1995 through 2010. For Japan, estimates generally ranged below 2.0% with the exceptions of 5.6% in electrical machinery and 6.1% in telegraph/telephone. For China, particularly rapid growth was foreseen in industries related to logistics and energy, including 11.8% in telegraph/telephone, 6.1% in transportation and 9.1% in crude oil/natural gas. As for South Korea, the telegraph/telephone industry, like its Japanese counterpart, displayed a strong prospect with estimated growth averaging 8.1% a year.

Effects of a Japan-China-South Korea FTA were simulated on an applied general equilibrium model, resulting in projected contributions to real growth in gross domestic product (GDP) of 0.033 percentage point for Japan, 0.484 point for China and 0.298 point for South Korea. With a model expanded to include the Association of Southeast Asian Nations (ASEAN), GDP-boosting effects of FTA for the original three countries came out even greater, rising to 0.061 point for Japan, 0.497 point for China and 0.366 point for South Korea.

### **Division of work over energy**

With respect to competitiveness, analyses show, Japan is ahead as producer of high-value-added goods by virtue of its superior standards of science and technology, while China excels in the production of low-value-added goods owing to its abundance of low-cost labor. South Korea comes in between, harnessing its comparative wealth of physical capital to a competitive advantage in the field of medium-value-added goods. The three countries, then, can expect to maximize the efficiency of resource allocations among them by respectively specializing in product categories where native strengths can be made the most of.

At the same time, developing countries such as China continue to stand to gain from assistance and cooperation from developed countries such as Japan. Having reached the highest level of economic development, Japan needs a close relationship with China for its own sake, since the latter's overflowing dynamism can

help Japan keep its economic vigor fueled and its living standard improving. Research results indicate the importance of policy initiatives to liberalize trade and investment and upgrade the protection of intellectual property rights in order to facilitate further increases in trade and direct investment among Japan, China and South Korea.

In Southeast Asia, an emerging consequence of continuing high growth is that the supply of energy is falling short of matching growth in consumption. According to statistics compiled by BP plc of Britain, Asia accounted for 28.9% of global energy consumption in 2002, rivaling North America and Europe-Eurasia including the former Soviet Bloc. Surging Asian energy demand, centered in China and other East Asian nations with their promise of sustained high growth, has the potential to exert negative influence on both regional and global economic growth. This calls attention to the importance of deepening cooperation in a variety of manners among energy-thirsty Japan, China and South Korea.

There is a wide range of conceivable areas of cooperation, including exploration of foreign energy resources, construction and operation of pipelines and other means of transportation, development of technologies for improving efficiencies in energy use, and crude oil stockpiling. To take the example of overseas oil exploration, Japan is experienced in prospecting while China has its credit successes in drilling wells and building and running production facilities at low costs. South Korea has a role to play in financing and construction.

Regarding stockpiling, the Japanese government could take a lease of a large oil terminal in Okinawa, now practically idle, and lease it out to China and ASEAN countries as a conveniently located and inexpensive joint stockpiling base.

At a time when IT businesses are expanding by leaps and bounds worldwide, Japan, China and South Korea together have captured large shares of global IT hardware production -- 37.7% in notebook personal computers (85.8% when Taiwan is added), 40.7% in desktop PCs and 58.1% in mobile phones as of 2002. When it comes to software production, however, the combined Japanese, Chinese and South Korean share in 2002 was only 14.5%, trailing far behind 40.2% for the United States and 31.0% for Europe.

Cross-border cooperation has a vital role to play if full advantage is to be taken of the growth of the overall IT industry including software. A framework has lately taken shape for both public and private sectors of Japan, China and South Korea to join hands to propagate open-source software. In a like spirit, a program of joint experiments is getting started with the aim of winning international standard status concerning the next-generation Internet Protocol, or IPv6.

For these initiatives to bear fruit, it is desirable to have in place supportive systems such as an arrangement to pool knowledge gained through international joint projects for sharing by enterprises of participating countries. A pertinent model is Europe's Eureka, a 17-nation partnership that has driven 1,300 projects investing an aggregate 14 billion euros (1.9 trillion yen).

Across Japan, China and South Korea, outmoded logistical infrastructures are impeding the expansion of trade in both hardware and software terms. In South Korea, a plan is under way to make a Northeast Asian logistical hub of its Incheon International Airport, including the introduction of four-runway service by 2008. But the ambition will not be fulfilled as long as China adheres to its current policy of one airline per one route. In China, besides, efforts to meet fast growing logistical demand are being hampered by restrictions on the entry of foreign capital in domestic logistical services, a barrier standing in the way of building up high-efficiency integrated transportation systems. As for Japan, old customs keep logistical costs high, for example a rigid regime of labor-management consultations over port-area conveyance practices. It is high time that the three governments began multi-track talks in the interest of higher logistical efficiency, transcending jurisdictional partitions.

### **Single currency is ultimate goal**

In the endeavor to realize sustained economic growth in East Asia, a major policy task is to keep regional currencies stable. A monetary union built around a single currency is the natural ultimate goal, but before that there should be two preparatory steps -- (1) pegging the value of each national currency to a basket of currencies and (2) creating an Asian Monetary System with the adoption of an Asian Currency Unit as its core.

Central to the first stage is the building up of consensus on the importance of

currency basket peg, including concomitant establishment of an Asian Monetary Fund with contributions from Japan, China and South Korea. By the second stage, the Chinese yuan would have to acquire convertibility and this would be premised on Beijing putting its economic policy management on a robust footing and cementing the foundation of its financial system.

Japan, on its part, should secure international confidence in its economy and finance on the strength of sound economic policies and step up efforts to further internationalize the yen. South Korea, with its recent experience of making the won convertible, can show the way for the rest of East Asia and play a constructive role as backer of Japanese and Chinese leadership.

Analyses under the joint research project point up the importance for Japan, China and South Korea to compete vigorously in the markets for goods and services, improve the quality of factors of production, and work together in the construction and operation of broadly defined infrastructures that are substantially of the nature of international public assets. An economic partnership agreement (EPA), of which free trade agreement is a part, is the most effective policy instrument for pursuing the said kind of competition-cooperation mix.

There are a number of obstacles for the three countries to overcome on the path to such a partnership. For instance, resistance is bound to come from sectors likely to be hurt by freer trade and investment. A countermeasure would be to provide people falling victim to intensified competition with education and training that would uplift their abilities and improve their chances of landing jobs of higher productivity.

The impediments will be the easier to clear the better shared the understanding of the merits of advancing liberalization and cooperation among the peoples of Japan, China and South Korea. Hence the importance of enlivening debate over EPA and moving ahead with relevant reforms wherever possible.

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