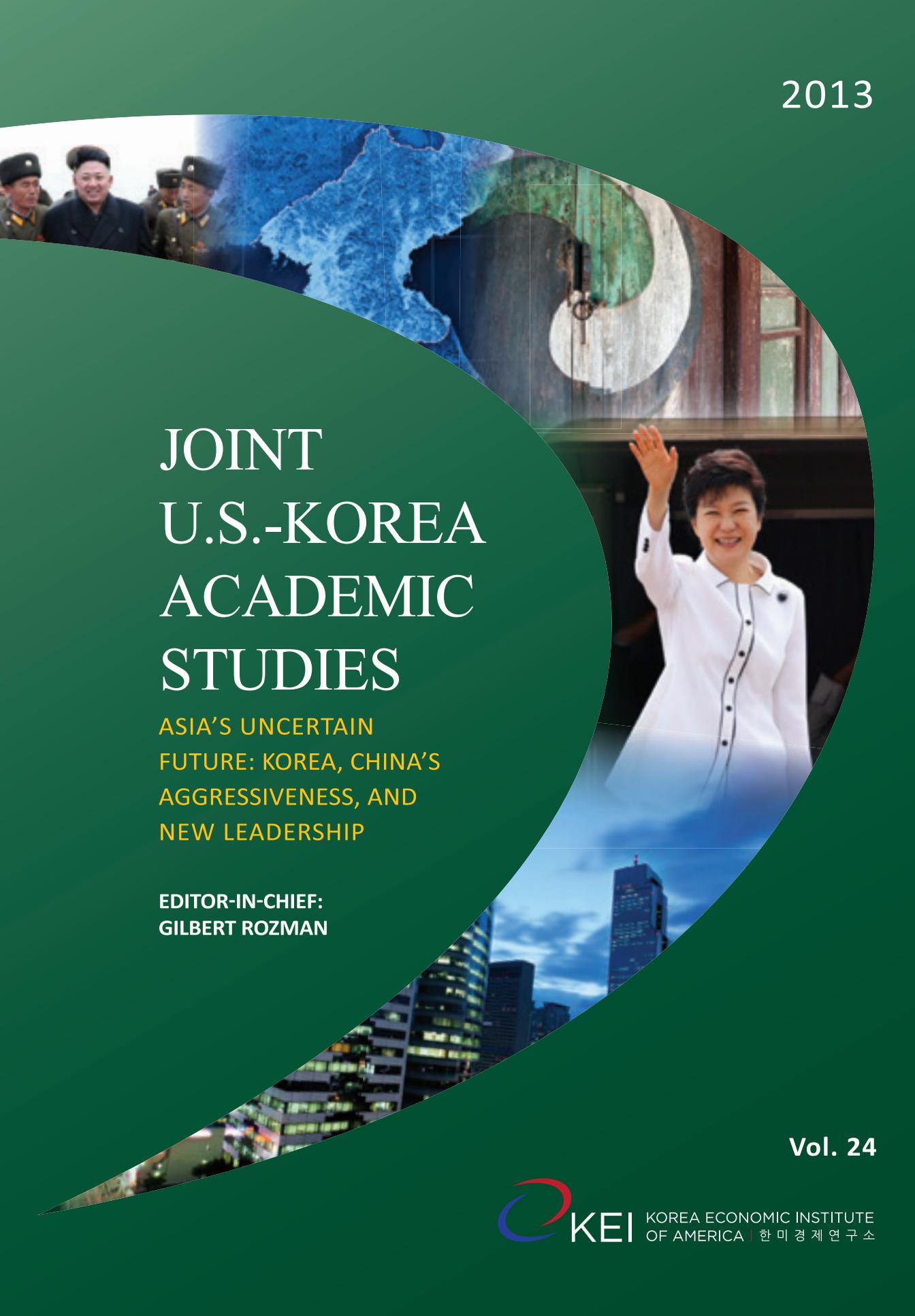


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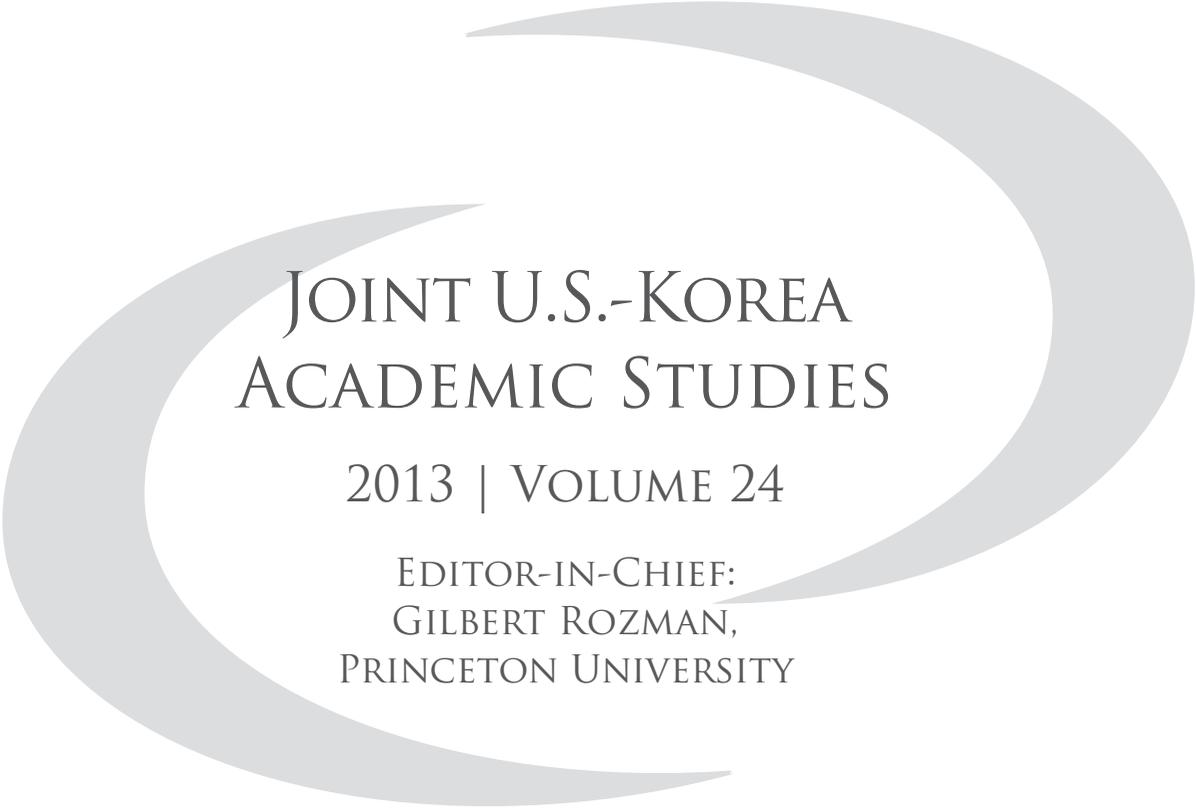


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CJK ECONOMIC TRILATERALISM:
THE PROSPECTS AND PERILS
OF A NEW FTA

INTRODUCTION

After more than a decade of energetic pursuit of FTAs, a moment of decision has arrived in 2013. Three far-reaching, multilateral initiatives are simultaneously under negotiation: TPP, Regional Comprehensive Economic Partnership (RCEP), and the CJK FTA. Their fates are intertwined, and their impact on the institutionalization of regional economic integration promises to define the future of Northeast Asia. The focus in Part III of this book is the CJK FTA, which, if concluded, will dramatically expand and deepen intra-Asian integration. If China succeeds in drawing both Japan and South Korea closer economically in this way, it would ensure that trilateralism, which was regularized in 1999 and gained momentum through separation from ASEAN + 3 in 2008, but appeared to be in jeopardy due to growing regional tensions from 2009 to 2013, is not dead. If Japan were to balk at what many now view to be China's suffocating embrace, the chances would rise for a sharp Sino-Japanese split with far-reaching implications for the region, with likely spillover damaging Sino-U.S. relations. Moreover, if South Korea were then to go ahead with a bilateral FTA with China, the divide could extend to Japanese-South Korean relations. How the CJK FTA talks proceed will have ripple effects on the other negotiations and on the balance between integration and polarization in Asia. As TPP negotiations intensified in the spring of 2013, drawing Japan closer to the United States, the CJK FTA talks seemed to be falling behind.

The three FTAs are being negotiated simultaneously. Since Japanese Prime Minister Abe Shinzo announced his administration's intention to join the TPP talks and then won approval from all of the states already involved in the talks, Japan is the sole overlapping presence in all three groupings. Given the advanced state of the TPP talks and the longstanding barriers to trade within Japan, this is likely to consume Tokyo's energy for a year or longer. Meanwhile, ASEAN is expected to push RCEP in the next months. Together, those talks may squeeze the CJK FTA into the background, although Sino-South Korean FTA talks could gain momentum.

The pessimistic case has been gaining momentum recently after years when realization of a CJK FTA was deemed to be just a matter of time. There are at least four reasons. First, unlike previous episodes, which were often characterized as "economics hot, politics cold," the firewall between economics and politics has begun to crack, with spillover from troubling political and security relations increasingly impinging on regional economic relations. Second, China's use of unofficial economic sanctions, such as the suspension of rare earth metal exports, has fueled growing concern in Japan and elsewhere about excessive dependency on a state that appears willing to play by its own set of rules. Third, leaders in the region have been arousing emotional national identity sentiments and catering to forces disinclined to compromise on protectionist interests. Finally, the deterioration of public goodwill in bilateral relations, most notably in Sino-Japanese ties but also between Japan and South Korea and China and South Korea, means that the trust necessary for an FTA is in jeopardy. In an uncertain economic atmosphere it is desirable to expand FTAs with one's closest trading partners, but this motivation does not necessarily trump anxieties about the overall nature of bilateral relations. Perhaps, most worth watching is whether or not Seoul and Beijing accelerate their bilateral trade negotiations especially if the Chinese prove helpful in pressuring Pyongyang, which could leave Tokyo marginalized as it concentrates on the challenge of negotiating its way into the TPP.

The four chapters that follow present perspectives from the three states in pursuit of the CJK FTA as well as those of the United States. They report on the significance of the CJK FTA

negotiations as seen from each country. They also address questions that include: What are the benefits that would accrue from an agreement, and what are the main obstacles to such a deal? The authors trace the past trade policies of each country and assess their respective progress toward broader FTAs, while also keeping their eyes on the geopolitical context that complicates the trust needed for the CJK FTA. They expose the differences in attitudes in the four countries, showing China most enthusiastic, South Korea largely also positively disposed, Japan much more hesitant, and the United States as refusing to view the CJK FTA as opposed to the TPP FTA, but eager to bring the TPP into existence first. A major difference is in how the chapters prioritize the impact of economic logic and geopolitical calculus in their analysis. If economics drives decisions, prospects rise. If politics are in command, trilateral trade liberalization seems a more distant goal.

Chang-Jae Lee offers an optimistic outlook on the CJK FTA's chances, emphasizing its promise for economic growth and its possibilities for improving the political climate. He traces a decade of preparations and catalogues many supporting factors at a time when these states cannot depend on the United States or the EU for growth. Lee highlights Korean analyses that point out that East Asia has become a major engine of global growth but, despite this, the region still lacks a mechanism to carry intra-regional trade to a new level. He recognizes that certain industries in South Korea will prove sensitive, most notably the textile sector with China and the automobile and machinery sectors with Japan. Whereas Japanese agriculture is sensitive toward the price advantages of South Korea, South Korea's agricultural and fishing interests will likely exert strong political pressure against a deal with China. Lee suggests that the order of priority for South Korea is the CJK FTA, the RCEP, and only then the TPP, since South Korea already enjoys preferential access to the U.S. market via the KORUS FTA. He predicts that South Korea will take a leading role in negotiating the CJK FTA, given its successful pursuit of other FTAs, its high level of intra-regional trade dependency, and its great need to reduce the level of tensions in the region.

Scott Harold sees China vigorously pursuing the CJK FTA, arguing that it has been transformed in China's view from a largely economic deal to a strategic agreement with implications for China's regional leadership role. Beijing aims to use such an agreement to reshape the economic trajectory of the region, thereby expanding its overall influence, wooing allies away from the United States and resisting what is perceived as a strategic threat in the form of the TPP. According to numerous Chinese sources, the FTA would not only bring many economic benefits, it also would offer geopolitical advantages. Harold identifies obstacles in China that reflect opposition from various interests, but he notes that Chinese analysts generally downplay these considerations, insisting that the only truly important barriers come from actors in Japan, South Korea, and the United States. Indeed, such analyses may be right. Of late, Japanese businesses have evinced considerably less support for the CJK FTA than previously. Harold concludes by describing the bargaining strategies Chinese analysts perceive as available to Beijing to reach a deal on the CJK FTA. The most prominent of these is the idea of offering substantial incentives to Seoul to ink a bilateral FTA that could be used to drive a wedge between South Korea and Tokyo as a way to put pressure on Tokyo to come to terms with Beijing in order not to be left behind. From this perspective, poor coordination between Japan and South Korea as well as lack of progress in the TPP talks would serve China's geopolitical aspirations and its economic plans.

T.J. Pempel puts Japan's approach to the CJK FTA in the context of a lengthy history of protectionism, exacerbated when Abe Shinzo served his first stint as prime minister in 2006-07, during which time he pulled back from Koizumi's reforms. While agreeing to both the CJK FTA and TPP would be beneficial economically and politically and while Abe is consolidating power in a way that may give him the political clout to proceed, Pempel argues that the political will necessary for pushing ahead on both deals may be lacking. After all, earlier discussion of an FTA between Japan and South Korea floundered on the prospect that Japan would have to open its agricultural sector. After meeting with Obama in February, Abe made the decision to join the TPP negotiations. Before the political climate in Japan may permit consideration of the CJK FTA, Japan will likely face heavy pressure from the states involved in TPP talks to confront its vested interests. Increasingly, Japan and South Korea are eyeing each other's responses to trade openness as their firms compete in similar markets.

In the final chapter in Part III, Claude Barfield traces U.S. trade policy, showing what preceded the Obama administration and what pathway the new administration followed, particularly after a sharp shift in trade strategy that came at the end of 2009. The TPP is widely described as the first 21st century agreement, although Barfield raises doubts about whether it can fulfill these expectations, noting various U.S. interests fighting to limit its scope. In his exploration of the evolution of intra-Asian regionalism, he describes the background to the CJK talks. More than the previous chapters, Barfield brings RCEP into the picture, pointing to three venues poised for competition. At stake are such questions as: Will ASEAN preserve its centrality by shepherding RCEP to a successful conclusion or will it be exposed as an ineffective organization incapable of retaining its central position as the driver of Asian reorganization? Seeing TPP as containment, will China push hard for RCEP? And in the face of competition, will the United States push hard for TPP? In Barfield's view, the CJK FTA is unlikely to go forward due to both political and economic opposition inside Japan, but a Chinese-South Korean FTA has better prospects. Barfield argues that a lot is riding on the TPP, and that the Obama administration should urge Japan and South Korea to be aware that U.S. economic interests in the TPP are deeply entwined with the country's regional security responsibilities. In Abe's February 2013 summit with Obama and in his March declaration that Japan would join the TPP negotiations, a breakthrough appeared to be in sight, leaving South Korea in bilateral FTA talks with China and on the outside of the rush for a 2013 TPP agreement.

Taken together, these four chapters make clear that the CJK FTA is inextricably connected to the region's strategic environment and the alternative FTAs of TPP and RCEP. They vary on whether the CJK talks will succeed, end in a bilateral Sino-South Korean FTA that excludes Japan, or be left behind as TPP and/or RCEP moves ahead. At the core of the discussion is the struggle between vested economic interests and the drive for removing barriers to more open trade. Doubters put even more weight on non-economic obstacles. The economists make a strong case for the benefits of FTAs, including optimists who foresee an East Asian FTA encompassing all. The skeptics warn, however, that the regional divide is deepening and, in the short run at least, trade institutionalization centering on China will be negatively affected. Uncertain prospects for the CJK FTA in 2013 may work to the benefit of TPP, especially if Japan continues to show strong preference for closer ties to the United States or grave doubts about becoming more dependent on China.

What the four chapters of Part III make clear is that decisions on TPP or the CJK FTA confront Japan, and to a lesser extent South Korea, with a choice on how to balance economics versus geopolitical considerations in the reshaping of East Asia. Japan, in particular, has a critical role by being involved in both sets of talks. The United States will be seriously tested and could see the scales tip away from inclusive regionalism if it does not pursue TPP with sufficient vigor. China is similarly tested by its perception that its preferred policy outcome is in direct competition with the TPP, forcing it to expend considerable effort to see if it can offer the necessary reassurances to move its priority FTA forward. The partner that can do the most to bridge the divide is South Korea, whose general support of the CJK FTA offers China an opportunity even as its earlier completion of an FTA with the United States affords it a relatively easy pathway into TPP should it choose to take that step.



The Chinese Perspective

Scott Harold

“The [work] report of the 17th Congress [of the Chinese Communist Party] declared that China will ‘implement a free trade area strategy’, the first time China has raised FTAs to the level of national strategy.”¹

“Signing an FTA is something one does not only for economic and trade reasons—such agreements also include strategic considerations related to local security and regional balancing.”²

“The large economic scope and regional impact that would come from establishing a China-Japan-Korea free trade area would ensure that China’s economic interests would not be negatively affected by not entering into TPP, and also guarantee that China’s regional economic cooperation strategy would play a driving role and not be disturbed by America’s strategic plot. It would also ensure that China will play a role and have influence in any future FTAAP talks.”³

Despite turbulence in its bilateral relations with Japan and South Korea over the past several years, China has expressed a continuing and growing interest in establishing a trilateral China-Japan-Korea free trade agreement with its Northeast Asian neighbors, commonly referred to as the CJK FTA. What initially motivated China’s leaders in the early 2000s to attempt to conclude such a sweeping trade deal with two large neighboring economies that have such differing political values and levels of development at a time when the PRC’s own economy was still adapting to greater competition as aspects of its WTO accession commitments were being phased in? Why did they accelerate their pursuit of such a deal in the late-2000s, a period of widely-commented upon backsliding on economic liberalization in the PRC and growing dominance of the economy by the state-owned sector? What benefits from and obstacles to such a deal do Chinese observers see? And, finally, how likely is China to continue its pursuit of such a deal in an era likely to be characterized by slower growth and heightened tensions over territorial disputes with its neighbors, and how do Chinese analysts suggest Beijing proceed?

China’s pursuit of such a deal in an environment characterized by the dominance of an entrenched state-owned sector and a slowing overall rate of economic growth, as well as a backdrop of regional tensions with Japan and South Korea over disputed islands and fishing rights, represents a puzzle for political analysts seeking to understand China’s overall policy motivations. They appear to run against the interests of some of the country’s most powerful economic interest groups as well as its apparent strategy of pressuring Japan and South Korea over disputed maritime features such as the Senkaku/Diaoyu Islands and Ieodo/Suyanjiiao.⁴ Drawing on a wide array of Chinese language primary sources, this paper explores how Chinese observers characterize the relevant background against which the CJK FTA proposal emerged; its perceived economic and geo-strategic advantages; the obstacles Chinese observers see to the completion of such an agreement; and the prospects for the deal moving forward.⁵ It argues that while Beijing’s interest in the CJK FTA was initially spurred by the deepening of regional economic integration in East Asia, more recently China’s motivation for seeking an FTA with Japan and Korea has as much to do with the competition for influence in Northeast Asia with the United States in the wake of the signing of the Korea-U.S. FTA (KORUS FTA) and the announcement of the Trans-Pacific Partnership (TPP) agreement as it does with purely economic issues. As Guoyou Song and Wen Jin Yuan have written, strategic political considerations loom large in the Chinese government’s FTA strategy:

From China's perspective, the [Trans-Pacific Partnership] framework is a crucial component of the US's recent policy initiative of 'returning to Asia,' which poses a challenge for China both economically and geopolitically. To counter-balance the US initiative, China is actively pushing for its own FTA agenda, in particular trying to move forward on the China-Korea and China-Japan-South Korea FTA negotiations, ultimately seeking to construct a regional web of its own free trade agreements.⁶

This chapter proceeds in four parts. Section one looks at the background setting against which China's interest in the CJK FTA developed and deepened. In section two, the study turns to an examination of the specific economic and geo-strategic benefits that PRC analysts see a CJK FTA as carrying. Following this, section three examines the obstacles to concluding such a deal that Chinese observers perceive. The essay closes with a look at the prospects of a CJK FTA in light of several important recent developments and how Chinese analysts assess the road ahead.

BACKGROUND

Chinese observers trace the origins of Beijing's interest in an FTA with Japan and South Korea to the 1997-1998 Asian financial crisis and the impetus it gave to policy coordination, trade liberalization, and continued economic integration as a recovery strategy.⁷ Following China's 2001 accession to the WTO and the stagnation of the Doha round of trade negotiations, Beijing began to pursue bilateral and regional FTAs designed to expand access to its neighbors' markets while tying their economic interests and developmental trajectories ever more closely to China.⁸ By 2004, this resulted in an FTA between China and its ten neighbors in ASEAN, with the China-ASEAN FTA (CAFTA) seen by many Chinese analysts as a step towards pan-Asian economic integration, including an FTA with Japan and South Korea. During these years, China did not see substantial initiatives by the United States or other actors to shape the geopolitical environment in Northeast Asia through economic agreements, and as such the motivations for seeking a CJK FTA, while present, were not considered pressing.

As China's GDP growth rate accelerated through the 2000s, its regional economic influence expanded rapidly, with large numbers of multilateral firms moving their end-site production and assembly chains to China, leading to regional economic integration (*quyu jingji yitihua*) centered on the PRC.⁹ Chinese analysts highlight this regional economic integration as a major reason for seeking an FTA with Japan and South Korea, arguing that Beijing needs the ability to shape the economic structure of the region in which it is active the same way that Brussels and Washington define the rules of the world's other two largest economic centers, the EU and NAFTA. To that end, between 2003 and 2009, a joint study team comprised of researchers from government-linked think tanks in China, Japan, and South Korea evaluated the prospects for a CJK FTA, concluding that such a deal would result in gains for all parties. Chinese analysts looking at the growing trade linkages and economic development of Northeast Asia noted that China, Japan, and South Korea were all highly trade-dependent economies whose primary exports markets were located outside of the region, with many calling for steps designed to "break away from reliance on the United States and the current dollar-dominated mode of globalization."¹⁰

In addition to its expanding economic weight and interests, China's motivation for pursuing a CJK FTA deal was given new impetus by the evolution of regional trade agreements and developments in the global economy during the latter years of the 2000s. By the time the think tank feasibility study had concluded, there were signs that extraregional developments in the form of housing bubbles and debt crises originating in the United States and Europe were beginning to pose risks to the economic progress of Northeast Asia, spurring Chinese leaders to intensify their efforts to press ahead with a trilateral Northeast Asian FTA. In late 2009, leaders from the three countries reached an agreement that a tripartite study group including government officials should be convened. A formal Joint Study Committee was launched in May 2010, concluding its work in a *Joint Study Report* on December 16, 2011.¹¹ Several developments combined to spur this increased Chinese attention to and commitment towards the formation of a trilateral Northeast Asian FTA.

First, the 2007 signing of the KORUS FTA promised to bring Seoul and Washington closer together both economically and politically and increased Washington's influence in the rules setting for the Northeast Asian region's economic architecture. The 2009 European Union-Korea FTA further reinforced the challenges Beijing faced in attempting to shape the evolution of the region's economy. Beijing sought to respond to these developments by accelerating its own efforts to ink a bilateral FTA with South Korea and to conclude the proposed trilateral FTA with South Korea and Japan.

Second, the global recession that began with the bursting of the U.S. housing sector bubble, the collapse of Bear Stearns and Lehman Brothers, and the insolvency of other major financial and industrial firms added further incentive to efforts to integrate the Chinese economy more deeply with regional partners as a way to reduce dependency on faltering demand in the United States, something Charles W. Freeman III and Wenjin Yuan have described as "a wake-up call for China's leadership."¹² As Sheng Bin has written, "in order to more effectively respond to the financial crisis and increase Northeast Asian regional cooperation, from 2008 onwards China, Japan, and Korea successfully hosted three leadership summits, leading East Asia's three most influential great powers towards the track of a more systematic form of regional cooperation."¹³ As Japan's economy began to slow, and as the sovereign debt crisis in the Eurozone economies emerged in early 2009, China further accelerated its efforts to negotiate a CJK FTA.¹⁴

Finally, the late 2008 U.S. announcement that it would join the TPP agreement, followed by the 2011 announcement by Japan that it would consider negotiating to join the TPP, led many Chinese analysts to conclude that the struggle to determine the shape of the region's economic future would boil down to a battle between a comprehensive liberal architecture defined by the United States or a more selectively open set of rules centered on agreements negotiated between Beijing and its neighbors. As Shen Minghui has written, China's priority should be to sign a CJK FTA because the "TPP is an attempt by the United States to set international economic rules in response to the development of East Asian cooperation, especially China's peaceful rise."¹⁵ Similarly, Wu Jinyan has written that China must push ahead with regional integration based on an FTA with South Korea and Japan because:

If [the TPP] agreement's expansion is successful, it will deal a serious blow to East Asian regional integration... [Thus] even if the difficulties are many... if we do not seize [the opportunity to determine the economic rules of the game in Asia], the chance to exert leadership over the process of economic

integration in East Asia will never again be in our hands [and] we will be unable to guarantee our interests.¹⁶

Indeed, for many Chinese analysts, including Professor He Li, if the United States and Japan join together in a TPP agreement, it will be a reflection of the two powers' strategy of "resisting China's peaceful rise," since at base:

The competitive relationship between the TPP's trans-Pacific scope for economic integration and East Asian economic integration is essentially a competition between a U.S.-led wide-area approach to economic integration and a Chinese-led approach to economic integration.¹⁷

Wei Lei and Zhang Hanlin describe the TPP in similar terms, arguing that "blocking the establishment of a unitary Asian trading bloc is an important goal of American trade policy," and going further to explain that in their view TPP is designed to "weaken China's regional economic influence."¹⁸

Clearly, while China's initial interest in a CJK FTA was driven by economic concerns, this motivation was insufficient to spur an extremely active effort to conclude such an agreement. More recently, however, the strategic implications of the effort to define the future direction of Northeast Asia's economic and trade development have given added geopolitical motivations to China's efforts to sign a deal, enabling leaders to override domestic economic interest groups' opposition as well as to pursue such an agreement even when political relations with Seoul and (especially) Tokyo are experiencing serious turmoil. For China, the CJK FTA has become an important tool for wooing U.S. allies Japan and South Korea; shaping the economic trajectory of Northeast Asia; expanding its regional influence; and resisting what it perceives as a strategic-level threat from the United States in the form of the TPP agreement. Indeed, to highly-protected Chinese state-owned enterprises, it would appear that a less demanding FTA with Japan and South Korea is less threatening than the demanding labor, environmental protection, intellectual property protection, and other high-level standards required by the anti-state capitalist TPP deal. This may explain why opposition to the CJK FTA from Chinese firms has been very hard to detect. The next section explores other advantages Chinese analysts expect a CJK FTA to bring to China, including both economic and geopolitical or strategic considerations.

CHINESE PERSPECTIVES ON THE ADVANTAGES OF A CJK FTA

Chinese analysts tend to break the advantages of an FTA with the country's two large neighbors in Northeast Asia into economic and political-strategic categories. Official policy statements from the Chinese government largely focus on the economic aspects of such an agreement, making only the most cursory comments on the geopolitical aspects of any CJK deal.¹⁹ Mainstream analyses published in the Chinese language press tend by and large not to depart very substantially from the Chinese government's own stated views of the economic aspects of a CJK FTA, taking these as their starting point and expanding on them marginally without ever expressing opposition to or reservations about such an arrangement.

The government's official view of the utility of a CJK FTA, as explicated by the Ministry of Commerce (MOFCOM), centers around the deal's anticipated "four big impacts" (*si da yingxiang*) and "three big utilities" (*san da zuoyong*).²⁰ The impacts that MOFCOM forecasts include:

- Domestic demand (estimated to rise by 0.4 percent of GDP), consumption (estimated to grow by 1 percent of GDP) and investment (also estimated to expand by 1 percent of GDP);
- Fiscal revenues, which are expected to expand despite the lowering of tariff rates as imports expand in overall volume while domestic demand, consumption, and investment rise leading to greater revenue from sales and value-added taxes;
- China's trade balance with the region, which is expected to rebalance, with Chinese exports growing by an estimated 4 percent even as imports grow by 7 percent, leading to a healthier and more politically-sustainable set of trading relations with the country's neighbors and even possibly contributing to a reduction in imbalances with the United States and EU; and
- Transformation in the structure of China's trade with Japan and South Korea, as an agreement gradually enables China to move away from a situation where it exports low-technology goods and imports high-technology products, thus allowing the PRC economy to climb the value-added chain into more advanced product markets.²¹

At the same time, MOFCOM analysts predict that a CJK FTA would carry utilities, including:

- Expanding foreign competitive pressure, broadening opening and reform, accelerating the pace of domestic firms' structural adjustment, and raising the efficiency of resource allocation;
- Matching economic diplomacy up to political diplomacy, thereby advancing the formation of a 'harmonious world'; and
- Establishing a stable political and security environment by expanding common regional interests, such as environmental protection, resource exploration and development, and combating transnational crime.²²

In addition, Zhao Jinping, Director of the State Council's Development Research Center, has stated in an interview with the Chinese media that his center's research indicates a CJK FTA could add as many as eight million new jobs to the Chinese economy, spurring exports to rise by 4.43 percent and imports to grow by 6.32 percent.²³ Other analysts at this center have claimed that a CJK FTA could cause China's GDP growth rate to accelerate by as much as 2.9 percent.²⁴ Chinese academics and think tank analysts tend to take these MOFCOM assertions as the starting point for their own discussions of a prospective CJK FTA, expressing confidence that it would lead to a "big increase" in Japanese and Korean investment into China; an expansion in overall trade between the three countries; greater regional integration; increased international competitiveness; an improved ability to resist the impact of global financial crises; and improved regional peace and security.²⁵

Chinese observers routinely highlight the "complementary" (*hubuxing*)²⁶ nature of the three countries' economies as a reason for pursuing an FTA, describing Japan as an advanced economy with large amounts of capital and high technology, South Korea as a newly industrialized country with large and sophisticated firms oriented towards exports, and China as a developing country with low-cost labor and land. Indeed, as Zhou Xinsheng, a professor at Shanxi College of Finance and Economics, argues in a typical formulation, the

lack of “any sort of regional cooperation framework has seriously constrained this region’s economic development,” something that a CJK FTA is intended to address.²⁷ In specific, the industry sectors that Chinese observers expect will see major advantages in a CJK FTA include textiles, tourism, labor-intensive services and manufacturing.²⁸ Additionally, some PRC observers highlight the utility of a well-crafted CJK FTA agreement as being likely to reduce trade conflicts through effective dispute resolution mechanisms and improve the efficiency of capital and resource allocation.²⁹

While official Chinese government statements maintain diplomatic propriety by avoiding almost any discussion of anything other than economic motivations for the pursuit of a CJK FTA, almost every scholarly, think tank, and business world analysis examined in the course of this study placed heavy, in many cases predominant, emphasis on the geopolitical imperatives for pursuing such a deal. Such analyses tend to describe “regional [economic] integration” (*quyu yitihua*) as the core of Beijing’s strategic foreign economic policy. Hyungdo Ahn, in an early assessment of China’s attitude towards the CJK FTA back in 2006, perceived that China was beginning to talk about using an FTA strategy to “build its position as a leading nation in world politics” by developing a “China-oriented economic cooperation structure in the region” so as to “build a road to a major hegemony against [the] U.S. using FTA policy.”³⁰ More recently, many PRC analysts highlight the value of a CJK FTA in countering the proposed TPP, which many observers, such as Cai Penghong, Director of the APEC Research Center at the Shanghai Academy of Social Sciences, describe as “a tool... of [the U.S.’s] Asia-Pacific strategy to contain China.”³¹ As Wenjin Yuan has written, such views are commonplace in China, where “the TPP agenda is considered by many Chinese policymakers and scholars as a centrifugal force arising to rip asunder the regional economic integration of East Asia... [and] economically contain China’s rise.”³² In response, Yuan notes, “the Beijing leadership is actively pursuing its own FTA agenda as a strategy to counter-balance the TPP agenda.”³³ As noted above, He Li argues for such an approach, asserting “China needs to rethink its approach to economic integration from a high-level strategic perspective so as to respond actively to the new challenges posed by TPP.”³⁴ The prospect of using a CJK FTA as a tool to resist expanding U.S. political and economic leadership in Asia, especially after the announcement of the U.S. intent to join TPP, was a major additional reason for pursuing a Northeast Asian trilateral FTA. At the same time, the existence of the TPP deal and other factors in China’s external relations have called into question whether a CJK FTA can actually be accomplished. The next section explores the stumbling blocks to such a deal that Chinese analysts perceive.

OBSTACLES TO A CJK FTA IN CHINESE EYES

Clearly, negotiations to integrate three economies as large, diverse, and complex as those of China, Japan, and South Korea, would be challenging under any circumstances. Several factors specific to the relationships between the three countries, as well as their ties to external actors, make a CJK FTA even more challenging. Chinese observers point to obstacles that will need to be overcome, including divergent political and value systems; contentious bilateral relationships stemming from a lack of political trust;³⁵ issues of historical conflict and intensifying territorial disputes;³⁶ tensions between Japan and China over regional leadership; and perceived U.S. opposition.

In addition, the challenges of liberalizing market access to certain industrial sectors in each country are expected to demand protection in ways that would complicate negotiations, owing to the “great differences in the industrial structures” of the countries’ economies.³⁷ Indeed, some Chinese observers see the “large gap in the levels of economic development” as both a positive factor (inasmuch as the economies complement each other) as well as a potential obstacle (given the greater vulnerability of Chinese economic actors and fears among some in the PRC that any deal will lock China into a perpetual position low on the value-added chain).³⁸ One concern is that relatively uncompetitive and highly protected agricultural and fisheries sectors in Japan and South Korea are likely to pose challenges to a CJK FTA, opposing market opening to China’s lower-cost agricultural products.³⁹ Additional obstacles are likely to include opposition from China’s relatively uncompetitive high-technology manufacturing services industry;⁴⁰ difficulties stemming from the challenge of harmonizing market rules, management, and standards across the three economies;⁴¹ and opposition from Chinese manufacturing firms operating in the petroleum, steel-making, automotive, mechanical and electronics, and ship-building sectors as well as those companies providing services in the financial, insurance, and royalties sectors.⁴²

Despite these concerns, Chinese analysts imply that the primary obstacles come not in the form of resistance from Chinese-side interests or left-wing Maoists opposed to free trade in principle, but rather from economic interests in Japan or Korea, or from the United States. This is almost certainly due to the extreme non-transparency of lobbying and policy-making in China. It also likely stems from the difficulty of getting analyses that oppose stated government positions placed in academic journals (a selection bias effect may affect our understanding of the true state of Chinese assessments of such a deal). The growth of nationalistic sentiment and the incentives for academics and think tank analysts to mute their criticisms and support government positions may also play a role. Finally, the impression that Chinese observers think that the obstacles to a CJK FTA come primarily from Japan, Korea and the United States may also derive from an acknowledgement that, when it is determined to do so, the Party can override opposition from economic interests due to its appointment power over the leadership of all major firms, and thus it will not be Chinese domestic actors who block any deal from being signed.⁴³

Mainstream academic and think tank analysis reflects a fairly high degree of consensus about the origins, benefits, and obstacles to a CJK FTA. Where one finds the greatest divergence in opinion in published Chinese analyses of such an agreement is in the realm of strategy for successfully concluding such an agreement, which is discussed in the final section below.

IS A CJK FTA STILL POSSIBLE AND HOW SHOULD CHINA PROCEED?

Tensions between Beijing and Tokyo over the Diaoyu/Senkaku Islands and between Seoul and Tokyo over Dokdo/Takeshima, as well as deepening strategic mistrust between China and the United States over the past three years,⁴⁴ make the prospects of concluding an agreement on a CJK FTA anytime in the near future unlikely. Although the leaders of China, Japan, and South Korea met in Beijing in May 2012 to ink a trilateral investment liberalization agreement, and promised to open FTA talks by the end of the year, these positive developments were rapidly overtaken by events, including the August 2012 visit to Dokdo by Lee Myung-bak; the September 2012 purchase of several of the Senkaku islands under

Noda Yoshihiko; and the state-permitted rampages against Japanese companies, properties, and persons under Hu Jintao.

In light of the row over the disputed islets, Ministry of Commerce spokesman Shen Danyang confirmed on September 20, 2012 “We are still discussing a trilateral free trade agreement between China, Japan and South Korea, but this will surely be affected by Japan’s unlawful ‘purchase’ of the islands.”⁴⁵ Despite the fact that top-level Chinese officials refused to meet with their Japanese counterparts during the early autumn of 2012, working-level talks on a CJK FTA went ahead as scheduled.⁴⁶ When leaders and trade ministers from the three sides finally did meet in Phnom Penh on November 20, 2012, they agreed to initiate talks on an FTA deal in early 2013.⁴⁷ Indeed in late February 2013, trilateral preparatory talks were concluded in Tokyo, with the three sides agreeing to a first round of formal talks in late March or early April, a surprising outcome in light of the escalating tensions stemming from Chinese air and maritime intrusions into Japanese-administered areas around the Senkakus.⁴⁸ While prospects for concluding a trilateral FTA in the near- to medium-term look bleak, Abe Shinzo’s announcement that he would push for Japan to join the TPP negotiations appears to have kept pressure on China. In response, Beijing appears willing to separate politics and economics, moving as far ahead on technical negotiations and talks as possible so as to preserve momentum even if concluding a final FTA is not possible at present. As of mid-March 2013, the transitions from Hu Jintao to Xi Jinping, from Noda Yoshihiko to Abe Shinzo, and from Lee Myung-bak to Park Geun-hye did not appear to have given any additional impetus to the proposed FTA, with each side focusing primarily on firming up administrative staffing, responding to the North Korean nuclear test, and managing their continuing differences over history and divergent claims to territorial rights.

Nonetheless, prior to 2012 at least, PRC analysts emphasized the “inevitability” (*biranxing*)⁴⁹ of a CJK FTA based on the three countries’ geographic size and proximity, which may explain both the absence of anxiety on the Chinese side as well as its confidence that economic logic will eventually drive Japan and Korea into Beijing’s embrace. As late as January 2012, for example, an official commentary by Zhong Sheng (a pseudonym for ‘Voice of China’) in *People’s Daily* argued that “a trilateral FTA is feasible and will benefit all three sides... [and] bring practical benefits to the people.”⁵⁰ Increasingly in 2012, however, Chinese academic and think tank observers gave voice to the view that the establishment of a CJK FTA would probably be a “mid- to long- term goal that will require a gradual approach to realize,” or even a “marathon.”⁵¹ Indeed, Hu Wenxiu has written that “the negotiation process is destined to be long and it may even be possible for the negotiations to last for another 10 years.”⁵² In no small part, the worsening prospects for concluding a CJK FTA can be attributed to China’s policies on the Senkaku Islands. Whereas previous Chinese analyses of Japan’s interest in a CJK FTA would routinely argue, as Shen Minghui did in comments in early 2012, that China need not worry too much about Japanese interest in the TPP because Japanese business groups’ interest in the China market would restrain Tokyo, since late 2012 Japanese firms have been moving to reduce their dependency on China and push their investments in other directions, and Japan is set to move forward with TPP while slow-rolling any CJK FTA.⁵³ Indeed, a December 2012 survey of Japanese firms by the JETRO indicated cooling interest in China, with only 52.3 percent indicating that they are likely to expand their business in China in 2013, a drop of 14.5 percent over the results of the same survey one year earlier.⁵⁴ Beijing has effectively undermined its strongest advocates for deepening economic integration inside the Japanese system.

If these developments seem alarming to Chinese policy analysts, most still appear to agree with Lin Zhiying, Vice-President of the Fung Business Intelligence Center in Hong Kong, who has written that “with China-Japan-Korea economic relations growing closer by the day, the search for a way to develop real cooperative mechanisms is only logical” since the three countries have a collective interest in reducing their reliance on extraregional export demand and increasing the portion of their economic growth that comes from intraregional trade.⁵⁵ Most Chinese analyses suggest that even if progress towards a CJK FTA is delayed, the overall direction of regional economic development is likely to continue to push the three countries towards ever closer cooperation, eventually resulting in a trilateral FTA. This likely reflects, at least in part, the political reality that it is almost impossible for any PRC-based analyst to publish an assessment of the CJK FTA’s prospects that would in any way find fault with the Chinese government’s reaction to the Senkaku/Diaoyu Islands crisis. What policy steps Chinese analysts think Beijing should adopt in order to get there is the final question this study explores.⁵⁶

Given the difficulties of concluding a CJK FTA, some Chinese observers have suggested that Beijing explore options for trying to force Tokyo to come to terms with Beijing on an FTA. One proposal that has gained a substantial following in the literature consulted for this study would see China drive a wedge between its Northeast Asian neighbors through competitive liberalization meant to incentivize Japan to play on China’s terms lest it be left on the outside of an emerging regionally-integrated trading bloc. For example, Wei and Zhang urge Chinese leaders to counter the advent of the TPP and spur Tokyo to agree to a CJK FTA by striving to:

Accelerate the implementation of a regional economic integration strategy and adopt ‘divide-and-conquer’ tactics... [Although] China wants to sign an FTA with Japan and South Korea, Korea’s attitude is relatively positive while Japan’s response is comparatively cooler. In light of this, China should first prioritize consolidating economic and trade relations with ASEAN and South Korea as a way to draw Japan into FTA negotiations.⁵⁷

Similarly, Jiang Xia has written that the “practical approach is for China to first establish a bilateral FTA with South Korea, and then through this entice Japan to join in, progressively taking steps to expand into a trilateral China-Japan-Korea FTA.”⁵⁸ Chen-Dong Tso, of the Center for China Studies at National Taiwan University, also sees signs that “China [seeks] to play Korea and Japan [off of] one another” and notes that the “most eye-catching” step China has taken in response to the advent of expanded TPP talks has been to try to “speed up the process of [negotiating a] China-Japan-Korea FTA and launch [a] China-Korea FTA.”⁵⁹

Even negotiating a China-South Korea bilateral FTA deal will not be easy, with *China Daily* citing “a source close to the talks” as claiming in late August 2012 that “it is unlikely that a free trade agreement between China and South Korea will be signed within two years, due to disagreements over key sectors” including agriculture, services and manufacturing for South Korea and chemicals, electronics, and automobiles for China.⁶⁰ Observers have warned that an approach to moving ahead on a CJK FTA that relies on pressuring Japan via a China-Korea FTA is likely to run into “no small number of obstacles” including both the prospect that negotiating a China-Korea FTA might stumble or drag on interminably, or else the possibility that Japan would simply ignore it or respond by joining the TPP agreement instead.⁶¹ Parting ways with those who argue that the road to a CJK FTA runs through Seoul, Shen points to Korea’s already extant FTAs with the United States and the European Union,

arguing that these make it less eager to sign additional FTAs, whether bilateral with China or trilateral with China and Japan. Rather than trying to sign a deal with Seoul first, or sign a simultaneous trilateral deal with Seoul and Tokyo, Shen advocates recognizing that Sino-Japanese relations are the key to achieving East Asian economic integration and fending off the threat to China's interests posed by the TPP agreement.⁶² While never laying out recommendations that go beyond the purely economic, Shen's emphasis on the need to recognize the critical importance of Sino-Japanese economic ties for China's overall national interests carries implications for how the country should conduct its broader foreign policy. At present, such advice is not likely to be heeded by Beijing, however.

Other approaches are under consideration in academic and policy circles, ranging from the long-term and abstract to the more concrete and near-term. Among the broader strategies analysts are considering, for example, are the ideas of Sheng Bin, who argues that, rather than pushing ahead directly to negotiations with Tokyo and Seoul, China should focus on expanding its soft power and work to build up a sense of East Asian community by striving to:

[I]nculcate and develop 'Asian values' together with other East Asian countries. The crux of this strategic choice is that it depends on whether or not other East Asian countries share as a common identity with China a vision of regional integration as goal and vision.⁶³

Sheng's colleague, Gong Zhankui, has argued similarly that alongside the growth of a regional common identity there is also developing "a trend towards Asia-Pacific regional trade agreements [that] will push the three countries toward establishing an FTA" and should be leveraged.⁶⁴

More specific ways Chinese analysts have argued the country's trade policy should proceed include focusing on less challenging tasks in the field of trilateral cooperation and expanding to a broader agreement later. For example, Zhou Xinsheng has argued for liberalizing rules governing investment, continuing the increasing specialization of production chains, and deepening regionally-integrated production networks as a way to push forward trilateral trade talks by leveraging sectoral and firm interests.⁶⁵ The trilateral investment liberalization deal inked by the three sides in March 2012 is an important step in this direction since, as Jin Yi has argued:

Investment and trade stand in complementary and supportive relation to each other... Thus, in the process of building an East Asian FTA, it will be necessary to design a bilateral or multilateral investment framework (or to expand the ASEAN investment area to include East Asia) as well as to establish an East Asian currency exchange system, and thereby through trade, investment, and financial integration push ahead with the realization of common East Asian goals.⁶⁶

Still other observers, such as Yuan Changjun, have suggested considering a strategy premised on multilateralizing the three Northeast Asian countries' FTAs with ASEAN into a "10 + 3" collective FTA; building practical cooperation at lower levels that would induce broader cooperation through steps such as agreements to cooperate on rail linkages or energy development and sharing modeled on the European Coal and Steel Community of the 1950s and 1960s that eventually led to the integration that produced the European Union in the 1990s; or accelerating and further developing the China-ASEAN FTA while also signing a

Comprehensive Economic Partnership agreement with South Korea as a step towards a bilateral FTA that could then be multilateralized to include Japan.⁶⁷ Yet another scholar, Zhang Jinping, has even suggested establishing a China-Russia FTA that would later be multilateralized to include Japan and South Korea as a Northeast Asian FTA, an idea that may gain currency as China and Russia resume high-level arms sales, energy cooperation, and a measure of diplomatic coordination on important international problems.⁶⁸

As we have seen, while China's initial interests in a CJK FTA were spurred by the prospect of economic gains, and later by the desire to build its national power through expanded market access, by the late 2000s the motivations for seeking such a deal from China's side had begun to shift towards a quest to insulate it from perceived economic and geopolitical threats from outside the region. It is these later developments that spurred increased efforts to ink a trilateral deal, even against a backdrop of slowing domestic economic reform and intensifying external tensions with its neighbors. While at present it is difficult to imagine the three sides successfully pushing ahead with an FTA because of the poor state of relations between China and Japan, should tensions between the two sides calm, Chinese analysts see numerous economic, and increasingly in recent years geo-strategic, reasons for Beijing to press ahead forcefully on a Northeast Asian FTA. Whether or not China has already done too much damage to its relationship with Japan to reopen a pathway to such a deal will depend in large measure on how Japanese observers perceive the advantages and obstacles to such a deal.

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The South Korean Perspective

Chang Jae Lee

During the early days of Northeast Asian economic cooperation immediately following the end of the Cold War, the China-Japan-Korea FTA (CJK FTA) was considered impossible, not even mentioned as a long-term goal. The Northeast Asian economic community was eventually forwarded as a vision, but without defining what it would be. Even as economic integration proceeded to the point that an FTA of this sort made increasing sense, it was considered difficult to achieve due mainly to non-economic factors such as historical legacies and political rivalries.

Functional economic integration has proceeded quite smoothly among the three countries as trade interdependency has skyrocketed over the past two decades. At the same time, the basic framework continued to develop, providing support for economic integration among the three countries. The most significant was the beginning of regular meetings among the leaders of the three countries since their first gathering in Manila in November 1999 under the framework of the ASEAN+3 summit. Independent trilateral summits have been taking place regularly since December 2008.

It was the trilateral leaders' meeting that launched the Trilateral Joint Research, which conducted the study on the CJK FTA for 2003-2009, and decisions were made at the independent trilateral summits to upgrade it to the Official Tripartite Joint Study for the CJK FTA and later to launch the CJK FTA negotiations. The year 2012 was significant because the three countries officially announced the start of the negotiation process after long preparation. Yet, this was also a time of deteriorating political relations among the three due to territorial disputes. At the end of 2012, there were changes of political leadership in all of these countries, leaving it up to the new leaders to finalize the process of forming the CJK FTA.

After examining the economic status of the three countries and their economic ties, this paper reviews a decade of preparation for the CJK FTA before analyzing positive factors for the CJK FTA as well as elements of risk that could hinder its realization. In doing so, the South Korean perspective is highlighted.

ECONOMIC STATUS OF CHINA, JAPAN AND SOUTH KOREA AND THEIR ECONOMIC TIES

China, Japan and South Korea account for about one-fifth of the world's economy. In 1992-2011, the share of the three economies has slightly increased from 19.2 percent to 20.5 percent. The respective shares of the three have changed a lot. China's economy soared from 2.0 percent to 10.5 percent, while Japan's decreased from 15.8 percent to 8.4 percent. The share of South Korea's economy rose from 1.4 to 1.6 percent. During the same period, their share of the world's exports and imports have substantially grown from 13.4 percent to 18.4 percent and from 10.2 percent to 16.9 percent, respectively. China's share of both jumped enormously, South Korea's also expanded, while Japan's share shrank markedly. Now all three are major trading nations. In 2011, the shares of China, Japan and South Korea in world exports and imports were 10.7 percent, 4.6 percent and 3.2 percent; and 9.5 percent, 4.6 percent and 2.8 percent, respectively.

As for their share of the world's inward and outward investments (in terms of stock), these were much lower than those related to trade; amounting to only 5.2 percent and 7.1 percent,

	1992				2011			
	Korea	China	Japan	CJK	Korea	China	Japan	CJK
Population ¹ (Million)	43.7 (0.8)	1,173.4 (20.9)	124.2 (2.3)	1,341.4 (24.0)	48.7 (0.7)	1,363.7 (19.8)	126.8 (1.8)	1,539.2 (22.3)
GDP ² (US\$ Billion)	338.2 (1.4)	488.2 (2.0)	3,852.8 (15.8)	4,679.2 (19.2)	1,116.2 (1.6)	7,298.1 (10.5)	5,869.5 (8.4)	14,283.9 (20.5)
Export ³ (US\$ Billion)	77.3 (2.1)	85.6 (2.3)	340.1 (9.1)	503.1 (13.4)	562.5 (3.2)	1,901.5 (10.7)	824.4 (4.6)	3,288.4 (18.4)
Import ³ (US\$ Billion)	83.0 (2.1)	81.9 (2.1)	233.0 (6.0)	397.9 10.2	524.4 (2.8)	1,741.5 (9.5)	854.7 (4.6)	3,120.6 (16.9)
Inward FDI ⁴ (US\$ Billion)	6.9 (0.3)	36.1 (1.5)	15.5 (0.6)	58.5 2.4	131.7 (0.6)	711.8 (3.5)	225.8 (1.1)	1,069.3 (5.2)
Outward FDI ⁴ (US\$ Billion)	4.4 (0.2)	9.4 (0.4)	248.1 (10.4)	261.9 (11.0)	159.3 (0.8)	366.0 (1.7)	962.8 (4.6)	1,488.1 (7.1)
Foreign Reserve ⁴ (US\$ Billion)	17.1 (1.6)	21.2 (2.0)	72.8 (7.0)	111.1 (10.6)	304.3 (2.8)	3,204.6 (29.8)	1,259.5 (11.7)	4,768.4 (44.4)

Note: 1) Figures in parentheses are shares in the world (%); 2) FDIs are in terms of stock; 3) Foreign reserves include foreign currencies and gold.

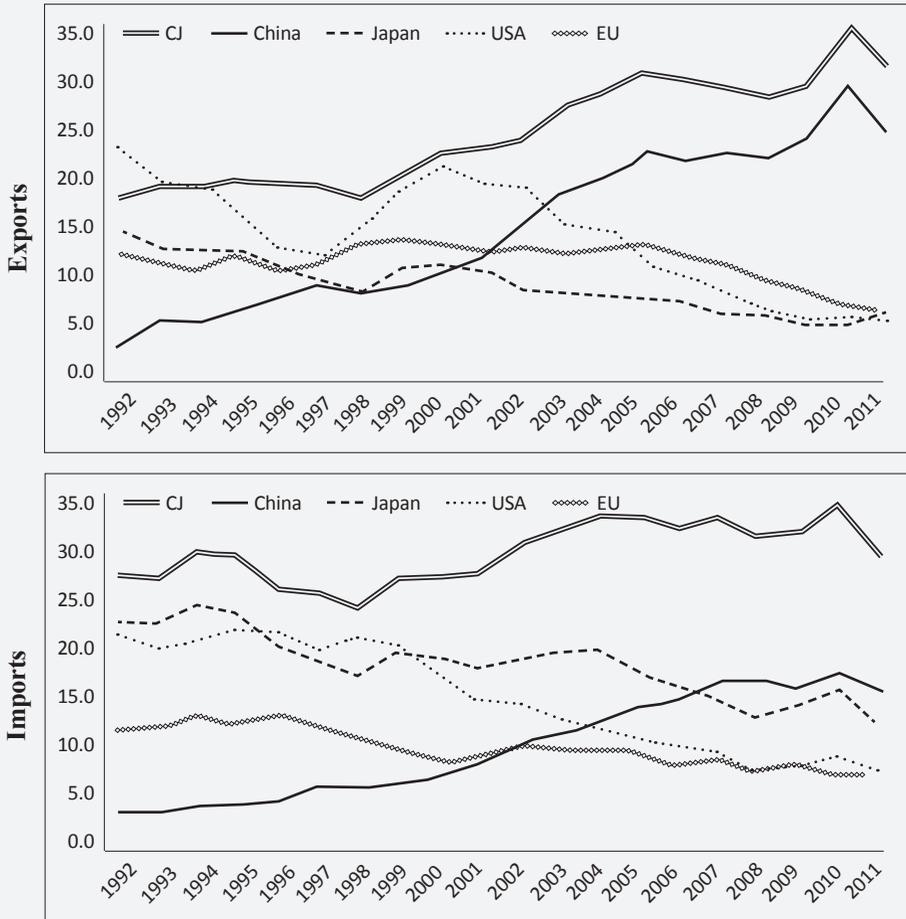
Sources: 1) Oxford Global Economic Databank [http://www.oxfordeconomics.com/oef_win/ReportPage.aspx] (on August 1, 2012); 2) IMF, World Economic outlook Database [<http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx>] (on August 1, 2012); 3) IMF. 2012. Direction of Trade Statistics; 4) UNCTAD Statistics [<http://unctad.org/en/Pages/Statistics.aspx/FDI>] (on August 1, 2012).

respectively, in 2011. The respective shares of China, Japan and South Korea represented 3.5 percent, 1.1 percent and 0.6 percent; and 1.7 percent, 4.6 percent and 0.8 percent, respectively. In addition, the three countries had 44.4 percent of the world's total foreign reserves in 2011, the shares of China, Japan and South Korea being 29.8, 11.7, and 2.8 percent, respectively.

ECONOMIC TIES OF CHINA, JAPAN, AND SOUTH KOREA

The three countries have become major trading partners for each other, even though their intraregional trade dependency levels, main trading partners, as well as export and import patterns vary. In the 1990s, the United States was Korea's most important export destination. However, in the 2000s, its share has continued to shrink, while China has become its predominant export destination. For 1992-2011, Northeast Asia's share in Korea's exports increased from 18.4 percent to 30.9 percent. China's share soared from 3.4 to 23.9 percent, while Japan's share diminished from 15.0 to 7.1 percent. Korea's export volume to China surpassed that to Japan in 2001, and China has been Korea's most important export destination since 2003. As for Korea's imports, Northeast Asia has continued to occupy the dominant place. In the 1990s, Japan used to be the major regional import source, while China has become Korea's largest import source since 2007. For 1992-2011, China's share in Korea's imports rose from 4.5 to 16.5 percent, while Japan's share decreased from 23.5 to 13.0 percent.

Figure 1. Korea's Major Export and Import Partners

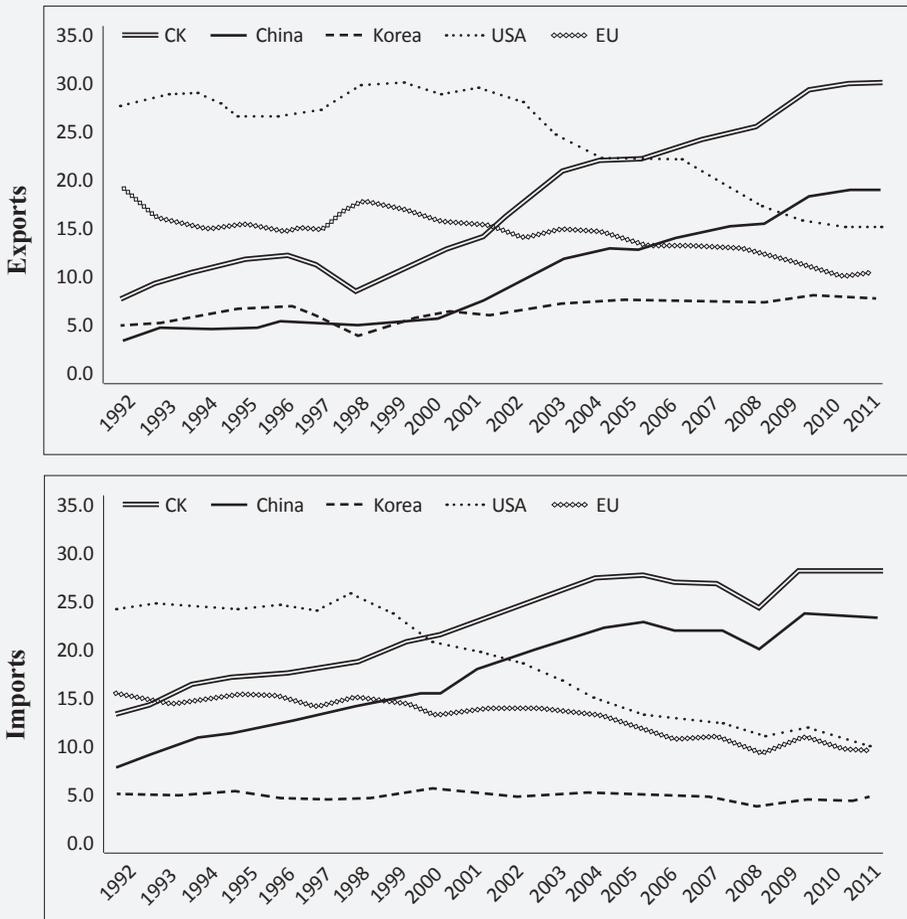


Source: IMF. 2012. *Direction of Trade Statistics*.

The United States had been Japan's major export partner for a long time, but China took over this spot in 2009. For 1992-2011, China's share increased from 3.5 to 19.6 percent, while that of South Korea rose from 5.2 to 8.0 percent, meaning that the share of Northeast Asia in Japan's exports grew markedly from 8.7 to 27.6 percent. With regard to imports, China has also become Japan's most important partner since 2002, replacing the United States. For 1992-2001, its share rose from 7.3 to 21.5 percent, while that of South Korea fell slightly from 5.0 to 4.7 percent, raising the overall share of Northeast Asia from 12.3 to 26.2 percent.

In contrast to South Korea and Japan, for whom Northeast Asia has become the most important export destination, the United States and the European Union have become China's most important partners. For 1992-2011, the share of Japan in China's exports decreased from 13.7 to 7.7 percent, while that of South Korea increased from 2.8 percent to 4.4 percent; the share of Northeast Asia in China's exports diminished from 16.5 percent to 12.1 percent. However, it has continued to be China's most important import partner, even though its share has diminished since 1999. Northeast Asia's share in China's imports increased from 19.9 to 30.9 percent in 1992-1997/8 before going down to 20.4 percent in 2011. Japan's share shrank from 16.7 percent to 11.2 percent, while South Korea's rose from 3.2 to 9.3 percent.

Figure 2. Japan's Major Export and Import Partners



Source: IMF. 2012. *Direction of Trade Statistics*.

As of 2011, Korea's intraregional export and import dependency levels were the highest among the three at 30.9 percent and 29.5 percent, respectively, while China's intraregional export and import dependency were the lowest – 12.1 percent and 20.4 percent, respectively. For 1992-2011, Japan's intraregional export and import dependency recorded the most significant growth, increasing from 8.7 to 27.6 percent and from 12.3 to 26.2 percent, respectively.

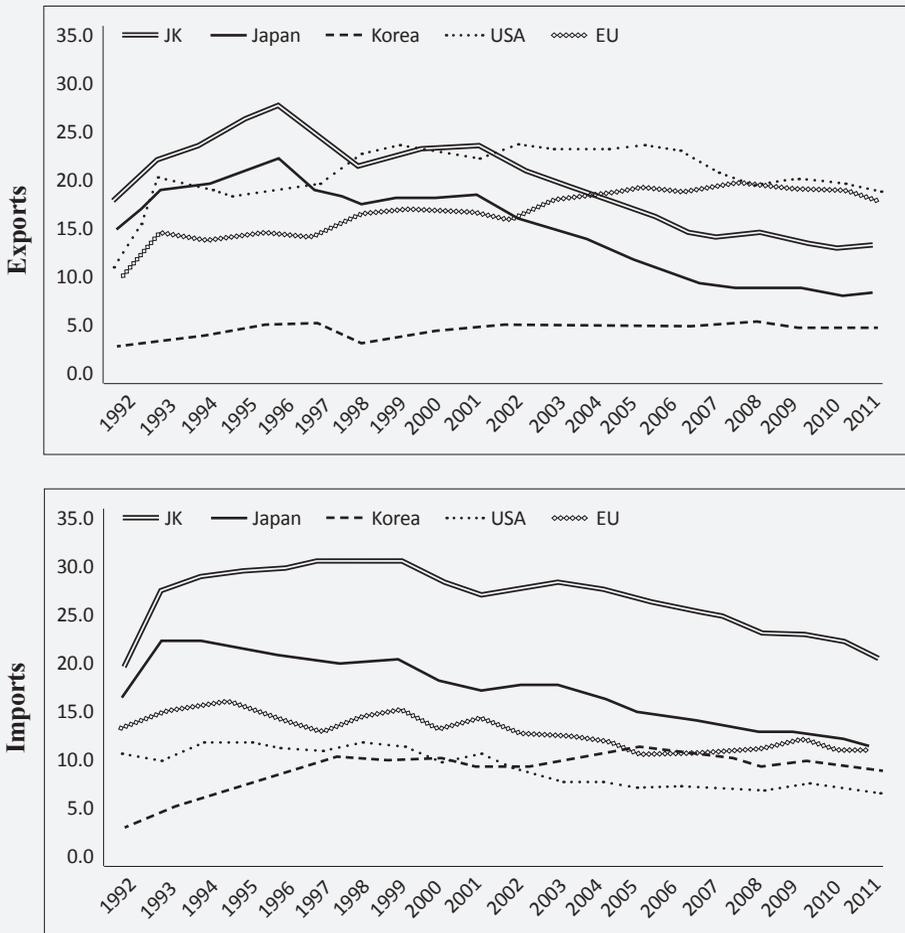
The share of intraregional trade among China, Japan, and South Korea has largely increased over the past twenty years. It grew in 1990 to 2004 from 12.3 to 24.1 percent before shrinking to 21.3 percent in 2011. However, as shown in Figure 4, it remains much lower than the shares of the EU and NAFTA and slightly lower than that of ASEAN.

A DECADE OF PREPARATION FOR THE CJK FTA

Trilateral Joint Research

In November 1999, the leaders of China, Japan and South Korea at their first summit during ASEAN+3 agreed on joint research to enhance economic cooperation among the three

Figure 3. China's Major Export and Import Partners

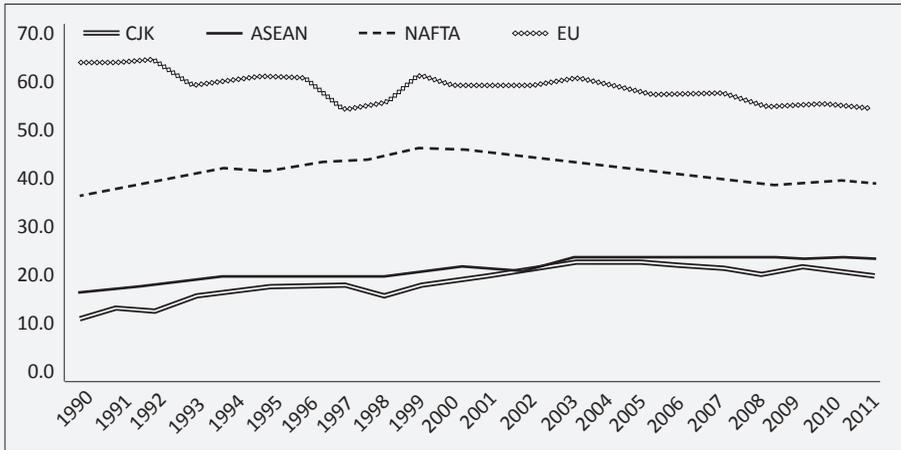


Source: IMF. 2012. *Direction of Trade Statistics*.

countries. The Development Research Center (DRC) of the State Council of the PRC, the National Institute for Research Advancement (NIRA) of Japan,¹ and the Korea Institute for International Economic Policy (KIEP) began Trilateral Joint Research in November 2000,² and they have conducted joint research on the CJK FTA since 2003. The Japanese government was initially reluctant before accepting the more qualified topic, “Economic Effects of a Possible FTA between China, Japan and Korea.” Although the joint research was supposed to last about three years, it actually took seven because the governments were not ready to upgrade it to the Official Tripartite Joint Study; however, at the same time, they did not want to stop it either for fear that it could weaken the momentum of the Trilateral FTA.

At the beginning of the Trilateral Joint Research, government officials and business representatives used to participate only in the international symposium where the results of each year’s trilateral joint research were discussed. However, business representatives of the three countries began to join the planning and mid-term workshops in 2006, and government officials also began to participate in those workshops as observers in 2007. Each year, the

Figure 4. Shares of Intraregional Trade of CJK and Other Regions



Source: IMF. 2012. *Direction of Trade Statistics*.

three institutions presented policy recommendations based on their joint research to the leaders during the trilateral summit. In 2009, the Trilateral Joint Research recommended upgrading the joint research on the CJK FTA to discussions among government officials.³ Over seven years, the three institutions conducted several CGE model simulations on macro-economic effects of the CJK FTA, also studying sectoral implications in the major manufacturing industries, agriculture, fisheries, as well as major service sectors. In addition, rules of origin and sensitive sectors were also examined.

The Joint Study Committee for FTA Among China, Japan and Korea

In December 2008, the first Trilateral Summit independent of ASEAN+3 was held in Fukuoka, Japan. The leaders agreed to launch an Official Tripartite Joint Study for a CJK FTA at the second Trilateral Summit in Beijing in October 2009. Accordingly, the first Joint Study Committee (JSC) for a CJK FTA took place in Seoul in May 2010, and the Joint Study was concluded at the seventh meeting, which was held in Pyeongchang, South Korea in December 2011.⁴ The JSC examined the coverage of the possible CJK FTA without prejudice to the future positions of the three countries in possible trilateral FTA negotiations, identifying the following issues: trade in goods, trade in services, and investment. Other issues may include, but not be limited to: technical barriers to trade, sanitary and phytosanitary measures, intellectual property rights, transparency, competition policy, dispute settlement mechanism, industrial cooperation, consumer safety, e-commerce, energy and mineral resources, fisheries, food, government procurement, and the environment.⁵

The JSC also agreed on four guiding principles for the CJK FTA negotiations: First, the CJK FTA should pursue a comprehensive and high-level FTA; second, the CJK FTA should be consistent with WTO rules; third, the CJK FTA should strive for balanced results and achieve a win-win-win situation on the basis of reciprocity and mutual benefit; and fourth, the negotiations should be conducted in a constructive and positive manner, with due consideration to the sensitive sectors in each country. The JSC also added that it shares the view that strong political will would be needed during the entire process for a CJK FTA.⁶

The outcome of the Joint Study was reported to the Economic and Trade Ministers' Meeting and the Fifth Trilateral Summit in Beijing in May 2012. The leaders welcomed the conclusion and recommendations, and agreed that the trilateral FTA negotiation would be launched in 2012 and that the three countries should immediately start preparations, including domestic procedures and working level consultations.⁷ Then, the trade ministers of the three countries met in Phnom Penh on 20 November 2012 at the 21st ASEAN summit and related summits, and announced the launch of the CJK FTA negotiations, deciding that the first round of the trilateral FTA negotiations would be held in early 2013.⁸

South Korea's Role

South Korea has assumed an important role in preparations for the CJK FTA. First, the Trilateral Joint Research was proposed by Kim Dae-jung during the first gathering of leaders in November 1999.⁹ Second, while the CJK FTA was mistakenly regarded as China's proposal, in reality, since China was the host of the Trilateral Joint Research in 2002, it was Zhu Rongji's role to raise the issue during the Trilateral Summit Meeting based on the research teams' report, but it was the Korean team that originally proposed the CJK FTA as the new topic. Third, with respect to the Official Tripartite Joint Study, apart from hosting the first and last meeting, the Korean side tried to play an intermediary role between China and Japan during the meetings.

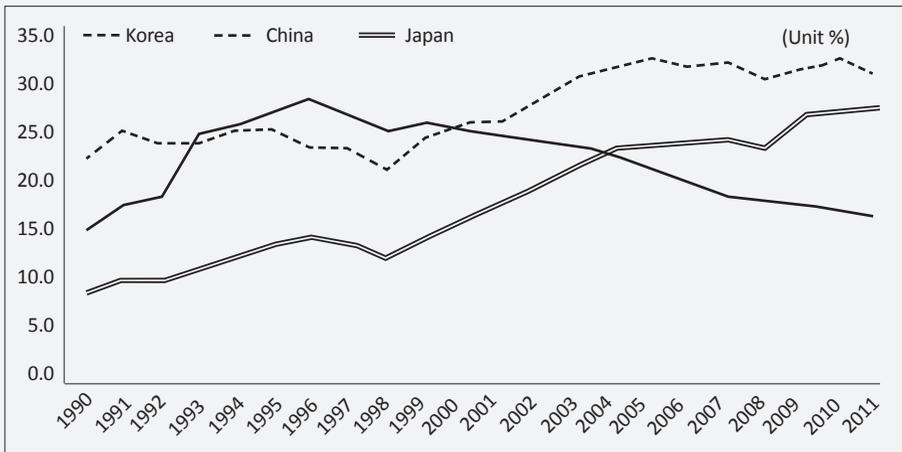
Admittedly, the South Korean government was not very active in promoting the CJK FTA in the mid-2000s when the Trilateral Joint Research was underway because it was more preoccupied with FTAs with the United States and the EU. It was China that was the most active in advancing the CJK FTA, while the Japanese government was the most cautious in the process for realizing the CJK FTA.¹⁰

SUPPORTING FACTORS FOR THE CJK FTA

Many FTAs Concluded by the Three Countries

It was at the turn of the century that Japan became the first Northeast Asian country that concluded an FTA. Then, South Korea and China jumped on the FTA bandwagon, and all three countries concluded many bilateral and multilateral FTAs within a short period of time. In addition, there are many ongoing FTA negotiations and FTAs under consideration. Japan concluded economic partnership agreements (EPAs) with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, the Philippines, Switzerland, Vietnam, India, and Peru. Japan is engaged in FTA negotiations with Korea, Australia and the GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the UAE), Canada, Mongolia, Colombia, and the start of negotiations was also announced for the CJK FTA and RCEP (Regional Comprehensive Economic Partnership).¹¹ China concluded FTAs with ASEAN, Pakistan, Chile, New Zealand, Singapore, Peru, and Costa Rica, and concluded a Closer Economic Partnership Arrangement (CEPA) with both Hong Kong and Macao. China is currently negotiating FTAs with the GCC, Australia, Iceland, Norway, SACU (Southern African Customs Union), Korea, and the start of negotiations was also announced for the CJK FTA and RCEP.¹² As for South Korea, eight FTAs with forty-five countries are in effect, namely FTAs with Chile, Singapore, the EFTA, ASEAN, India, the EU, Peru, and the United States. It also concluded FTAs with Turkey and Colombia, and is in the midst of FTA negotiations with Canada, Indonesia, China, Vietnam, and the start of negotiations was also announced for the CJK FTA and RCEP.¹³

Figure 5. Intra-regional Trade Dependency Between China, Japan and South Korea



Source: IMF. 2012. *Direction of Trade Statistics*.

Despite the fact that the three countries have pursued active FTA policies, there is no FTA among Northeast Asian countries. In fact, Korea-Japan FTA negotiations started in December 2003 and have been stalled since November 2004. Currently only Director-General-level consultations on a Korea-Japan FTA are under way. As for the Korea-China FTA, after the official tripartite joint study on a Korea-China FTA, which was conducted from March 2007 to May 2010, four rounds of negotiations were held in 2012. South Korea and China have pursued relatively active FTA policies and seem to be natural partners with which to form a regional trade agreement. To become a global FTA hub, South Korea has to form some type of FTA with China and Japan, be it trilateral, two bilaterals, or a de facto FTA with the RCEP or a combination of these.¹⁴

High Trade Dependency

As noted above, South Korea’s dependency on intra-regional trade has been high, and Japan’s, which was relatively low in the early 1990s, has risen quite rapidly over the past twenty years, reaching 26.9 percent in 2011, below Korea’s 30.2 percent. South Korea’s current trade volume with FTA partners accounts for about 35 percent of its trade, and if the CJK FTA were added, it would climb to about 65 percent.¹⁵

In recent years, China has been most positive for the CJK FTA, while Japan seems to have been relatively reluctant. However, given their intra-regional trade dependency, it would be rational for both South Korea and Japan to be more active in realizing the CJK FTA.¹⁶

Strong Manufacturing Sectors

In 2010, China, Japan, and South Korea represented more than 25 percent of the world’s total manufacturing exports in textiles and clothing (38.3), electronic machinery (33.9), non-electric machinery (29.5), other manufacturing (28.7), transportation equipment (26.4) and leather, rubber, and shoes (25.6).

Among products (HS 6-digit) whose total exports exceed \$1 billion, China, Japan, and South Korea represented more than half of the world’s exports for the 147 products in the HS

Table 2. Shares of CJK in the World's Manufacturing Exports (Unit: %)

	CJK		South Korea		China		Japan	
	1995	2010	1995	2010	1995	2010	1995	2010
Wood, paper, furniture	3.6	14.1	0.7	0.8	1.5	11.8	1.4	1.5
Textiles, clothing	21.4	38.4	5.9	2.3	12.4	34.5	3.1	1.6
Leather, rubber, shoes	18.2	25.6	4.2	2.5	8.7	18.7	5.3	4.3
Metals	14.1	18.1	2.8	3.3	3.3	9.0	8.0	5.8
Chemicals	11.4	14.2	1.9	3.0	2.3	6.1	7.2	5.1
Transportation equipment	20.3	26.4	2.9	7.4	0.7	6.3	16.6	12.7
Non-electric machinery	18.3	29.5	1.8	3.1	1.3	17.9	15.3	8.5
Electronic machinery	26.0	33.9	6.1	6.0	2.9	20.7	17.1	7.2
Mineral products	8.5	9.1	1.8	0.9	3.4	5.6	3.3	2.6
Petrochemicals	3.9	4.2	1.7	2.1	2.2	1.3	0.0	0.8
Other manufacturing	22.5	28.7	2.4	5.4	5.6	17.0	14.5	6.4

Source: UNCOMTRADE Database

6-digit category in 2010. Furthermore, Table 3 shows that the three trade mainly intermediate goods among them. An FTA among three competitive manufacturing countries who trade mainly intermediate goods with each other would contribute to raising further the competitiveness of their manufacturing sector by deepening competition among firms and lowering production costs.

There is no comprehensive survey of the views of South Korean manufacturing firms on the CJK FTA. According to the survey conducted by the Institute for International Trade, 68.1 percent of them supported the Korea-Japan FTA, while 58.8 percent supported the Korea-China FTA.¹⁷

Weak Service Sectors

Unlike the manufacturing sector, the three countries lag behind in the service sectors. In 2011, China, Japan and South Korea were the fourth, sixth and fifteenth largest commercial service exporting countries, respectively, while they ranked the third, fifth and thirteenth, respectively, in commercial service import in the world. As shown in Table 4, they represented 10 percent of the world's service exports and 12.7 percent of the world's service imports, which were much lower than their shares in the world's exports and imports in goods.

Table 3. Structure of Intra-regional Export of CJK by Production Process (Unit: %)

Goods	China		Japan		Korea		CJK	
	2000	2009	2000	2009	2000	2009	2000	2009
Intermediate	32.3	42.0	71.5	73.0	74.0	71.2	58.4	61.1
Capital	1.0	21.4	24.0	17.0	11.4	22.7	16.2	20.1
Consumption	48.8	33.3	3.4	6.6	13.9	5.2	22.0	16.0

Source: UNCTAD, UNCOMTRADE Database [online].

Table 4. Status of China, Japan and South Korea in Service Trade (Unit: US\$ Bil, %)

Exports				Imports			
Rank	Country	Amount	Share	Rank	Country	Amount	Share
-	World	4,168.8	100	-	World	3,953.0	100
1	US	580.9	13.9	1	US	395.3	10.0
2	UK	273.7	6.6	2	Germany	289.1	7.3
3	Germany	253.4	6.1	3	China	236.5	6.0
4	China	182.4	4.4	4	UK	170.4	4.3
5	France	166.6	4.0	5	Japan	165.8	4.2
6	Japan	142.5	3.4	6	France	143.5	3.6
7	Spain	140.4	3.4	7	India	123.7	3.1
8	India	136.6	3.3	8	Netherlands	118.2	3.0
9	Netherlands	133.5	3.2	9	Ireland	114.3	2.9
10	Singapore	128.9	3.1	10	Italy	114.0	2.9
15	South Korea	93.8	2.3	13	South Korea	98.2	2.5

Source: WTO [online].

A CJK FTA could be used for the three countries to raise the competitiveness of their service sectors by further liberalizing them. In this regard, South Korea, having concluded FTAs with both the United States and the EU, seems well positioned to push forward the liberalization of service sectors during the CJK FTA negotiations.

Region-wide FTA Sought in East Asia

Since the East Asian Vision Group proposed the establishment of the EAFTA (East Asia Free Trade Area) in November 2001, the discussion of a region-wide FTA has continued among academics and government officials. Following the recommendations of the study by the Joint Expert Group on the EAFTA and the Tract Two study on the CEPEA

(Comprehensive Economic Partnership in East Asia), working groups were formed among government officials to prepare the region-wide FTA in East Asia. In November 2012, leaders of the sixteen ASEAN+6 countries agreed on the launch of the RCEP (Regional Comprehensive Economic Partnership). ASEAN has already formed FTAs with six dialogue partners and several FTAs have been concluded among the dialogue partners. So, in order to achieve a region-wide FTA, an FTA(s) regardless of type, including a CJK FTA, would be needed among the three countries. A CJK FTA as well as a region-wide FTA in East Asia could also contribute importantly to economic integration in the Asia Pacific.

Global Financial Crisis and European Fiscal Crisis

Considering the economic difficulties of the EU and the United States in the wake of the global financial crisis and the European fiscal crisis, China, Japan, and South Korea cannot continue to depend heavily on those markets, especially for final goods. Larger Northeast Asian and East Asian markets would be needed. In addition, in order to revive the world economy, East Asia is expected to become the engine of economic growth once more. A CJK FTA and RCEP could help by increasing the volume of intraregional trade and by also enlarging the market for non-regional countries.

Trilateral Summit

The trilateral summits have played an important role during the preparation for the CJK FTA. They could be crucial for the negotiations because the leaders will meet regularly to discuss important issues related to their countries, and the CJK FTA is likely to be one of the most important.

RISK FACTORS TO THE CJK FTA

Domestic Politics Related to Sensitive Sectors

As with other FTAs, a CJK FTA is likely to face strong opposition from the sensitive sectors in each country, particularly in South Korea and Japan. The geographic proximity among the three countries could further intensify the sensitivity for industries like agriculture and fisheries. For Korea, most sensitive sectors would be related to trade in goods, and the sensitive sectors vis-à-vis China would be quite different from those vis-à-vis Japan. For China, agriculture, fisheries, and some manufacturing sectors would be sensitive for South Korea. Since China has definite price competitiveness over South Korea in most agricultural and fishery products, there would be strong domestic political pressure from those engaged in these sectors. Rice, beans, barley, red beans, mung beans and sesame, red pepper, garlic, and onions are likely to be sensitive agricultural products.¹⁸ With regard to manufacturing, even though the level of South Korea's average tariff rates is not that high, those engaged in SMEs, especially in textiles, are likely to resist trade liberalization with China.

As for Japan, since its average tariff rates are much lower than those of South Korea and many of its manufacturing sectors are considered more competitive, South Korea's manufacturing sector, in general, is likely to be reluctant. In particular, the auto and machinery industries could be regarded as sensitive.

Table 5. South Korea’s Tariff Rates Vis-à-Vis China (Average for 2007-2009)

	Exports to China				Imports from China			
	Exports		Tariff rate		Imports		Tariff rate	
	Amount (US\$million)	Share (%)	Simple average (%)	Weighted average (%)	Amount (US\$million)	Share (%)	Simple average (%)	Weighted average (%)
Textiles	2,412	3.2	11.04	10.22	4,944	8.6	10.03	11.19
Petrochemicals	14,355	18.9	5.95	4.76	1,128	2.0	5.89	5.25
Precision chemicals	1,960	2.6	6.67	6.47	2,884	5.0	6.07	5.27
Steel	4,262	5.6	7.58	5.67	11,611	20.2	3.36	1.07
Non-ferrous metal	2,708	3.6	6.14	3.66	2,233	3.9	5.94	3.72
Machinery	12,805	16.9	7.71	5.53	4,088	7.1	6.63	5.80
Automobiles	885	1.2	19.94	24.89	21	0.0	8.18	7.84
Auto parts	2,289	3.0	9.02	8.50	668	1.2	8.00	8.00
Electronics	24,004	31.6	6.05	2.04	20,481	35.6	5.32	2.81
Daily necessities	2,129	2.8	11.53	7.62	3,917	6.8	6.70	7.14
Others	8,165	10.7	6.10	4.91	5,612	9.7	4.09	3.52
Manufacturing	75,973	100.0	8.06	4.70	57,587	100.0	6.54	4.02

Source: Kim Do-hoon, “CJK FTA and its Effect on the Manufacturing Sector,” presentation at the CJK FTA Hearings on October 24, 2012 (in Korean).

According to the aforementioned survey by South Korea’s Institute for International Trade, 26.8 percent of manufacturing firms were opposed to the Korea-Japan FTA, and the opposition was particularly strong in machinery, steel, and textiles; while 36.8 percent of manufacturing firms were opposed to the Korea-China FTA, and the opposition was particularly strong in daily necessities and steel.

Domestic Politics Related to Past History and Nationalism

Along with sensitive sectors in each country, Kim Soung-chul regards insufficient mutual trust, disputes over territory, natural resources, past history, and strong nationalism as main obstacles to regional cooperation.¹⁹ Recent territorial disputes, which seem to have surfaced in part to serve domestic politics, have aggravated the situation and become the most serious risk factor that could hinder the realization of the CJK FTA.

Table 6. South Korea's Tariff Rates Vis-à-Vis Japan (Average for 2007-2009)

	Exports to Japan				Imports from Japan			
	Exports		Tariff rate		Imports		Tariff rate	
	Amount (US\$million)	Share (%)	Simple average (%)	Weighted average (%)	Amount (US\$million)	Share (%)	Simple average (%)	Weighted average (%)
Textiles	601	2.8	9.07	9.26	416	0.8	10.20	9.20
Petrochemicals	1,302	6.0	4.51	4.64	3,902	7.4	5.82	3.79
Precision chemicals	1,035	4.8	3.49	3.27	3,960	7.6	6.14	5.72
Steel	3,134	14.4	3.00	2.84	11,206	21.4	3.06	1.30
Non-ferrous metal	737	3.4	3.77	2.44	1,650	3.1	5.85	5.59
Machinery	2,262	10.4	0.10	0.06	8,973	17.1	6.49	5.74
Automobiles	25	0.1	0.00	0.00	639	1.2	8.07	7.52
Auto parts	440	2.0	0.07	0.00	1,120	2.1	8.00	8.00
Electronics	6,528	30.0	0.15	0.12	13,269	25.3	5.32	3.01
Daily necessities	1,292	5.9	5.20	2.06	1,999	3.8	6.64	6.76
Others	4,388	20.2	2.61	2.11	5,286	10.1	4.36	5.91
Manufacturing	21,745	100.0	3.24	1.77	52,420	100.0	6.62	4.10

Source: Kim Do-hoon, "CJK FTA and its Effect on the Manufacturing Sector," presentation at the CJK FTA Hearings on October 24, 2012 (in Korean).

In fact, the CJK FTA has been considered impossible or premature given that the three countries have not overcome past history. It may be unrealistic for the three countries to start the CJK FTA negotiations in 2013 even after ten years of preparations, as they are still struggling to surmount historical legacies. Or, maybe it is time to start the process of overcoming past history by reversing the way of thinking: the Trilateral FTA could actually serve as the first step toward reducing regional tension and overcoming past history. Although the European economic integration experience cannot be copied exactly in Northeast Asia, the three countries could learn the lesson that the main motivation for the initial economic integration was to avoid another war in Europe.

In this regard, South Korea has a natural role to play. First, the most visible rivalry being between China and Japan, South Korea could serve as an intermediary. Second, given the divided Korean Peninsula and North Korea being the center of regional security tensions, South Korea could benefit the most from easing tensions in Northeast Asia. Therefore, it should be more active in advancing the CJK FTA.

Other FTAs

Lastly, the CJK FTA could face competition from other FTAs. Korea-China negotiations have already been underway since May 2012 with four rounds held, while Korea-Japan FTA negotiations have been suspended since November 2004, and nine working level meetings were held for 2008-2011 to reopen the negotiations. The launch of the Korea-China FTA could have influenced the Japanese position vis-à-vis the CJK FTA in a positive way and could also be a positive factor in the resumption of the Korea-Japan FTA. However, if the Korea-China negotiations advance too far before launching the CJK FTA and the two countries want to adopt the same modality for the CJK FTA, it may be difficult for Japan to accept. So, some coordination in terms of modalities would be needed between the Korea-China FTA and the CJK FTA. However, if the CJK FTA negotiations face serious difficulties, South Korea could be tempted to go for the two bilateral FTAs instead.

Another risk factor is the RCEP, if the CJK FTA negotiations fail to advance whereas the RCEP negotiations go smoothly; a de facto CJK FTA could be realized within the RCEP before the de jure CJK FTA. In order to avoid this scenario, the three countries should speed up the CJK FTA negotiation process. In doing so, they could also assume a leadership role in the process of forming the RCEP.²⁰

The last risk factor could be the TPP. If Japan prefers to join it over the CJK FTA, the latter could be delayed. The CJK FTA is still likely to be achieved because all three countries, Japan in particular, will support the RCEP. Additionally, Japan's domestic political pressure related to the TPP would also be strong. For South Korea, having concluded the FTAs with the United States and most of the participating countries, the additional benefits as well as costs would not be that great.

PROSPECTS FOR THE CJK FTA AND OTHER FTAs FROM THE KOREAN PERSPECTIVE

Since South Korea has mainly dealt with bilateral FTAs including plurilateral FTAs such as the Korea-ASEAN FTA, Korea-EU FTA and Korea-EFTA; the Koreans are not familiar with the CJK FTA, not to mention the RCEP or TPP. So, there is no clear view from the political parties on the CJK FTA. It appears that even the Korean government does not have yet a detailed strategy for these FTAs. Instead, both the government and the public are focused on the ongoing Korea-China FTA.

According to the only available survey on the CJK FTA done by the Korea's Importers' Association on October 4-8, 2012, 87 percent of Korea's importers supported the CJK FTA. Certainly, this survey does not reflect the view of the general public. Nevertheless, it is true that no strong opposition was raised against the CJK FTA. Rather, there is vociferous opposition to the Korea-China FTA from the agricultural sector, and some academics and business people expressed concern about the negative effects of the Korea-China FTA on Korea's agriculture and SMEs. At public hearings for the CJK FTA in Seoul on October 24, 2012, agricultural activists disturbed the meeting, but they voiced opposition mainly to the Korea-China FTA.

With regard to the Korea-China FTA, public opinion seems quite ambivalent. According to a survey by the Korean Chamber of Commerce made public on November 11, 2012; 71.3

percent of firms were positive about the Korea-China FTA, while 28.7 percent were against it. But at the same time, 84.8 percent of firms said that the government should put priority on minimizing the damage from the Korea-China FTA. Thus, the Korea-China FTA is likely to be concluded, but it may take time and its level of liberalization may not be that high.

With regard to the CJK FTA, although many studies have been done in South Korea by academics, few studies seem to be relevant at this stage where the CJK FTA negotiations are about to take place and the Korea-China FTA negotiations are underway. As for the road map to the CJK FTA, various scenarios have been suggested. My view has also evolved in time: in the early 2000s, it seemed to me that the most realistic scenario was to start from the Korea-Japan FTA followed by the Korea-China FTA, then the CJK FTA;²¹ in 2005, I argued that the most realistic way to reach the CJK FTA would be via the two bilateral FTAs, namely, the Korea-Japan FTA and the Korea-China FTA;²² and in 2011, I expressed preference for a direct path to the CJK FTA, even though talks for the Korea-China FTA were likely to begin first.²³ Other scholars proposed similar ideas: Park Sung-hoon suggested the “NAFTA way” approach, i.e., starting from the Korea-China FTA to reach the CJK FTA,²⁴ whereas Park Bun-soon thought that it would be desirable to pursue the CJK FTA directly instead of the Korea-China FTA and the Korea-Japan FTA.²⁵

Now, four rounds of Korea-China FTA negotiations have already been held, while the restart of the Korea-Japan FTA negotiations has yet to be announced. In addition, the Korean government is fully committed to starting the negotiations of the CJK FTA and the RCEP. So, as far as the CJK FTA is concerned, it has to pursue both the indirect way via the Korea-China FTA and also a direct path to the trilateral FTA.

As for RCEP, since it is still lesser known to the public than the CJK FTA, most Korean academics and government officials seem to think that the priority should be given to the CJK FTA rather than the RCEP; even though the target year for the conclusion of the RCEP negotiations is 2015, while no time table was set for the CJK FTA. Given that all three countries are involved in the RCEP, the CJK FTA and the RCEP are closely linked to each other. A delay in the CJK FTA could postpone the RCEP, but at the same time, since the RCEP could not be realized without a *de facto* FTA among the three countries, the RCEP could also facilitate the CJK FTA.

As for the TPP, South Korea is currently not overly interested. First, as mentioned above, Korea has already concluded or is negotiating FTAs with the participating countries. Second, the Korea-China FTA talks are under way, and the CJK FTA and RCEP negotiations are about to start. Thus, at this moment, the order of priority for South Korea is likely to be the Korea-China FTA, the CJK FTA, the RCEP and the TPP. However, it is difficult to predict the order of conclusion of these FTAs as well as the Korea-Japan FTA, for there are simply too many variables.

CONCLUSION

Although the CJK FTA was considered by many unthinkable, pursuit of it has continued. As a result, the three countries finally agreed to launch negotiations. The trilateral summits have been instrumental in advancing the process, supported by deepening economic ties, especially the rise of intraregional trade. However, recent instances of territorial disputes remind us that

the road ahead could be quite bumpy due to non-economic factors. In addition, as in other FTAs, each country has sensitive sectors, and the geographic proximity of the three countries could further aggravate the situation for industries such as agriculture and fisheries. On top of that, the CJK FTA could compete with other bilateral FTAs or ongoing regional FTAs such as the RCEP and TPP.

Nevertheless, it seems to me that the positive factors for the CJK FTA are more powerful than its risks. All three countries have already concluded many FTAs respectively, and their intraregional trade dependency is quite high, for South Korea and Japan in particular. Moreover, they have many similarities such as having strong manufacturing sectors and less competitive service sectors, so that a CJK FTA could be used to further improve their competitiveness in manufacturing while making their service sectors more competitive.

The CJK FTA would also contribute to the formation of the RCEP. In fact, the global financial crisis and the European fiscal crisis provide an additional rationale for the CJK FTA and RCEP, because the enlarged regional market would be needed given the economic difficulties facing the United States and the EU. Difficult issues linked to history and political tension, usually cited as the main obstacles to the CJK FTA, could turn positive by reversing the usual way of thinking: the CJK FTA could be used as a means to overcome them.

Lastly, South Korea has played an important role in the process of preparation of the CJK FTA, and there are many solid reasons why it is likely to assume a substantial role during the CJK FTA negotiations. Its intraregional dependency is the highest among the three countries, so the CJK FTA would be of particular importance. Being a divided country, South Korea would gain the most from the reduction of tension in the region. Finally, South Korea's accumulated experience in forming FTAs with major countries such as the United States, the EU, and ASEAN could be used to achieve the FTA with its two closest trade partners.

ENDNOTES

1. Since 2009, the Institute of Developing Economies (IDE-JETRO) has been the representative institution for Japan.
2. In the first two years, they conducted a joint study on trade facilitation and investment issues.
3. The upgrade of the Trilateral Joint Research on a CJK FTA was facilitated by the decision made at the ASEAN+3 Economic Ministers' Consultation in Bangkok in August 2009 that working groups of government officials will be formed to prepare a region-wide FTA in East Asia, following the recommendations of the Joint Expert Group for the EAFTA Phase II Study and the Track Two Joint Study for the CEPEA.
4. The other meetings were held in Tokyo (second), Weihai, China (third), Jeju, Korea (fourth), Kitakyushu, Japan (fifth) and Changchun, China (sixth).
5. "Joint Study Report for an FTA among China, Japan and Korea," December 16, 2011, p. 147.
6. "Joint Study Report," pp.147-48.
7. "The Fifth Trilateral Summit Meeting among the People's Republic of China, the Republic of Korea and Japan, Joint Declaration on the Enhancement of Trilateral Comprehensive Cooperative Partnership," May 13, 2012, Beijing, China.
8. "Press Release on the Launch of the FTA Negotiations among China, Japan and Korea," November 20, 2012, Phnom Penh, Cambodia.
9. As for the historic meeting, it was initiated by Kim Dae-jung following Obuchi Keizo's suggestion.

10. However, it was reported that the Japanese side argued for the immediate start of CJK FTA negotiations during the Economic and Trade Ministers' Meeting in May 2012.
11. Additionally, FTAs with the EU and Turkey are under preparation, according to the official website, the CJK FTA and the RCEP are also listed in this category. <http://www.mofa.go.jp/policy/economy/fta/index.html> (January 9, 2013).
12. In addition, FTAs with India and Switzerland are under consideration; according to the official website, the China-Korea FTA and the CJK FTA are also listed in this category. http://fta.mofcom.gov.cn/enarticle/enrelease/201301/11454_1.html (January 9, 2013).
13. In addition, many FTAs are under preparation including FTAs with Japan, Mexico, the GCC, Australia, New Zealand (preparations in progress for reopening negotiations), MERCOSUR, Israel, Central American countries (Panama, Costa Rica, Guatemala, Honduras, El Salvador) and Malaysia. It is interesting to note that unlike the Japanese official website where the Japan-Korea FTA is listed in the category of FTAs under negotiation, according to the Korean official FTA website, the Korea-Japan FTA is listed in the category of FTAs under preparation for reopening negotiations. <http://www.fta.go.kr/new/index.asp> (January 9, 2013).
14. This point will be further dealt with in Section 6.
15. Bark Taeho, "Korea's FTA Policy, KORUS FTA and East Asian Economic Integration," presentation at Peterson Institute for International Economics on May 16, 2012. Based on the UNCTAD COMTRADE Database, South Korea's exports to and imports from FTA partners represented 36.5 and 31.5 percent of its totals in 2011.
16. South Korea's growing trade dependency on China could be regarded as a geopolitical concern.
17. "Survey of Manufacturing Firms' Views on the Korea-Japan FTA and the Korea-China FTA," Institute for International Trade, February 2010 (in Korean).
18. Moon Han-pil, "CJK FTA and Agricultural Sector," presentation at the CJK FTA Hearings on October 24, 2012 (in Korean).
19. Kim Soung-chul, "China-Japan-Korea FTA and the Security and Foreign Policy," Presentation at the International Seminar on the CJK FTA co-organized by Korea Institute for International Economic Policy and Trilateral Cooperation Secretariat, September 19, 2012.
20. Park Sung-hoon also argues that the CJK FTA should precede the RCEP so that the three countries could play an important role in the process of forming the RCEP. Park, Sung-hoon, "The Korean Perspective for East Asian Economic Integration," in Chun Hong-tack and Park Myung-ho, eds., *Integration Strategy for East Asia (II): Focusing Korea, China and Japan* (Seoul: KDI, 2011) (in Korean).
21. Lee, Chang Jae, "Towards a Northeast Asian Economic Community: A Korean Perspective," in Kim Yangseon and Chang Jae Lee, eds. *Northeast Asian Economic Integration: Prospects for a Northeast Asian FTA*. (Seoul: Korea Institute for International Economic Policy, 2003).
22. Lee, Chang Jae, et al., *The Economic Effects of a China-Japan-Korea FTA and Implications for the Korean Economy* (Seoul: Korea Institute for International Economic Policy, 2005) (in Korean).
23. Lee, Chang Jae and Ho-Kyung Bang, *From Northeast Asian Economic Cooperation to East Asian Economic Integration: Toward an Era of East Asia* (Seoul: Korea Institute for International Economic Policy, 2011) (in Korean).
24. Park, Sung-hoon, "The Korean Perspective for East Asian Economic Integration," in Chun and Park, eds.
25. Park, Bun-soon, *One East Asia – East Asian Economic Community, Search for Integration and Coexistence*, (Seoul: SERI, 2010) (in Korean).

The Japanese Perspective

T.J. Pempel

On November 20, 2012, at the Japan-China-ROK Economic and Trade Ministers' Meeting in Phnom Penh, Cambodia,¹ Ministers Edano Yukio, Chen Deming, and Bark Tae Ho, announced that they were launching negotiations to forge an FTA among their three countries. The announcement and the negotiations were the next logical step in a series of deepening and more institutionalized economic ties among the three countries that had been advancing for at least two decades.

China, Japan, and South Korea's increasing economic interdependence has been the immediate consequence of deepening cross border investment and trade, both linked to the growing significance of East Asia's regionally based multinational production facilities. UNCTAD estimates that intra-Asian investment now accounts for at least 40 percent and as much as 50 percent of total Asian FDI.² Investment and trade have soared in tandem, with particular gusto since the 1997-98 financial crisis (see Figures 1-4). By 2001 China had become the ROK's number one target for outgoing investments and in 2002 China-Hong Kong became South Korea's largest export market, replacing the United States. China has also replaced the United States as Japan's number one trading partner and has also become a major destination for outgoing Japanese FDI. China-based Japanese firms have become a key engine in Japan's still limp economic growth. Chang-Jae Lee's chapter provides more extensive data on these ties and the rising interdependency that has resulted. In addition, China is the major destination for Taiwanese FDI and is far and away Taiwan's leading economic and trade partner.

Paralleling Northeast Asia's regional economic integration has been the expansion and deepening of regional institutions. For Japan, Korea, and China, the most important of these started in mid-1995 when ASEAN initiated an expansion in its geographical reach by inviting the three Northeast Asian countries to join them in the ASEAN+3, which then expanded from a series of meetings among senior officials into an annual meeting of heads of state. It has since been active in promoting financial cooperation through the Chiang Mai Initiative (CMI) as well as two regional bond market initiatives. CMI has deepened its resources, become multilateralized in its holdings now known as Chiang Mai Initiative Multilateralization, decoupled itself steadily from rigid IMF conditionality, and now has a single contractual agreement to allow members to draw on emergency funds.³ Japan, along with Korea and China, has been an active proponent of these initiatives.

In addition, all three countries are active members in the virtual alphabet soup of regional institutions complementing the ASEAN+3: APEC, ARF, and the East Asia Summit (EAS). The three were also active in the now suspended Six-Party Talks as well as at least twenty other functionally specific institutional fora.⁴

The three have, since about 2001-2002, also become active promoters of bilateral and multilateral FTAs or Economic Partnership Agreements (EPAs).⁵ Virtually non-existent in East Asia at the time of the crisis, such trade pacts quickly became a favored state instrument designed to improve intraregional trade ties while exerting national influence over trade policies in ways not dependent on the flagging negotiations in the WTO's Doha Round. In May 2010, the Asian Development Bank (ADB) noted that the East Asian region was number one world wide in terms of FTA activity, with 45 in effect, and another 84 in various stages of preparation.⁶ At the same time, the three have yet to finalize any bilateral or trilateral FTAs with one another.

This generally cooperative and deepening economic and regional institutional interdependence among China, Korea, and Japan contrasts with their deteriorating political and security relations. Almost simultaneous with the signing of the 2012 trilateral agreements, China and Japan became engaged in a highly contentious quasi-military confrontation over the Senkaku/Daiyou Islands. As two political democracies aligned with the United States through security alliances, Japan and the ROK enjoy substantially better relations than those between Japan and China. Nonetheless, Japan-ROK relations have also deteriorated as a consequence of their own maritime dispute—the Dokdo/Takeshima island. Japan’s leadership finds itself in a complex and often contradictory set of relations with China and South Korea as it seeks to sort out policy options on economic trilateralism: deepening economic interdependence and enhanced multilateral linkages combined with rising security tensions. Can or should security tensions be played down in hopes of forging deeper and presumably mutually beneficial economic and institutional ties? Or, conversely, would such enhanced ties work to the disadvantage of Japan by bolstering the security strengths of China on the one hand and the economic competitiveness of South Korea on the other, both to the detriment of Japan? This chapter seeks to sort out where Japan’s leaders now stand along with the internal debates about perceived benefits and likely obstacles to future actions.

TRILATERAL ECONOMIC INSTITUTIONALIZATION

At the heart of trilateral institutional relations is the annual trilateral summit. Since first agreeing to meet together under the rubric of ASEAN+3, the three met regularly on the sidelines of different formal meetings, often with no more than high-sounding but non-committal post-conference announcements. They eventually agreed to hold an institutionally-independent leaders’ meeting on an annual basis, motivated in part by the desire to forge a more expeditious mechanism through which to deal efficiently with issues specific to themselves and not constrained by the slow moving, consensus-oriented “ASEAN Way.”

Since the first of these trilaterals took place in Fukuoka, Japan in December 2008, the agendas for cooperation in economics (as well as in the political and security arenas) have grown rapidly with each successive meeting. Thus, in the Beijing meeting of October 9, 2009, the three countries agreed to work toward mutual trust in the political arena; they went on to stress the possibilities for win-win cooperation in a host of economic areas based on complementarities in “key areas such as business, trade, finance, investment, logistics, intellectual property, customs, information, science and technology, energy...” along with other items ranging from cultural exchange to green technology.⁷

The following year in Jeju, Korea, the three went much further, issuing a Trilateral Vision Statement for 2020. They also committed themselves to the “institutionalization and enhancement of [the] Trilateral Partnership”⁸ by creating a permanent secretariat, headquartered in Seoul, which came into place in 2011. Additionally in May 2010, the three began a joint study to forge a trilateral FTA, and they committed to establishing a joint investment treaty as well.

The May 2011 meeting took place in Tokyo soon after the triple disaster in Fukushima with the result that most of the official statements promised further cooperation but made few concrete agreements.⁹ The Fifth Trilateral Summit in Beijing, in contrast, announced cooperative efforts

across a wide range that included disaster relief, integrated transportation, customs protection, and nuclear safety to mention but a few. Unmentioned were the territorial disputes among the three. And most tangibly, just before the summit, the three signed a Trilateral Agreement for the Promotion Facilitation and Protection of Investment among Japan, China, and the ROK.¹⁰ By the time the first CJK Trilateral Summit actually took place, "...not only had negotiators from the three countries already met in the form of six consultation rounds to hammer out the provisions, but they had also concluded five solid rounds of negotiations – all spanning a period of about three years. These concerted consultations and negotiations, prior to high-profile moves survived some of the worst political relations between especially China and Japan starting in 2005, and even when the APT [ASEAN+3] process had ground to a halt."¹¹ The trilateral investment treaty represents a substantial step toward systematizing and formalizing the rules governing all cross-border investments among the three.

At the same time, as Saadia Pekkanen makes clear, the treaty does not throw open the borders of all three. Each of these countries remains relatively restrictive of incoming FDI: the OECD's FDI Restrictiveness Index for 2012 ranks China as the first, Japan as the sixth, and South Korea as the fifteenth most restrictive environment among the fifty-five nation states that it analyzes.¹² Yet, as she notes, the very fact of "institutionalization can constrain the actions and conduct of public and private interests in different jurisdictions, provide a binding rules-based framework for dealing with trade partners, help support business operations across borders, secure the momentum and speed of regional economic integration, and potentially boost national economic welfare over the long term." In short, this FDI commitment to trilateralism by all three was far from trivial.

In a follow up to the investment treaty, the three countries announced in November 2012 at a summit in Phnom Penh, that they would begin negotiations to craft a trilateral FTA. The potential economic benefits to each country would be enormous, not least for Japan. China, Japan, and South Korea depend on each other for about 20-30 percent of their external trade. Japan's *Nikkei* reported if the trilateral FTA is concluded with the easing of tariffs on manufactured and other goods, Japan's exports would be expected to increase by \$60 billion.¹³ Only 14 percent of Japan's exports are covered by existing FTAs (or EPAs) in contrast to 56 percent for ASEAN, 45 percent for Hong Kong, 25 percent for China, and 28 percent for South Korea. It has a considerable distance to go in order to catch up to East Asia's rapidly moving FTA train. All of these points lay the groundwork for asking just how likely such a trilateral trade agreement is to be realized and what possible impediments remain to the steadily deepening as well as enhanced institutionalization of both trade and financial links among China, Japan, and Korea.

JAPAN: ECONOMICS AND NEIGHBORS

For the first four to five decades after the end of World War II, Japan's political economy followed a highly consistent course. Japan's postwar foreign policy pivoted on its close ties to the United States, both militarily and economically. Defense expenditures were kept low, balanced out by U.S. security guarantees and bases on Japanese territory. Moreover, to spur the economic recovery of its most important Cold War ally in East Asia after World War II, the United States opened its markets to Japanese exports without requiring reciprocal access for American products in Japan. For decades, Japan's economy remained one of the most resistant to FDI and foreign manufactured imports of any other industrial democracy. The United States

and Japan became major trading partners. Until the latter half of the 1980s, approximately 11 percent of all U.S. exports went to Japan, while 20 percent of imports came from Japan. For Japan, some 36-39 percent of their exports went to U.S. markets, while 23 percent of total imports came from the United States. Endemic to Japan's domestic economic success were strong formal and informal impediments to competition from foreign investment and foreign manufactured goods. The persistence of such protectionism continues to haunt and impede Japan's current economic situation, as it has since the 1990s.

Though Japan took a "low posture" in its regional policies following the highly disruptive domestic disputes over the 1960 revision of the bilateral security treaty, it normalized relations with South Korea in 1965 and those connections were enhanced by the agreement between Kim Dae-jung and Obuchi Keizo to put past animosities on the back burner and to work to improve bilateral ties. (The subsequent death of Obuchi removed the personal chemistry between the leaders of the two countries that had been vital to the warming relations, leaving their agreement more aspirational than practical.)

Japan was also quick to normalize ties to China following the surprising Kissinger-Nixon visits in 1971; Tanaka Kakuei opened normal diplomatic relations in 1972. After 1978, China broke with earlier policies to embark on what has since been 35 years of greater openness to FDI and trade as well as closer engagement with the United States and other democracies. Japanese investors were among the first to leap at the business opportunities presented by these transformed China markets. In 1978 Japan and China signed the "Japan-China Peace and Friendship Treaty." Shortly after that, the Japanese government entered into its first long-term commitment to provide ongoing ODA to China. In the subsequent thirty years, China was the largest single recipient with Japan accounting for approximately 60 percent of all aid received, approximately 3.4 trillion yen in loans and grants.¹⁴ In the aftermath of the Tiananmen massacre, the Japanese government was also the first major country to re-engage with China and to break with the diplomatic and economic sanctions imposed by other Western powers.

Yet Japan's relations with China have become far worse in the last two to three years while those with South Korea have been highly problematic. It is necessary to ask what went wrong in the interim. To me the answer lies in Japan's domestic political economy and can be reduced to two key changes over the last two decades: first, Japan's economy has been largely stagnant, representing a stark contrast to the phenomenal growth in GDP the country enjoyed from 1952-1990, as well as a contrast to the blistering economic performance of China and the less white hot but nonetheless substantial growth achieved in the ROK; and second, partly in response to this twenty years of economic torpor, Japanese domestic politics has become far more nationalistic, introspective, and suspicious of its relationships with the ROK and China. Neither trend bodes well for future political or economic ties between Japan and its two neighbors.

ROOTS OF JAPAN'S SOURING RELATIONS

Current internal debates about how best to connect to its two most immediate neighbors are intimately linked to competing Japanese domestic perceptions about how best to deal with its own economic problems in conjunction with its regional and global political and security concerns. Broadly stated, Japan's deteriorating political relations with China and South Korea are a function of the political leadership's unwillingness or inability to take the politically painful

steps needed to carry out deep structural changes in the domestic economy, domestic tensions exacerbated by growing insecurity regarding the changing nature of the security environment Japan now confronts. The two of course are linked. The failure to revitalize the Japanese economy through structural reforms has deprived policymakers of a key tool in their prior regional diplomatic toolbox—namely regional economic muscle. Since past strength hinged on the economic dynamism the country demonstrated from the early 1950s into the very early 1990s, current economic limitations, in turn, foster growing concern about the regional and global security situation. Absent the extensive diplomatic leverage that comes from economic strength, Japan's political leaders have instead retreated to a policy of seeking electoral support by appeals to introspective populism, the results of which are periodic diplomatic disasters with China and South Korea.

From today's vantage point it is difficult to recall that twenty years ago Japan's economy was the envy of the world. Its GNP was soaring; its banks were among the most dominant in the world; Ginza coffee shops catered to Japan's nouveau riche with expensive cakes flaked with real gold; and one triumphalist business executive declared that all Japan might need to buy from the United States were mop handles and buckets. From that self-congratulatory perch, Japan has fallen far. Once an economic model to be emulated, it is now an economic lesson in what to avoid. The statistics cataloging Japan's economic decline are cumulatively depressing. Throughout most of the last two decades GDP growth staggered along at an anemic zero to one percent. The country has seen dramatic falls in its global ranking in per capita GDP, along with its labor and capital productivity, while fiscal policies have whipped up a devilish brew of mounting public sector debt, sustained deflation, rising youth unemployment, and visible homelessness in its major cities. Stock market indicators in 2013 stood at half the level they enjoyed twelve years before and only one-quarter the level at the end of the 1980s. Japan's global and regional economic weight has consequently been eviscerated. Between the early 1990s and today, Japan's share of global GDP shriveled to 8 percent, a share almost equal to that which it had held in 1970. Japan has surrendered virtually all of the gains in global economic weight that it had accumulated between 1970 and 1990. The country that once led the world in the introduction of tantalizing consumer products currently struggles to shed the label "Galapagos Tech"—an evolutionary wonder producing goods for only self-absorbed residents of Japan insulated from broader trends of globalization. Consequently, Japan, the initial catalyst for the region's economic success, has become ever less the driver or beneficiary of East Asia's enhanced regional economic strength.

In contrast, over the last thirty years, Chinese economic growth has soared, while South Korea has transformed its own economy, achieving substantial success particularly in the aftermath of the 1997-98 financial crisis. Of symbolic significance, in 2011 China replaced Japan as the world's second largest economy in nominal GDP and China has been eclipsing Japan as the economic engine of the region while simultaneously using its economic muscle as a tool in its regional diplomacy, as noted in Scott Harold's chapter.¹⁵ Even countries skeptical of China's long-term political goals are finding it in their self-interest to accommodate to its enhanced economic and diplomatic muscle.

South Korea, hard hit by the 1997-98 crisis, went through a series of domestic economic restructurings, opened many of its previously closed markets, pursued FTAs with its major

trade partners and has recently negotiated bilateral trade pacts with both the United States and the European Union, two of its major markets, while enjoying an average growth rate of 4.9 percent in its GDP from 1998-2010.¹⁶ As Chang-Jae Lee's chapter makes clear, South Korea has been an active proponent of FTAs with most of its major trading partners and to date has signed eight FTAs with forty-five countries and is actively negotiating still others. Given the extent to which many South Korean and Japanese products compete vigorously for global markets, South Korea's domestically difficult decisions embracing higher levels of economic openness throw down an undeniable challenge to neighboring Japan with its reluctantly sluggish baby steps away from prior protectionist policies.

In addition to China and South Korea, other countries have also closed their once-wide economic gaps with Japan on living standards and wealth. Japan, long the economic leader in the region, has fallen back in the pack. One recent comparison of per capita GDP noted that: "For years, Japan was Asia's richest and most powerful economy. It was the first Asian economy to industrialize, and the emerging Asian tigers—Hong Kong, Singapore, South Korea, Taiwan and later China—merely followed in its tracks. Now, however, Japan is steadily being overtaken."¹⁷ Japanese citizens now lag behind their richer counterparts in Singapore, Hong Kong, and Taiwan, with South Korea poised to pass Japan within five years.

The enhanced economic competitiveness of so many of Japan's neighbors provides a stark indictment of Japan's rickety macro-economy and its waning capacity to influence events within the region. One indication of Japan's shrinking role in the regional economic picture has been the reduced centrality of Japanese capital to investment across East Asia. Japan was the largest investor by far during the 1980s (nearly a 5:1 margin over the number two investor, the United States). During the 1990s Japan retained its number one position, but its lead declined to only 1.5 times that of the United States. By the 2000s, Japan had fallen into the number two slot.

It is not as though policymakers deliberately ignored the nation's economic slide, but for the first decade after Japan's bubble burst, the prevailing policy emphasis driven by the political orientation of the ruling LDP, emulated the long-term model that had kept the party in power: outsized government spending for public works and construction with little attention to the rising share of public debt or to the country's vast problem with non-performing loans. Most importantly, little attention was placed on encouraging the structural reforms in domestic industry and the regulatory structures that would move the country beyond its longstanding focus on exports to a more sophisticated service orientation based on domestic-driven demand. For the better part of two decades the government's prevailing policies have sought to shore up, rather than build from, the country's initial keys to growth—enhanced exports and domestic market protection. Such an approach has stood in stark contrast to the recommendations of the 1985 Maekawa Commission, which concluded that Japan's long-term economic success would require domestic structural reforms, greater domestic liberalization, and a focus on improved living standards for Japanese consumers.¹⁸

The impediments to change have been far more political than economic. In particular, the LDP concentrated its policymaking firepower on efforts to continue its electoral supremacy by impeding substantial structural reforms of the nation's economy. Doing so would have required a reconfiguration of the party's electoral base and the probable loss by many LDP parliamentarians of their cherished Diet seats. Protection of the party's office holders took

priority over remedying the nation's plummeting total factor productivity. Low-productivity, but politically powerful sectors, such as agriculture, medical delivery, food services, and construction, remained largely immune from political challenge. As a consequence, as one McKinsey study showed, even Japan's ten largest companies in fifteen of sixteen industrial groups (autos were the lone exception) today "are less global than their overseas peers, as measured by the percentage of revenues, assets, and stock ownership outside Japan."²⁰

Koizumi Junichiro sought to break the deadlock of such failing policies by eliminating the stranglehold of the LDP's old guard. His administration tackled the problem of non-performing loans head on, and he challenged many longstanding LDP sacred cows (including construction, toll roads, and the postal system). Yet economically savvy as his targets may have been and adroit as he may have been at catalyzing a reconfiguration of the LDP's political base, he proved far less deft in his regional foreign policy. He enraged both China and South Korea with his regular visits to the Yasukuni Shrine. Koizumi further inflamed Japan-China tensions by ending ODA to China, declaring on November 24, 2004 while en route to an ASEAN meeting that it was time for China to "graduate" from receiving Japanese aid.²¹ Koizumi also embraced George W. Bush and the U.S.-Japan alliance by taking a host of steps that expanded the role and sophistication of Japan's Self-Defense Forces and their coordination with U.S. military forces, among which was the specific identification of China as a potential enemy of Japan.²² These moves conflicted quite explicitly with China's goal of enhancing its own influence over the shape of regional security and economics and moved Japan away from its prior tight engagement with Asia in favor of a reinvigoration of its security ties with the United States.

The successes achieved by Koizumi in breaking the stranglehold of several of the LDP's most economically unproductive but political entrenched sectors were, moreover, quickly squandered by his successors. After achieving a stunning electoral success in the 2005 Lower House elections, Koizumi neglected to institutionalize his dual economic and electoral victories. Instead he allowed the party to revert to type as two of his three short-term successors, Abe Shinzo and Aso Taro, assiduously reversed his reforms, returning the party to control by its old guard, and ensuring the continued pursuit of protectionism and cronyism.

Simultaneously, Abe and Aso added fuel to Japan's regional frictions by their fulsome embrace of Japan's most xenophobic instincts, calling among other things for constitutional revision, a return to "traditional values," "super-sizing" the abductee issue and other fears centering on North Korea,²³ injecting enhanced nationalism into school textbooks and classroom instruction, and seeking to create an "arc of freedom and democracy" that most observers saw as a not-very-subtle effort to "contain" China.

The electoral rebuttal to the LDP was severe. The long-dominant party lost badly in the Upper House elections of 2007 and was subsequently crushed by the DPJ in the Lower House elections of 2009. When the DPJ came into office it carried a policy platform committed to sweeping economic reform efforts and improved relations with the other countries of Asia.²⁴ The party proposed stronger ties with China and South Korea through deeper economic integration and enhanced diplomatic engagement. It advocated "constructive dialogue" to resolve contentious territorial disputes with the two countries and argued that it would restore trust with its neighbors by admitting Japanese aggression during World War II and promising to make no official visits to the Yasukuni Shrine. A major economic delegation of some 600 Japanese business leaders, led by DPJ strongman Ozawa Ichiro, symbolized the DPJ's effort

to improve both economic and diplomatic relations with China. At home the DPJ's economic policies, focused on "putting people's lives first" as the DPJ pumped billions of yen into creating a stronger social safety net and expanding child welfare allowances, along with cutting road tolls and reducing the (almost non-existent) taxes on small businesses. Such programs, though highly popular with voters, were extremely costly. More frustratingly, they did little to advance the needed structural economic reforms.

Even if the DPJ agenda was promising, leaders proved inept at implementation. Three successive DPJ prime ministers suffered from major gaffs: Hatoyama Ichiro faced both a personal financial scandal as well as troubles with the United States over the relocation of the marine corps base at Futenma; Kan Naoda, as Japan's sixth prime minister in five years, resigned after a disastrous failure to deal adequately with disaster relief during the March 11, 2011 triple disaster at Fukushima; Noda Yoshihiko, though perhaps a far more astute politician, took the economically positive but politically suicidal step of raising the consumption tax in an effort to deal with the country's massive public debt problem. As one cynical summary of the three years of DPJ government concluded "it has reneged on, failed to implement and even reversed many of its campaign pledges," leading it to be trounced by the LDP in the December 2012 elections. The one legacy of DPJ government that might well prove useful in dealing with Japan's economic malaise was Noda's halting efforts to have Japan join negotiations for the TPP.

JAPAN AND ITS CURRENT FREE TRADE OPTIONS: OBSTACLES AND OPPORTUNITIES

Japan faces the possibility of joining as many as three looming multilateral Asia-Pacific FTAs. The trilateral CJK trade pact under negotiation with China and Korea is obviously one; TPP is a second; the third is the Regional Comprehensive Economic Partnership (RCEP). All three would advance the agenda of free trade in the wake of the stagnation in negotiations at the Doha Round of WTO liberalizations,²⁵ requiring various degrees of trade and FDI liberalization on the part of Japan. But the three are quite different in their probable trade inclusiveness (and the political pain likely to be demanded) as well as in the countries that would be included (creating different mixes of "allies" and "adversaries").

The economics of Japan's ties to China and Korea certainly speak to the advantages of the trilateral FTA. The long-term benefits to Japanese exporters might reach as high as \$60 billion.²⁶ The existing trilateral investment treaty means an economically and administratively valuable precedent is already in place. Yet at the same time, Japan and Korea previously engaged in eighteen months of negotiations toward a bilateral trade pact in 2004-2005 only to have the talks end in failure, due essentially to Japan's reluctance to liberalize its agriculture and other politically protected sectors. As one Korean diplomat noted at the time: "Seoul was ready to sign a 'high level, comprehensive' agreement with Tokyo even though that would be painful for many small and medium South Korean companies in protected industries... We are prepared to weather domestic resistance to [a trade agreement] but if we start on the basis that a certain Japanese ministry [Agriculture] offers us, we would be subjected to severe domestic criticism."²⁷

The economics of Japan's ties to China and Korea certainly speak to the advantages of the trilateral approach. Should a trilateral FTA be signed, this three-country economic bloc

would be the world's third biggest behind NAFTA and the EU. The combined economies would cover 1.5 billion people and amount to \$14 trillion in gross domestic product. The long-term benefits to Japanese exporters might reach as high as \$60 billion.²⁸ A trilateral FTA would also allow Japan and South Korea to more easily tap into China's huge market. China certainly wants to be involved in such an FTA to help it check the economic and security influence of the United States in East Asia. In this regard China envisions the CJK FTA as an important alternative to TPP, which is being strongly pushed by the United States. Three rounds of negotiations are set for 2013.

Because Korea and China are considering a bilateral FTA that would not include Japan, it is clearly worrisome to both countries that Japan may be entering the trilateral talks only as a way to "keep in check rapid progress in Seoul and Beijing," as Huh Yoon cynically opined.²⁹ He noted, it is one thing to get together to talk; it is quite another to reach an agreement.

Offsetting the possible difficulties Japan might face in liberalizing its market are two distinct upsides to the CJK FTA from Japan's perspective. First, given the high levels of economic protection in China along with the preeminence of SOEs as well as China's political desire to forge a trilateral FTA, the economic demands for liberalization of the Japanese market could be much less than those of joining the TPP. Furthermore, China's sense of urgency in creating an FTA mechanism to offset some of the appeal of the TPP appears to have made it more amenable to softening diplomatic tensions with Japan over the Senkaku/Diaoyu controversy.

The TPP, in contrast, is likely to make the strongest demands for structural economic changes within Japan. The TPP has become the signature trade target of the Obama administration which sees it as an Asia-Pacific expansion of NAFTA and an important component of its "pivot" toward Asia. If U.S. views prevail, the eventual agreement will be a "comprehensive and high standard agreement for the 21st Century" that would eliminate most tariffs, systematize trade regulation among all members, and be comprehensive in covering all trade related issues, including, for example, rules of origin and labor protections. Moreover, it would encompass not simply trade but the promotion of economic development and collective growth.³⁰

In early 2013, incoming Prime Minister Abe convinced his reluctant LDP to endorse his decision to enter into TPP negotiations, starting with the seventeenth round scheduled for May 2013 in Lima, Peru. This came only after hints in his meetings with Obama that there might be "carve outs" for politically sensitive economic sectors at least prior to entering the negotiations per se. Abe has played that theme consistently in attempting to win domestic political support for joining the negotiations. After returning from his D.C. visit he told a crowd of 3,500 lawmakers, party members, and guests who had gathered for the annual convention of the ruling LDP: "I will protect Japan's agriculture and its food at all costs. I ask you to please trust me, believe in me."³¹

Despite the probability of far greater difficulty in liberalizing politically sensitive sectors of Japan's economy should Japan opt for TPP, the benefit in terms of shoring up Japan's relations with the United States could make the risk worth taking. After all, the United States is at the core of TPP while China and Korea are not. Equally important economically, if Japan joins under the strict standards of the TPP, the country would receive a major impetus toward structural reform and enhance its appeal to other countries seeking additional FTAs.³²

In mid-April the other countries agreed to allow Japan to enter negotiations. Clearly, the earlier Japan gets into discussions the greater its voice is in the give-and-take of negotiations, and the more substantial the structural reforms Japan makes to its economy, the greater the long-term benefits are likely to be. However, big changes in the quest for macro-economic benefits can exact high costs from micro-economic losers and the greater the likelihood of costly political repercussions. Criticisms of Japan's concessions to the United States just to enter negotiations began soon after Abe's return.³³

Finally, RCEP was begun only in December 2012, advanced primarily by ASEAN, though China is also enthusiastic (again since the United States would not be involved). It aims to be the largest free-trade bloc in the world, comprising all ten ASEAN nations and the six other countries with which the group has FTAs. The grouping includes more than three billion people, has a combined GDP of about \$17 trillion, and accounts for about 40 percent of world trade. Negotiations are slated to begin in early 2013 and to conclude by the end of 2015. The idea for the RCEP was first introduced in November 2011 at the ASEAN Leaders Summit in Bali, as officials attempted to reconcile two existing regional trade architectures. China pressed for the East Asia Free Trade Agreement, which restricted the grouping to ASEAN+3. Japan has long favored the Comprehensive Economic Partnership in East Asia of the ASEAN+6 countries. ASEAN leaders struck a balance with the RCEP, adopting essentially the Japanese membership formula, but also adding an open accession scheme that would allow other members to join so long as they agree to comply with the grouping's rules and guidelines. Plans for RCEP would create a minimalist FTA with no member forced to adopt policies with which it disagrees and allowing for major carve-outs of sensitive industries. As such, the domestic economic demands of RCEP would be far less for Japan than joining TPP or the CJK FTA. Yet, the United States is notably absent from RCEP, a serious concern for policymakers anxious to bolster security ties to it and also to avoid being swamped in multilateral bodies dominated by China. RCEP would most likely reflect substantial Chinese influence throughout any negotiations.

Japanese leaders will certainly strategize about how to approach each of these three potential pacts in light of both economic and political goals. Economically, RCEP would be the least painful domestically and it would offer some political benefit by enhancing the centrality of ASEAN+6, which Japan has long promoted. But at the same time RCEP would not include the United States and would do little to spur significant structural reforms at home, and hence RCEP would be of minimal long-term economic benefit to Japan. TPP would be painful at home but would be exceptionally valuable in many ways. Barfield and Levy concluded: "An agreement with the United States, Japan, Australia, New Zealand, and Chile at its core would have the economic heft to set a new standard for Asian integration. Furthermore, if the TPP remains open to new members as expected, it could serve as the foundation for a Pacific Ocean-spanning free trade area."³⁵ Most critically for Japan, it would create enormous pressures for precisely the kinds of structural reform that could return it to economic strength regionally and globally.

The CJK FTA may provide Japan, both politically and economically, with a "Goldilocks' solution," not quite as painful domestically as TPP but not as economically vapid as RCEP. The trilateral would also offer the possibility of improved diplomatic and political relations with two countries that are among Japan's most important trade partners but among its most nettlesome neighbors. Intriguingly, a strategy that included Japanese participation in both TPP

and the CJK FTA could well achieve far more than either in isolation—closer ties with both the U.S. on the one hand and China and Korea on the other, along with enhanced trade ties with three of Japan’s major markets, as well as economic and diplomatic outcomes that would address a host of problems currently vexing the country’s domestic economy. The only real impediment to pursuit of such an approach remains Japanese politics. Whether the new LDP government and Abe in particular are willing to take such a bold step is far from certain. Clearly Abe’s past behavior and statements make one skeptical. Yet the LDP enjoys a powerful majority in the Lower House and if it can gain similar leverage in the July 2013 elections for the Upper House, the political muscle would be there if, perhaps, not the political will.

APPENDIX

Figure 1. Percentage of Japanese Outward Foreign Direct Investment by Country

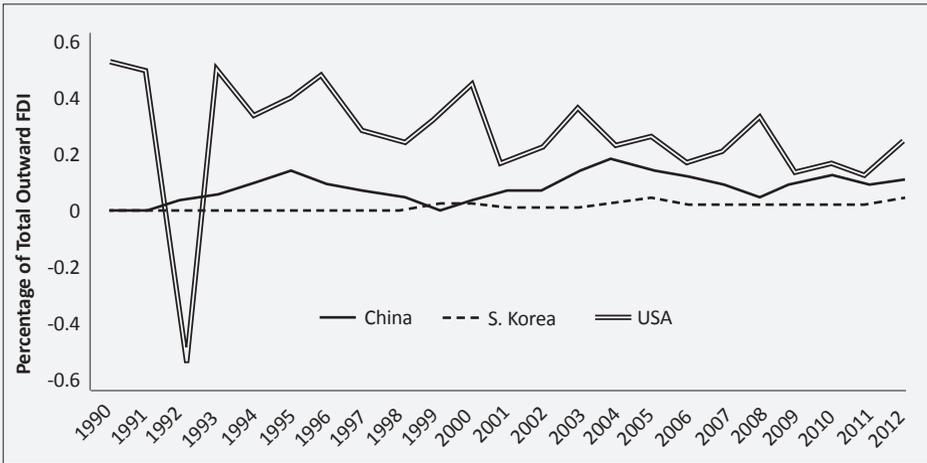


Figure 2. Japanese Outward Foreign Direct Investment by Country

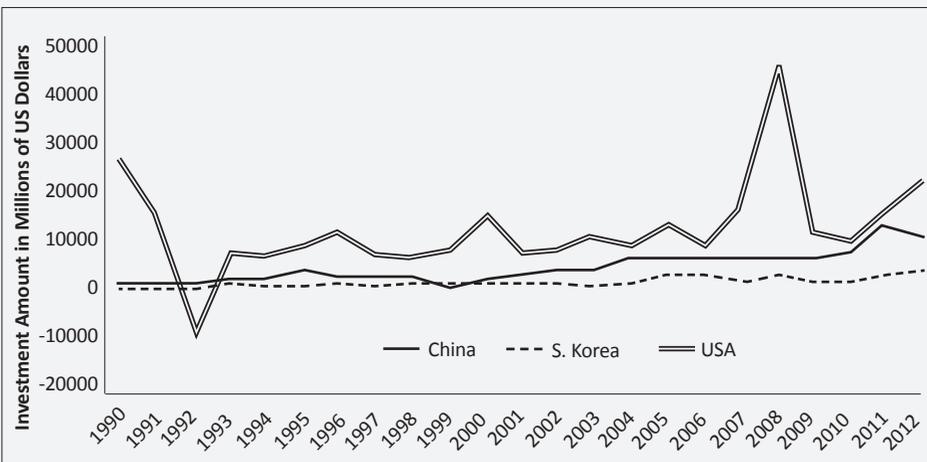


Figure 3. Intraregional Trade Volume in Northeast Asia (1984-2011)

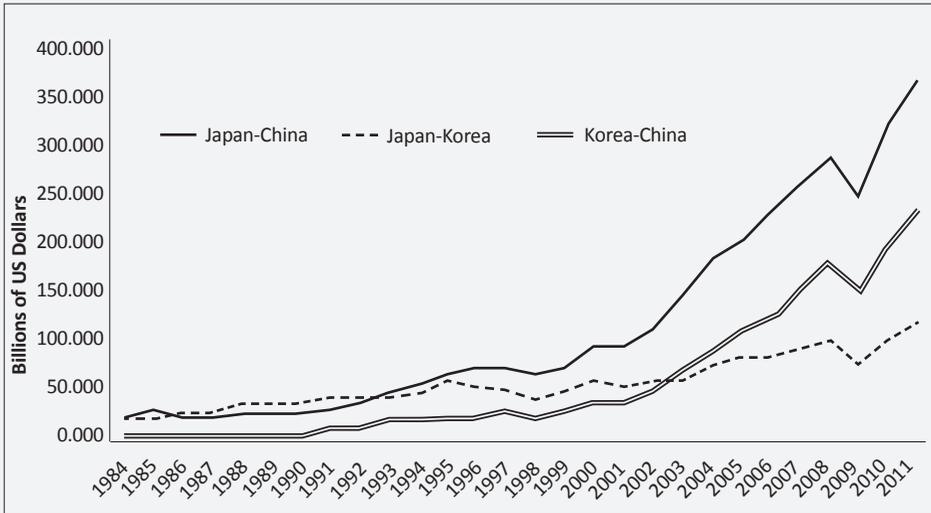
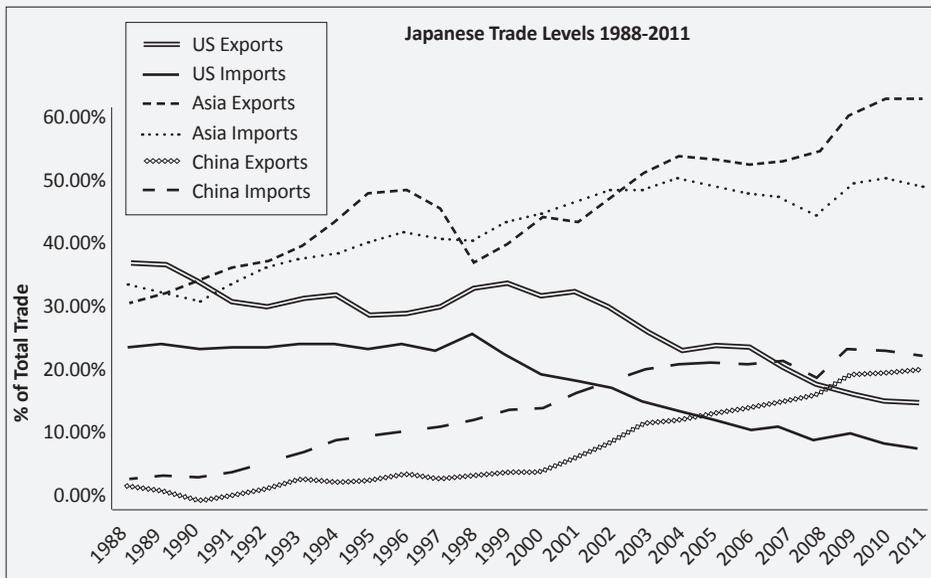


Figure 4. Japan's Trade with Major Partners



Source: Prepared from Ministry of Finance, Trade Statistics. <http://www.jetro.go.jp/en/reports/statistics/>

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The U.S. Perspective

Claude Barfield

The proposed China-Japan-Korea (CJK) FTA, if it comes to fruition, will be a major economic accomplishment in its own right; but it will also constitute an important milestone and potential way station on the road to a region-wide FTA, embodied in previous proposals for an ASEAN+6 agreement and in the recently launched negotiations for a Regional Comprehensive Economic Partnership (RCEP) agreement. This chapter analyzes the implications for the United States of the CJK FTA against the background of competing pathways to an ultimate regional economic architecture.

U.S. TRADE POLICY: FROM MULTILATERALISM TO TRANS-PACIFIC REGIONALISM

From 1945 to the late 1980s, the United States steadfastly adhered to multilateralism in international economic policy, taking leadership in the GATT and in the other pillars of the postwar Bretton Woods agreement, the World Bank, and the IMF. What follows is a very brief history of the shift in policy that saw regional and bilateral policies and agreements supplement multilateralism in trade policy.¹

Changes came to the fore in the George H.W. Bush administration, notably under the leadership of Secretary of State James Baker, the driving force behind a significant reorientation of U.S. international economic policy. With regard to trade policy, Baker stated that in addition to liberalization under the GATT, “bilateral and minilateral systems may help move the world toward a more open system.”² NAFTA became the most immediate symbol of the U.S. shift, but soon after Asia also moved to a top priority. Baker was quickly receptive to the proposal put forward by Australia and Japan for APEC, in which the United States would be expected to play a leading role. And he was immediately hostile to the subsequent proposal by Malaysian President Mahathir for an East Asian Economic Caucus that would include only Asian nations and exclude the United States. It was in response to Mahathir that Baker famously set out an enduring U.S. strategic position when he avowed that the United States would oppose any “plan that drew a line down the middle of the Pacific,” with the United States on one side of the line and Asian nations on the other. As Baker would state later in his memoirs, while there was no immediate security challenge to the United States at that time, he viewed his statement as a projection of diplomatic and security power as well as a statement of economic interest. The inextricable linkage between U.S. economic and trade goals with larger diplomatic and security goals has been a hallmark of U.S. policy toward Asian integration down to the present time.³

Bill Clinton was fortunate to preside over what historians have labeled the brief “unipolar moment” in postwar history. The Cold War was over, and U.S. economic and military power unchallenged. More specifically, in Asia by the mid-1990s Japan had begun its long period of stagnation and China’s rise was still just over the horizon. Thus, regional security concerns remained dormant, and economic priorities came to the fore with the upgrading of APEC in U.S. trade priorities and the establishment of Bogor goals of free trade in the Asia-Pacific by 2010 for developed APEC nations, and 2020 for developing APEC nations. The U.S. tried unsuccessfully to change the APEC mode of operation (concerted unilateralism) in 1997-98. With the failure to move toward binding reciprocity-based rules, the Clinton administration, in effect, gave up on APEC as a near-term vehicle for trade and investment liberalization.⁴

The shock of 9/11 deeply colored and shaped the foreign and international economic policy of the George W. Bush administration. The war in Iraq and the war on terrorism moved to center stage; and from 2001 through 2005, APEC drifted. Though Asian regional policy seemed rudderless during these years, Bush administration trade policy did not ignore Asia. It played a key role in two crucial strategic innovations instituted by U.S. Trade Representative Robert Zoellick. The first was the doctrine of “competitive liberalization,” a slogan that signaled a commitment to supplement the multilateral agenda in the WTO with one to negotiate FTAs, bilaterally, minilaterally with small groups of nations, or regionally if the opportunity presented itself. Zoellick argued that the discrete use of the huge U.S. market would trigger a competitive process toward global free trade. The second hallmark was a public and explicit linkage between trade policy and overall U.S. foreign and security policy. In speeches and congressional testimony, Zoellick succinctly elucidated the elements of the twin trade and security goals. He affirmed that in choosing prospective FTA partners, the Bush administration would seek “cooperation—or better—on foreign and security policy... Given that that the U.S. has international interests beyond trade, why not try to urge people to support our overall policies.”

Under these criteria, the Bush administration went on to conclude some seventeen FTAs with nations around the world. With regard to Asia, Zoellick saw FTAs as a means of getting around the stalemate in APEC. Thus, the United States completed a pending FTA with Singapore; successfully negotiated an FTA with Australia; commenced negotiations with Thailand and Malaysia (suspended later); and, most significantly, negotiated an FTA with South Korea. Foreign policy considerations played a central role in the choice of partners: Australia was moved to the head of the line as a result of support for the war in Iraq. Conversely, New Zealand was rebuffed because of long-standing disagreements over nuclear policy and its opposition to the 2003 invasion of Iraq.⁵

Finally, of great significance for this paper, during its last months in office, the Bush administration announced that it would move to enter the so-called P-4 trade negotiations (New Zealand, Brunei, Singapore and Chile) that aimed for a high level, deep integration trans-Pacific trade pact that would ultimately encompass all of the major economies of the region. With U.S. membership, the negotiating title became the Trans-Pacific Partnership Agreement (TPP).

THE OBAMA ADMINISTRATION AND THE ASIAN PIVOT

Though in many ways the foreign policy of the Obama administration differed dramatically from that of the Bush administration, diplomatic and security considerations played a large role in shaping trade policy in both administrations. This was underscored by the decision of the Obama White House to assign major strategic and political decisions to the National Security Council, and not to the USTR. Further, the role of individual leadership in shaping U.S. Asian policy forms a key element, with Secretary of State Hillary Clinton’s central focus on Asia providing a bookend to Secretary Baker’s guiding vision two decades previously.

Obama and Asia: Trade and Economic Policy

As he entered office, Obama seemed an unlikely candidate to push forward a bold United States trade agenda. Famously, in the 2008 campaign he boasted that he had opposed the NAFTA

agreement and subsequent bilateral FTAs; and he led a Democratic party deeply divided by trade liberalization and globalization issues. For almost a year the United States, in effect, had no trade policy, but by the end of 2009, a combination of economic imperatives and foreign policy challenges impelled a major turnaround on the trade front.

Though the financial crisis ebbed during 2009, the recession dragged on; and despite continuing Democratic congressional opposition, Obama turned to trade policy—and exports—to boost the flagging U.S. economy. This resulted in a major National Export Initiative to boost U.S. exports around the world, but particularly in the rapidly expanding Asian economies. Under the initiative, the president promised to double U.S. exports over a five-year period.⁶

Asia: The Pivot

Though economic factors were important, what more decisively shaped policy were the rapidly shifting diplomatic and security conditions in the region. Within months after Obama assumed office, North Korea heightened tension on the peninsula and threatened South Korea, a U.S. ally, by first conducting an underground nuclear test, and then lobbing two rounds of short-range missiles across the Sea of Japan (East Sea). Pressure mounted immediately for a show of support for South Korea, resulting, from the administration's own accounts, in a decision by the president to announce a goal of completing negotiations on the stalled KORUS agreement.

On a broader scale, even before the Obama administration took office, Beijing had hardened its attitude and diplomacy on a raft of disagreements and conflicts with its East Asia neighbors. Though not repudiating the mantra of a “peaceful rise,” China's leaders became much more assertive in their relations with individual nations—as well as ultimately with ASEAN as an organization. In May 2009, the government published a map of the South China Sea containing nine dashed lines in a U-shape that laid claim to over 80 percent of this maritime area. Subsequently, it clashed repeatedly with its neighbors, particularly the Philippines and Vietnam inside this self-proclaimed perimeter. In addition, the PRC grew bolder in contesting the claims of South Korea and Japan, respectively, in the Japan and East China seas.

TPP, Symbol of the “Pivot”

Secretary of State Clinton's first trip abroad was not—as had been traditional—to Europe, but to Asia. In speeches and testimony during the first months of the administration she proclaimed with some bravado that the United States was “back” in Asia, vowing to pursue a “more rigorous commitment and engagement.” To that end, she beefed up the economic resources and mission of the State Department and pressed for forward movement on U.S. regional trade and investment issues. Within months, the United States had signed the Treaty of Amity and Commerce with ASEAN, paving the way for membership in the East Asian Summit. The secretary made nine trips to Asia, more than to any other region. Most significantly, just before Obama's first trip to Asia in November 2009, the administration announced that it would move to ratify the KORUS FTA and would join the TPP talks initiated by the Bush administration.

Obama's Trip to Asia

The president's 2009 commitment to the TPP set the stage for the substantive capstone of the U.S. “pivot” during his nine-day trip to Asia in November 2011. Starting in Hawaii as host to the APEC Leaders Meeting, the president went on to make major pronouncements

and policy advances in Indonesia where he met with ASEAN leaders and became the first American president to join the East Asian Summit. Obama chose Australia to deliver his most far-reaching address reaffirming the U.S. commitment to Asia—and to the Australian alliance. “The United States is a Pacific power, and we are here to stay,” he averred, adding: “In the Asia Pacific in the 21st century, the United States of America is all in.” Later in Darwin, the president and the prime minister announced a new security arrangement under which the United States would deploy a rotating group of 2500 marines, establishing an important symbolic presence in maritime Southeast Asia.

From the outset of the trip in Hawaii, however, it was the TPP that created the “buzz” that would continue through the remainder of the president’s journey. With the announcement that a “framework” had been agreed to, the TPP moved to center stage as the most concrete symbol of renewed U.S. leadership in the region. As deputy national security adviser Michael Froman has recently stated: “This really embeds us in the fastest-growing region of the world, and gives us a leadership role in shaping the rules of the game in that region.”⁷

THE TRANS-PACIFIC PARTNERSHIP AGREEMENT: WHAT IT IS AND WHERE IT STANDS

Just what is the TPP and why is it so significant for the future leadership role of the United States in Asia? The current negotiations grew out of a four-nation agreement (P-4) concluded in 2006 by Chile, New Zealand, Brunei, and Singapore. Subsequently, Australia, Peru, Vietnam, and the U.S. signed on, followed in 2010 by Malaysia and most recently by Mexico and Canada. Detailed negotiations began early in 2010, and since then there have been seventeen formal negotiating sessions. The ultimate goal of the TPP is to include all of the nations in APEC.⁸

REDO FOR JAPAN?

At the present time, should the eleven nation negotiations be successful, the TPP would encompass an FTA of some 658 million people and almost \$21 trillion in economic activity. Should Korea and Japan join the agreement, as many expect in 2013-2014, the territory would expand to a combined GDP of \$27 trillion, constituting a trade bloc of over \$10 trillion in goods and services. If the negotiations for the CJK FTA prove successful, the resulting trade bloc would constitute about 20 percent of world GDP and about the same percentage of world exports. China is the largest trading partner and a major investment destination for both Japan and Korea. In 2011, trilateral trade volume amounted to \$690 billion, almost six times the total in 1999. Together Japanese and Korean investment in China amounts to over \$130 billion.⁹

Substantively, the TPP has been called the first “21st Century Agreement.” If successful, it will put in place international trade rules to lower or eliminate “behind the border” domestic barriers to foreign competition. Among the twenty-nine chapters under negotiation will be rules to open government procurement contracts to foreign competitors, rules to liberalize service sectors, such as telecommunications, banking and accounting, non-discriminatory health and safety regulations, fair competition with state-owned enterprises, and a level playing field for foreign investment.

Despite the emphasis on 21st century regulatory reform, there are also longstanding 20th century trade issues that will prove difficult to resolve. For the United States, the greatest challenges stem from sugar, dairy, cotton protection and subsidies, textiles, so-called rules of origin that hamper clothing supply chains, and finally union demands for interference with the labor laws of TPP trading partners. In the end, the key to success will come down to trade-offs between 21st century liberalization and old-fashioned 20th century protectionism.

INTRA-ASIAN REGIONALISM

The countries comprising ASEAN have striven mightily to make certain that ASEAN as an entity remained the central focus of East Asian regionalism. This was true despite the fact that a number of ASEAN nations—for instance, Singapore, Thailand, Malaysia, and Brunei—independently forged bilateral FTAs with individual trading partners. Thus, for some years, ASEAN has proceeded on several tracks. First, internally ASEAN incrementally moved to complete the promise of a *de facto* as well as *de jure* FTA among ASEAN member states. At this point, the goal is to achieve a unified ASEAN Economic Community by December 2015. In addition, through the ASEAN+1 process, ASEAN has completed FTAs with China, Japan, India, Australia, and New Zealand. By and large, these agreements do not aim for so-called “deep integration,” but rather for more shallow liberalization focusing on incremental tariff reduction.¹⁰

Modeling efforts have produced somewhat differing economic results, depending on the assumptions and calculations behind the particular model. In an initial effort in 2005, the Korea International Economic Policy Institute (KIEP) found that under the most conservative assumptions (the so-called static model that includes tariff reductions and not liberalization of services or does not factor in potential productivity gains) the CJK FTA would increase the GDP of China, Japan, and Korea, 0.89 percent, 1.05 percent, and 3.27 percent, respectively. Exports from the three nations would increase 11 percent, 5 percent, and 8 percent respectively.¹¹ More recently Chinese scholars, using less restrictive assumptions, predicted that over the medium term the CJK FTA could raise China’s GDP by 2.9 percent, Japan’s by 0.5 percent, and Korea’s by 3.1 percent, over baseline increases.¹² Finally, in a just published, exhaustive analysis of the economic effects of sequential liberalization under both the so-called Asian track and the TPP track, Petri, Plummer, and Zhai find that implementation of the CJK FTA by 2015 would result immediately in income gains for China, Japan, and Korea, of 0.2 per cent, 0.4 percent and 1 percent respectively.¹³

Though further liberalization of the Chinese, Japanese and Korean economies would benefit their ASEAN trading partners, prospects for a stand-alone CJK FTA have raised serious concerns throughout Southeast Asia. Specifically, ASEAN leaders worry openly whether the CJK FTA—as well as other trade movement in the region—put at risk the centrality of ASEAN as the lynchpin of East Asian economic integration.¹⁴ ASEAN fears combined with the PRC’s stepped up effort to head off the challenge of the TPP explain the decision in November 2012 to launch formal negotiations for a RCEP in 2013.

RCEP

At the November 2012 ASEAN summit, two important decisions were taken: first, ASEAN nations agreed to postpone completion of the planned ASEAN Economic Community (AEC)

from January 1 to December 31, 2015; and second, ASEAN launched the RCEP, with the aim also of completing negotiations by the end of 2015. Formal negotiations among the ASEAN+6 nations are slated to begin sometime in the first half of 2013. Inevitably, RCEP is being compared with the TPP. If successful, both would reduce the “spaghetti bowl” effect of the multiple bilateral agreements that have been concluded throughout East Asia. There is also some overlap in membership in that Australia, New Zealand, Singapore, Malaysia, Brunei, and Vietnam are participating in both negotiations. In other ways, however, the two agreements, if successfully completed, will be quite different. First, unlike the TPP where individual ASEAN nations are negotiating separately, in RCEP ASEAN is represented as a single economic and political entity, including, from the outset, even the less developed ASEAN members: Laos, Cambodia, Myanmar.

In part, this membership difference—as well as the inclusion of ASEAN as a distinct entity—has dictated contrasting ground rules for the negotiations. First, according to the ASEAN Secretariat’s statement of the RCEP Guiding Principles and Objectives for Negotiations, there will be a great deal of flexibility in the negotiating mode, which “can be accomplished in a sequential manner or a single undertaking or through any other agreed modality.” RCEP will also provide “special and differential treatment to ASEAN Member States.”¹⁵

Finally, there is one other highly significant difference between the two potential agreements. RCEP’s membership is fixed and limited to the present sixteen negotiating partners (though at some later date after conclusion of the agreement it could be expanded). TPP, on the other hand, is unique in that it has added members during the course of the negotiations, starting with the P-4, then adding five additional partners from 2005 to 2010, and two additional members, Canada and Mexico, in December 2012. There is also the potential that two more nations, Korea and Japan, could join before the terms of the agreement are settled in 2013-2014.¹⁶

Substantively, in contrast to the deep integration goals of the TPP, the initial aims for the RCEP are less ambitious. Three negotiating subgroups are being established in goods, services and investment; but it is not expected that the agreement will contain many of the “behind the borders,” nontariff barrier liberalization rules that are the object of TPP negotiators. At a minimum, the RCEP negotiators have set as a goal the simplification and harmonization of the existing ASEAN+1 agreements. For instance, differing tariff classifications in these agreements could be unified into one system; and as nearly as possible, a common tariff schedule could be constructed. As an important complement, the agreement will attempt to simplify the multiple rules of origin (ROOs) in the bilateral pacts. On services, some of the ASEAN+1 agreements contain WTO-Plus commitments; others do not. The goal would be to expand existing WTO-Plus commitments, as well as to introduce new liberalization in additional sectors.¹⁷

FUTURE SCENARIOS: CJK, RCEP, AND THE TPP

This concluding section considers potential future scenarios for the emerging Asian economic and trade architecture. It begins with an analysis of political and security factors that may complicate—both frustrating and spurring—diverse future outcomes. It then

describes plausible pathways for negotiations leading to a future FTAAP, including the role of the CJK FTA, RCEP, and the TPP.

History, Conflict in the South China Sea, and the U.S. “Pivot” to Asia

FTAs, whether bilateral or regional, are not undertaken in an economic vacuum. Gains to GDP, terms of trade, and export enhancement are all important factors in deciding to embark upon negotiations, but these calculations are always shaped by equally important political and security judgments. This juxtaposition is certainly evident in the recent history of economic and political integration in East Asia. This paper highlights several of the most important background factors.

Beijing, Tokyo, Seoul

Recent events are playing out against the advent of more belligerent moves by the PRC. After the Second World War, China, in the famous nine-dotted line map (inherited from the Chinese Nationalist Government), officially laid claim to some 80 percent of the South China. Only in recent years, however, has conflict flared, driven by the prospect of large deposits of oil and gas reserves. While in most cases, the true legal rights are lost in the mists of history, both the PRC and other claimants (Japan, Vietnam, Philippines, Brunei, and Malaysia) have stepped up their assertion of claims and their defenses. The growing tension between Beijing and Tokyo over the Senkaku/Diaoyu Islands has spilled over into economic relations. The PRC, despite a recent record of intransigence on regional disputes with its neighbors, is by no means totally at fault for the dangerous escalation: the Japanese government’s move to “buy” the islands, to some degree, forced Beijing to more vigorously assert its own authority, leading to the current standoff with ships from both nations circling each other in the area. The dispute has fed nationalist impulses and groups in both nations, hampering efforts to move forward on closer trade relations.

Similarly, Japan and Korea have become embroiled in highly emotional disputes, such as the alleged use by Japan of “comfort women” during the long Japanese occupation of Korea. Earlier, Japan had “apologized” for the human rights violations, but recently some Japanese politicians in the newly triumphant LDP have called for rescinding the apology, sparking deep resentment in Korea. In addition, Japan and Korea are embroiled in a territorial dispute over a rocky outcropping in the Sea of Japan that Korea calls Dokdo and Japan calls Takeshima.¹⁸

ASEAN Centrality

A second looming dilemma concerns the viability of the “centrality of ASEAN” in future moves toward Asian economic and political integration.¹⁹ As this chapter has noted, RCEP is at least partially driven by ASEAN’s determination—at least aspiration—that the confederation will continue to occupy the driver’s seat as closer economic and political ties are forged over the next decade. This aspiration faces internal and external challenges. Internally, it is by no means clear that ASEAN will meet the 2015 deadline to complete the AEC through final liberalization of tariff and nontariff barriers. The deadline has already slipped from January to December 2015, and outside observers express skepticism that even that goal is attainable—skepticism reinforced in January by warnings from Indonesia’s trade minister that his country was not “ready to face the AEC” and little had been done to prepare for the new obligations.²⁰

Of equal importance are outside pressures—most particularly from Beijing—that already have caused fissures among ASEAN nations and almost certainly will continue. The failure in May 2012 to produce a joint communiqué at the close of the ASEAN Ministers Meeting was the result of an open, direct intervention by the PRC that caused Cambodia, the chair, in effect to veto any reference to conflicts over South China Sea territorial claims. It was an unprecedented failure in the forty-five years of such meetings; as one observer noted “The ‘ASEAN Way’ of consensus failed.”²¹ The divisions continued at the November 2012 East Asian Summit, when Cambodia once again succumbed to PRC pressure but was met with strong opposition from the Philippines, with support from Singapore, Malaysia and Thailand. In defiance of the PRC demand for individual bilateral negotiations, Singapore Prime Minister Lee Hsien Loong called for “multilateral talks between ASEAN and Beijing.”²²

Should ASEAN fail to meet its AEC deadlines or should the PRC continue to exploit economic hegemony over the smaller, least developed ASEAN states, it will put ASEAN’s future in peril. At worst, individual ASEAN nations might drift toward independent economic and political arrangements, leaving ASEAN itself an increasingly hollow shell.

The U.S. Pivot

A third strong influence on future developments in East Asia will be the future course and impact of the Obama administration’s pivot to Asia. Though there were strong economic reasons for joining and leading the TPP, as noted above, following Obama’s landmark trips to Asia in 2011 and 2012, the TPP has become the single most important symbol of the U.S. commitment to a continuing strong leadership role in the region. Thus, success or failure of these trade talks will have repercussions well beyond the undoubted large trade and investment consequences.

With the RCEP now launched alongside the TPP, in the future the two negotiations will be seen as both complementary and competing visions for an Asian economic (and ultimately political) architecture. The PRC, particularly, has evinced strong misgivings about U.S. strategic goals in the region. While official pronouncements have been fairly circumspect, outside spokespersons—economic and security analysts, former military figures and other former officials—have more bluntly labeled the TPP as a vehicle for the “containment” of China.²³

The competition and divisions over the TPP and RCEP, however, should not be overstated. On the U.S. side, Obama administration officials have stressed repeatedly that the TPP is not aimed at China—and that in time, they hope and foresee that China will see fit to join the agreement. And it is true that TPP member nations, from the outset of the negotiations, have stressed that the TPP is a way station to the larger goal of a FTAAP, which would include, at a minimum, all of the nations in APEC. It is still likely that the PRC will for the near and medium term continue to see the RCEP as the main vehicle for further regional liberalization, but the RCEP itself has an open-ended membership policy and, theoretically, there would be nothing to preclude U.S. membership.

GOING FORWARD: U.S. OPTIONS AND PRIORITIES

What follows is a brief list of possible pathways for East Asian regionalism, and recommendations for U.S. policy and actions.

The TPP

Whatever transpires with the CJK FTA or RCEP, in 2013 and 2014, the U.S. should focus almost exclusively on the successful conclusion of the TPP negotiations. As this author has written elsewhere, 2013 is “crunch time” for the TPP.²⁴ Since early 2010, TPP member states have held seventeen intense negotiating sessions. It is now agreed by the TPP trade diplomats that much of the technical detail has been cleared away, and over the next few months tough political decisions will have to be made by the heads of state or their immediate political staffs. As noted above, for the United States, the tradeoffs will entail pressing for liberalization on the so-called 21st century issues, while conceding ground on more traditional 20th century issues: advances on services, investment, SOEs, and regulatory reform against concessions on textiles, sugar and dairy subsidies, rules of origin, and possibly labor regulations.

Should the negotiators not be able to point to major compromises and work-arounds for sensitive issues in the fall of 2013, there is a real danger that the talks will unravel. Though it will take much longer to complete, the RCEP now stands as a potentially viable alternative, and a path that for the moment is closed to the United States.

CJK FTA

The economic benefits of the proposed CJK FTA for each individual nation have been authoritatively documented in a number of studies. But the key determinants of forward progress over the next several years lie outside trade and investment statistics: trilateral political and security considerations will have equal place in governing the outcomes. During the last months of 2012 and the first months of 2013, relations between the PRC and Japan deteriorated dramatically, as an action/reaction syndrome seemed to take hold, heightening chances for conflict. Since the election, however, Abe has followed a mixed course. On the one hand, he has drawn back, adopting a more conciliatory tone. In January 2013, he dispatched envoys to both Beijing and Seoul, with the stated purpose of preparing the ground for future high-level exchange of visits and accommodation. On the other hand, on his first visits to Vietnam, Singapore, and Thailand, he seemed to revive Aso Taro’s “arc of democracy” from his earlier term as Japan’s leader, Fukuda, taken as a rallying cry for resistance to Chinese hegemonic ambitions.²⁵ In mid-January, the Obama administration became so concerned with the drift toward confrontation that it sent a high-level mission to Japan and South Korea to call for “cooler heads to prevail” in the developing crisis.²⁶

Some observers argue that, despite the obstacles, the economic gains from the proposed trilateral FTA will trump diplomatic spats, and that for the foreseeable future the combination of “hot economics, cold politics” will be the norm.²⁷ Others, including the view in this paper, hold that over the short term both economic and strategic factors will delay the CJK FTA. Abe faces domestic opposition to any move toward greater liberalization of the Japanese economy. The combination of economic divisions with heightened nationalistic resentment against China makes it unlikely that the trilateral negotiations will go forward quickly.

Such is not the case, however, with a parallel bilateral FTA negotiation between the PRC and Korea, whose outgoing trade minister, Bark Taeho has stated often over the past year that protection of Korea’s large investment in China was a high priority for his government. In his view, that protection can best be achieved through either the CJK FTA, or—as now seems more likely—through a bilateral CK FTA.²⁸ With regard to its largest trading partners—

China, the United States, the EU and Japan—Korea already has completed FTAs with two. A bilateral agreement with the PRC would leave only the Japanese market where no preferences were available. Given this situation, Korea is likely not to fret over a desultory process for the CJK FTA.

And how should the United States react to the CJK FTA, whatever the course and timing of the trilateral negotiations? From a foreign policy perspective, the Obama administration should craft a positive response, since it is in U.S. interest that relations among China, Japan and Korea not deteriorate further and threaten East Asian stability. Though closer economic ties do not guarantee enhanced political relations, they do have an ameliorating effect—and they can act to keep politicians mindful of the positive benefits through promised spurs to economic growth and wellbeing in all three economies.

RCEP

If the thesis advanced in this paper is correct—that the crucial time for completion of the TPP negotiations (at least for the eleven current member states) is within the next twelve to eighteen months—then initially there will be no real competition between the RCEP and the TPP. The RCEP nations have set a tentative goal of finalizing an agreement by 2015. This goal almost certainly will not be met—failing a decision to sign a purely political document almost void of substance.

Various RCEP member states have argued—particularly those that are also participating in the TPP process—that the final agreement must achieve a higher level of liberalization than existing WTO rules, even if the RCEP does not aim for the very high so-called 21st century standards of the TPP. Given the diversity of membership (including still-closed economies such as India and Indonesia) and the huge development gaps among members, RCEP negotiations are likely to extend some years beyond the current timetable.

What, then, should be the U.S. response? Following a general rule to encourage trade and investment liberalization no matter where it occurs and what the specific circumstances, the United States should adopt a positive response, supporting any initiative or alternate path that will lead to an ultimate FTAAP. Beyond this benign response, there are more specific actions that the Obama administration should take in coming months. First, the United States should give higher priority to forging a closer economic relationship with ASEAN. In November 2012, at the ASEAN Summit, Obama and ASEAN leaders reset economic relations with the launch of the Expanded Economic Engagement (E3) initiative, which could bolster ongoing Trade and Investment Framework (TIFA) negotiations. While Obama has greatly increased U.S. attention to ASEAN, the TIFA negotiations have proceeded fitfully. Partly, this is a result of the reluctance of some ASEAN nations (Indonesia) to commit to further liberalization, and partly this stems from the reality that the less developed ASEAN states lack the capability to sustain an opening of goods and services. Whatever the reason, the United States should take the lead in pushing for incremental reforms, possibly staggered and tailored to the development level of individual ASEAN members.²⁹

As this chapter was being completed, an important turn of events reconfigured the regional architectural landscape in East Asia: this was the formal decision by Prime Minister Abe to request that Japan be included in the TPP negotiations. Abe's decision stemmed from several

factors. First, during a February visit to the United States, Abe received from President Obama the assurance he needed that while “all goods would be subject to negotiation,” Japan would not be required to precommit to specific liberalization measures. The joint statement read: “Recognizing that both countries have bilateral trade sensitivities, such as certain agricultural products for Japan and certain manufactured products for the United States, the two governments confirm that, as the final outcome will be determined during the negotiations, it is not required to make a prior commitment to unilaterally eliminate all tariffs upon joining the TPP negotiations.”³⁰

The second factor was Abe’s calculation that his very high personal approval ratings with the Japanese public (over 70 percent), signaling support of his comprehensive economic reform plans, would give him the clout and power to win crucial July elections for the upper house of the Diet, even with the risky decision to enter TPP negotiations. Thus, on March 15, Abe formally requested to the eleven members of the TPP that Japan be allowed to enter the trade talks. He directly tied the decision to his broader plans for economic reform, and he adopted a strong sense of urgency, stating: “Emerging countries in Asia are shifting to an open economy, one after another. If Japan alone remains an inward-looking economy, there will be no chance for growth. This is our last chance. If we miss this opportunity, Japan will be left behind.”³¹

As it turned out, both the United States and Japan moved with dispatch to complete negotiations for Japan’s formal entrance into the TPP talks. (The U.S. position was central to moving the process forward, as other TPP nations, though they had specific concerns, were certain to follow the U.S. lead). On April 12, the two nations announced that they had reached terms of an agreement that would allow the United States to support Japan’s entrance into the negotiations after a 90-day period for congressional notification. It was expected that Japan would join the next round of TPP negotiations scheduled to take place in Peru in mid-July.³²

Under the agreement, Japan and the United States issued separate statements confirming preliminary decisions in the politically sensitive automobile and insurance sectors. Both agreed that the United States would phase out its auto tariffs—2.5 percent on cars and 25 percent on trucks—over the longest period possible under any future TPP deal; and Japan agreed to negotiate liberalization of other nontariff barriers to foreign automobile sales, such as standards, certification, and distribution. As a gesture of good faith, Japan also pledged not to expand further the Japan Post’s products in cancer and medical products insurance.³³

Japan’s swift entrance into the TPP negotiations will have major consequences for both the concurrent CJK FTA negotiations, as well as the RCEP negotiations. Abe has now given top priority to the TPP. Crucially, he has established an independent negotiating team above the cabinet and in his own office. That team will be headed by Cabinet Secretary Yoshida Suga, and will report directly to the prime minister. This will lessen—though not eliminate—the strong influence (and veto power) of powerful cabinet ministries, particularly the agriculture ministry.

Thus, for the foreseeable future most resources and attention will be devoted to the TPP negotiations, and the CJK and RCEP negotiations will perforce take a back seat. In sum, these recent events and decisions reinforce the point made earlier in the paper: that the TPP

is now on a faster timetable than either the CJK or RCEP negotiations and, if successful, will not compete with them.

More broadly, for the United States, there are both great benefits and great dangers in Abe's decision. On the plus side, most observers hold that once Japan has acted Korea will follow soon after with a request for membership. The addition of Japan and Korea will in turn constitute an important tipping point, giving the TPP the heft and weight in Asia to become the central focus of an East Asian economic architecture. If successful, a thirteen-member TPP would create a \$27 trillion trade bloc (40 percent of world GDP), that includes about one-third of total world trade.³⁴

Down the road, the danger is that, despite its commitment not to reopen decisions already made in TPP negotiations and to negotiate swiftly and in good faith, Japan could prove obdurate and unable to fulfill its promises to greatly reduce or eliminate major nontariff trade barriers. This could lead to a crisis in the negotiations or produce a stalemate. In order to avoid this outcome, the Obama administration will have to give the TPP top priority status as the talks move to crucial decisions in late 2013. Japan will have to compromise—but so will the United States and other TPP members.

In the end there are both overriding economic and security reasons for the United States to include Japan and Korea in the TPP. First, if the CJK FTA does go forward to completion, there will be a moderate, but identifiable negative discriminatory effect on U.S. corporations and the U.S. economy, while all three CJK FTA economies would achieve important income gains. In contrast, if the two join the TPP, Petri et. al. calculate that Japan and Korea will experience income gains (vs. a base case) of 0.3 and 0.2 percent respectively in 2015—rising to 1.8 and 2.0 percent in 2020.³⁵ The United States would also benefit from small GDP and trade gains.

On the strategic and security fronts, there is one highly relevant developing reality to consider. The current debate in the United States over the mounting U.S. debt is well beyond the subject of this paper, but the debt crisis, trade policy, and future Asian security policy dovetail down the road. While there is great uncertainty about how the negotiations will play out, one thing is certain: for the foreseeable future U.S. defense expenditures will be highly constrained, putting at risk the ability to make good on the security promises implicit in the Asian "pivot." Successful TPP negotiations that encompass the United States and its major Asian allies will make it much less difficult for Obama and his successors to persuade Congress that U.S. economic interests in Asia are inextricably entwined with U.S. security responsibilities.

ENDNOTES

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ASIA'S UNCERTAIN FUTURE: KOREA, CHINA'S AGGRESSIVENESS, AND NEW LEADERSHIP

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