Trilateral Trade Relations among China, Japan and South Korea: Challenges and Prospects of Regional Economic Integration

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China’s emergence as a global and regional manufacturing center has significant implications for the Northeast Asian economies of Japan and South Korea. China’s trade with Japan and South Korea has been rapidly growing in relative importance, largely facilitated by China’s rise as a regional production base as well as changes in the trade structures between China and her neighbours. Indeed, in recent years, China has been the main driving force behind Northeast Asian trade interdependency. The strong economic linkages and complementarities among China, Japan and South Korea augur well for the further integration among the three Northeast Asian countries. Establishing a trilateral free trade arrangement (FTA) provide new opportunities to enhance the three countries’ overall growth potential through trade and investment. However, such Northeast Asian regional integration is destined to be a long, drawn out process. The forging of a trilateral trading arrangement between China and her two neighbours remain a long term vision in view of the many outstanding issues and obstacles.

Key words: economic interdependence, integration, trilateral FTA, intra-regional trade, trade intensity

Introduction

The emergence of China as a manufacturing hub has dramatically altered trade dynamics in the region and has significant implications for Northeast Asia.\(^1\) China increasingly operates not just as a locomotive for regional economic growth, but also as a powerful catalyst for Northeast Asian economic integration. The interdependence of China and the Northeast Asian countries of Japan and Korea has been rapidly increasing due to China’s role as a central player in the production networks of the region. In recent years, China has been the main driving force behind Northeast Asian trade interdependency, providing the largest market share increase for Japan and South Korea. Driven
mainly by market forces, the rapid rise in Northeast Asian intra-regional trade augur well for further economic integration among the three countries concerned.

Together, the trilateral grouping of China, Japan and Korea constitute a significant proportion of world population and output. Combined, the Northeast Asian countries had a population of 1.5 billion (24% of world population) with a nominal GDP of US$5,668 billion (about 18% of world GDP) in 2002, while total trade is estimated to reach US$1.7 trillion (13% of world trade). China is currently pushing for Northeast Asian tripartite cooperation with Japan and South Korea, and has proposed the possible creation of a free trade agreement involving the three economies at an ASEAN meeting in Phnom Penh in November 2002. It has initiated a joint study with Korea and Japan on possible Northeast Asian economic cooperation, and according to a recent intergovernmental study by China, it is anticipated that bilateral annual trade volume between China and Japan will reach US$130 billion by 2005, while that with Korea will reach US$55.5 billion.\(^2\)

Despite the potential for deepened economic linkages between China, Korea and Japan, Northeast Asian regional integration is destined to be a long, drawn out process constrained by various obstacles. There are historical, cultural, political, ideological and other economic factors at play, hindering the move towards the formation of a formal economic grouping. It is beyond the scope of this paper to discuss all the diverse and complex issues, and discussion will mainly focus on the regional implications for Northeast Asia of China's emergence. The structure of this article proceeds as follows. The first section studies the economic structures and trade patterns among China, Japan and Korea. Major changes that occurred in the structure of China's trade with her neighbours have important significance for Northeast Asia. The next section examines the major trends in Northeast Asian trade and investment which is largely facilitated by China's rise as a regional production base. There is evidence that the magnitude of ties between China and her neighbours are rapidly growing in relative importance. The third section analyses the prospects for strengthening and extending Northeast Asian regional economic cooperation before concluding.

China's Trade Relations with Japan and Korea

Since the 1970s in the postwar era, ties between China, Japan and Korea have been slowly evolving. With China's drive towards economic modernisation, China's recent trade relations with Japan and Korea have been influenced mainly by the growth and expansion of the Chinese economy. In fact, Sino-Japan and Sino-Korean trade grew faster than China's foreign trade with the world from 1990-2002 (Table 1 and Figure 1). During the same period, China's trade with Korea experienced faster growth than China's trade with Japan, with the rapid rate of growth mainly attributed to China's imports from Korea, particularly in the early 1990s. China's imports from Korea grew at an average annual rate of 62.7% during 1990-95, higher than China's imports from Japan which averaged 22.4% annually during the same period.