

Economic Clustering in Northeast Asia (China, Japan and Korea): Strategic Implications for Australia¹

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Abstract

This paper examines the rationale, structure and implications of recently proposed Northeast Asia (China, Japan and South Korea) trilateral FTA so as to ascertain its potential impact on trade with Australia. It will be argued that the emergence of this nascent political and economic cooperation between China, Japan and South Korea will require Australia to strategically reposition its trade with these countries and other trading partners.

Introduction

During the annual China-Japan-South Korea (CJK) summit, held on 13 May 2012 in Beijing, Premier Wen Jiabao (China), Prime Minister Yoshihiko Noda (Japan), and President Lee Myung-bak (Korea) announced their intention to begin negotiating a trilateral free trade agreement. Negotiations between the three countries took over a decade to reach this stage. This decision to establish an economic cluster between three of Australia's major trading partners is likely to embrace many of the countries belonging to the Association of Southeast Asian Nations (ASEAN) in the longer term. This is a significant issue as the future of Australia is increasingly dependent on Asia and that future will be determined substantially by the ability of the Australian economy to compete in a variety of business arenas in this region (Francois and Wignaraja 2008; Department of Foreign Affairs and Trade (DFAT) 2011a; Department of Foreign Affairs and Trade (DFAT) 2011b). This paper sets out a preliminary analysis of the emergence of a new regional economic clustering involving China, Japan and South Korea (hereafter referred to as Korea) and its impact on Australia. The first section offers an overview of the importance of trade with CJK to the Australian economy. This is followed by an exploration of the prospects for, and development in, Northeast Asian economic integration. The next section then examines Australia's attitude towards the proposed CJK FTA whilst the penultimate section analyses the policy implication for Australia. The paper concludes with the proposition that Australia will need to reposition its strategic trade relations with the CJK cluster.

The importance of CJK to the Australian economy

Australia has long been a market-driven trading country. In 2010, Australia achieved A\$16.8 billion trade surplus. This accounted for more than 20 per cent of Australia's gross domestic product (GDP). Much of Australia's trade surplus is made with the trade of goods and services with the member economies of Asia-Pacific Economic Cooperation (APEC). In particular, China, Japan, and Korea (CJK) are three major trading partners. In 2010, CJK accounted for 47 per cent of Australia's total goods and services exports (DFAT 2011). In 2010 this region accounted for 30.2 per cent of Australia's two-way trade worldwide. In particular, China has become Australia's largest trading partner both in exports (\$64.4 billion)

¹This is a preliminary discussion paper to be followed by further investigation.

and imports (\$41.1 billion), Japan was the second largest partner for two-way trade(\$63.6 billion) and Korea was ranked the 4th largest trading partner (\$29.5 billion). Details are provided in tables 1 to 3. In this period the US was ranked the 3rd largest trading partner with Australia. This level of trade is not a recent phenomenon as can be seen in figures 1 and 2.

Table 1: Australian merchandise trade with China, 2010-11

Trade activity	Total share	Rank	Growth (yoy)
Exports to China (A\$m): 64,835	26.4%	1st	39.4%
Imports from China (A\$m): 41,109	19.2%	1st	13.0%
Total trade (exports + imports) (A\$m): 105,945	23.1%	1st	27.8%

Source: Department of Foreign Affairs and Trade (<http://www.dfat.gov.au>)

Table 2: Australian merchandise trade with Japan, 2010-11

Trade activity	Total share	Rank	Growth (yoy)
Exports to Japan (A\$m): 46,880	19.1%	2nd	26.5%
Imports from Japan (A\$m): 16,685	7.8%	3rd	-6.2%
Total trade (exports + imports) (A\$m): 63,565	13.8%	2nd	15.9%

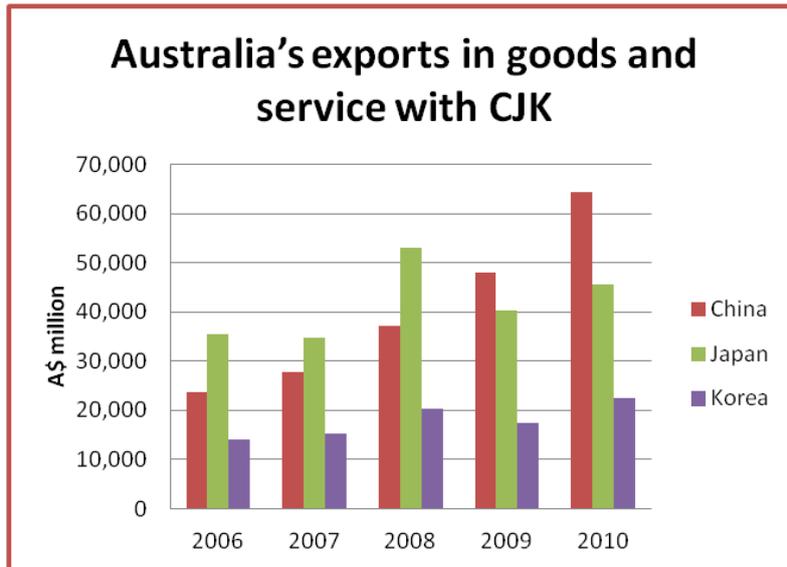
Source: Department of Foreign Affairs and Trade (<http://www.dfat.gov.au>)

Table 3: Australian merchandise trade with Korea, 2010-11

Trade activity	Total share	Rank	Growth (yoy)
Exports to Korea (A\$m): 22,543	9.2%	3rd	36.7%
Imports from Korea (A\$m): 6,984	3.3%	9th	-0.9%
Total trade (exports + imports) (A\$m): 29,527	6.4%	4th	25.4%

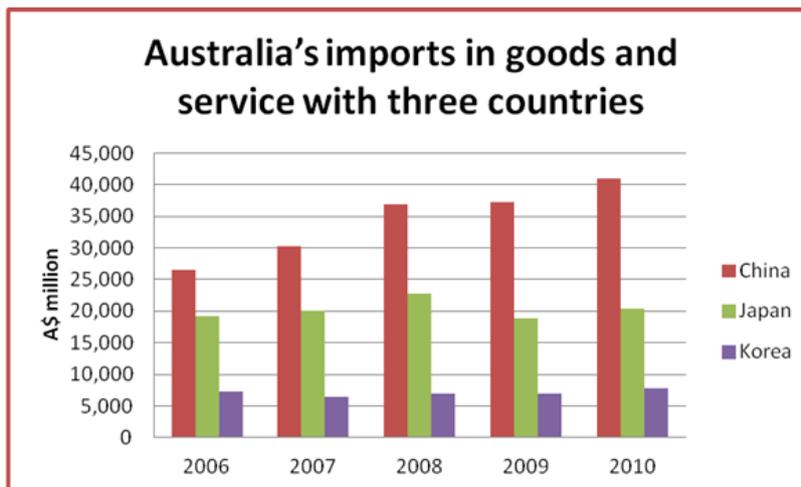
Source: Department of Foreign Affairs and Trade (<http://www.dfat.gov.au>)

Figure 1: Australia's exports with CJK



Source: Australia's trade with the East Asia, 2008; 2010

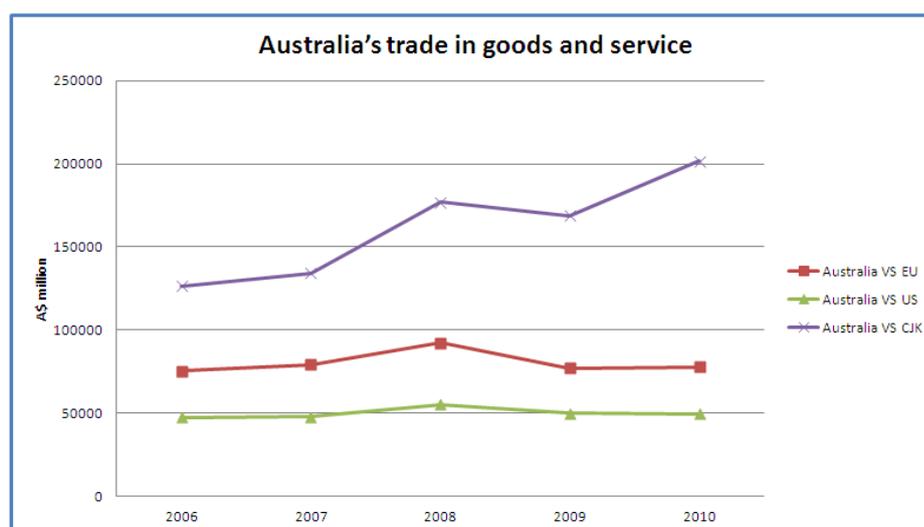
Figure 2: Australia's imports with CJK



CJK's economic and political changes and their changing role in the international political economy has had, and is having, an impact on Australian interests. CJK has been an important regional partner to Australia in many areas and interests. Recent trade statistics, that shows the significance of Australia's trade with the Northeast Asia²(China, Japan and Korea), demonstrate the importance of those countries to Australia's economic well-being. In 2010 Australia's trade volume (export/import) with these countries (A\$199 billion) far exceeded the combined total (A\$127 billion) of trade with the United States (U.S.) and the European Union (EU). Details are provided in Figure 3 and tables 4 to 6. Overall, 43 per cent of Australia's total global trade 2010 was with CJK.

²Though the precise area of Northeast Asia varies, it normally includes China, Japan, Korea, Mongolia and eastern part of Russia. In terms of economic strength, China, Japan and Korea comprise the core of the region. As such, throughout this paper, Northeast Asia and East Asia refers to China, Japan, and Korea.

Figure 3: Australia's trade with EU/USA/CJK



Source: Australia's trade with the European Union, 2008; 2010
 Australia's trade with the Americas, 2008; 2010
 Australia's trade with the East Asia, 2008; 2010

Table 4: Australia's trade in goods and service with China, Japan, Korea (A\$ million)

Year	Imports	Exports	Total trade
2006	53098	73255	126353
2007	56693	77714	134407
2008	66593	110461	177054
2009	63003	105653	168656
2010	69087	132409	201496

Source: Australia's trade with East Asia, 2008; 2010

Table 5: Australia's trade in goods and service with EU (A\$ million)

Year	Imports	Exports	Total trade
2006	46263	28968	75231
2007	51430	27921	79351
2008	59811	32401	92212
2009	51201	26084	77285
2010	50966	27008	77974

Source: Australia's trade with European Union, 2008; 2010

Table 6: Australia's trade in goods and service with US (A\$ million)

Year	Imports	Exports	Total trade
2006	31963	15681	47644
2007	32084	15876	47960
2008	37286	17852	55138
2009	34763	15234	49997
2010	35273	14498	49771

Source: Australia's trade with the US, 2008; 2010

Historically, the primary interest has been based on commodity trade. CJK is a large export market for coal, iron ore and concentrates, crude petroleum and natural gas, totalling A\$101.4 billion in 2010, one third of total amount of trade with East Asia (DFAT 2011:3). Clearly, trade with CJK is of paramount importance and this 'cluster' represents a significant market for Australian goods and services. The future of Australia is considered to be in East Asia and that future will be determined by the ability of Australian economy to compete in a variety of business arenas across Asia (Francois and Wignaraja 2008; 2010; 2011). Despite this volume of trade, CJK do not have bilateral free-trade agreements (FTA) with Australia, or indeed with each other even though they have negotiated a significant number of bilateral agreements with other countries. This three nation free-trade agreement (CJK-FTA) has the potential to dramatically change the economic landscape of Asia and presents serious political and economic challenges, and opportunities to Australia.

Prospects for, and developments in, CJK economic integration

Since the outbreak of the 1997 Asian financial crisis and the expansion of the EU into central and eastern Europe, the success of the North American Free Trade Agreement has stirred much interest in regional economic and monetary cooperation in East Asia (Aminian 2005; Kawai and Wignaraja 2010). While Northeast Asian economic integration is being achieved sporadically due to the political and economic characteristics of the region, the new millennium has brought about the rise of Northeast Asia economic integration, regional trade and investment relations, financial cooperation, environmental cooperation, science and technology cooperation, and industrial cooperation (Cheong 2003; De Santis 2005; Chia 2010; Kawai and Wignaraja 2010; Estrada, Park et al. 2011; Naoko 2011). The tariff barriers among the three countries in Northeast Asia have been reduced; the weighted average tariff in 2004 of the three economies was less than 6 percent, as compared to more than 20 percent in 1991 (De 2006:2). In 2010, the aggregate GDP of CJK accounted for nearly 20 percent (US\$12,344 billion) of the world's total and their trade volume accounted for 18.5 percent of the world's exports and 16.3% of the world's imports. CJK's share of the world's inward and outward foreign direct investment (FDI) (flows) represented 9.2 percent and 12.8 percent, respectively in 2010 (Korean Ministry of Foreign Affairs and Trade 2011). In 2011, CJK's three-way trade reached US\$690 billion.

China, Japan and Korea are now increasingly the leading players in the spread of economic clustering in the form of Free Trade Agreements (FTAs). China has concluded FTAs with New Zealand, ASEAN, Chile, Singapore, Peru, Pakistan and Costa Rica, and has also signed Closer Economic Partnership arrangements with Hong Kong SAR and Macao SAR. China is currently negotiating FTAs with the GCC, the SACU, Australia, Switzerland, Norway and Iceland. Japan has 12 economic partnership agreements (EPAs), namely those with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, the Philippines, Switzerland, Vietnam and India. Korea is also actively pursuing FTAs. Currently, 8 FTAs are in force, namely those with Chile, Singapore, EFTA, ASEAN, India, the EU, Peru, and the United States. In addition, Korea is now negotiating with Australia, New Zealand, the GCC, Colombia, Turkey, Canada and Mexico for FTAs (Korean Ministry of Foreign Affairs and Trade 2011). Overall, CJK have now over 30 agreements in the pipeline (Kawai and Wignaraja 2010).

Despite CJK's important role in the world and the consensus among the member nations that economic power and competitiveness as a result of the economic clustering would certainly be enhanced, substantial economic integration (FTA) has not yet evolved. Given the many FTAs among Asian countries, including ASEAN+1 FTAs, the missing links are among the three Northeast Asian countries (Lee and Bang 2011).

However, some progress has recently been made:

- November 1999, Manila: At the ASEAN+3 Summit Meeting, the leaders of China, Japan and Korea (CJK) met for an historic gathering, and a Trilateral Summit Meeting has since taken place annually.
- December 2008, Fukuoka: the first independent Trilateral Summit Meeting took place outside of the ASEAN+3 framework, and the independent Trilateral Summit Meeting has become an annual event.
- October 2009, Beijing: CJK leaders agreed to launch an Official Tripartite Joint Study for a CJK FTA at the Trilateral Summit Meeting.
- Seven meetings of the Joint Study Committee for a CJK FTA were held between May 2010 and December 2011.
- Establishment of the Trilateral Cooperation Secretariat in September 2011.
- 13 May 2012 in Beijing: Premier Wen Jiabao (China), Prime Minister Yoshihiko Noda (Japan), and President Lee Myung-bak (Korea) announced their intention to begin negotiating a trilateral free trade agreement.
- The Joint Study Committee's report is to be submitted to the leaders at the Trilateral Summit Meeting in late 2012.

All this makes imminent sense. CJK is presently the major global manufacturing centre. CJK's export-driven growth model, demonstrating a similar layout of industries engaging in exports and imports, accelerates the current intra-trade boom. The current labour structure division between China, Japan and Korea has also boosted intra-regional trade; Japan and Korea develop sophisticated technology while China is the world's factory due to its low labour and production costs. China produces and processes final products with parts and pieces provided by Japan and Korea. These final products are then exported mostly to the United States and the EU. From 1992 to 2010, the exports and imports of the three countries increased rapidly. In 2010, CJK accounted for 10.4 per cent, 5.1 per cent and 3.1 per cent of the world's total exports, respectively, and represented 9.1 per cent, 4.5 per cent and 2.8 per cent of the world's total imports, respectively. The share of intra-regional trade among the three countries has increased steadily; from 12.3 per cent in 1990 to 19.0 per cent in 1996 and to 24.1 per cent in 2004. During 2010, China was the largest trading partner of Korea and Japan, and the two countries were regarded as the second largest trading partners of China. In 2010,

Japan was Korea's second largest trading partner and Korea was Japan's third largest trading partner (Korean Ministry of Foreign Affairs and Trade 2011).

At present the total value of trade in services sees China, Japan and Korea ranked 4th, 5th and 13th respectively in the world. Bilateral trade in services among the three countries has witnessed rapid growth in recent years. Between CJK, the trade volume in services has increased from US\$6.5 billion in 2000 to US\$24.7 billion in 2009, between Korea and China from US\$4.3 billion in 2000 to US\$15.7 billion in 2009, and between Korea and Japan from US\$12.8 billion in 2000 to US\$16.1 billion in 2009. This represents an annual growth rate of 15.9 per cent, 15.6 per cent and 2.5 per cent respectively (Korean Ministry of Foreign Affairs and Trade 2011). The Chinese government estimates that the CJK FTA could raise China's GDP by up to 2.0 per cent, Japan by 0.5 per cent and Korea by 3.1 per cent. This constitutes a strong rationale for a CJK FTA.

In the wake of the global financial and the European fiscal crises, given that the economic prospects for the United States and EU remain uncertain, East Asia (primarily CJK) is expected to lead world economic growth in the foreseeable future. CJK believe that a wider EAFTA will open the era of East Asia, enabling them to maintain their economic dominance, enlarge internal markets and create a stable international political and security environment. This new economic clustering will build on the ongoing process of economic integration in East Asia, such as ASEAN+3, ASEAN+6, as well as the Asia-Pacific region by providing a comprehensive and institutional framework in which a wide range of trilateral cooperative arrangements would evolve.

This new centre of Northeast Asian economic power will rival that of North America and EU. The proposed CJK FTA would most likely have a similar impact on Europe, namely decreased trade and investment with the three member countries. Currently, the EU has an FTA with Korea, but not with China or Japan. Also, with the exception of Norway, none of the European countries is in FTA talks with China. Switzerland is the only European country with an FTA with Japan. Equally importantly, CJK do not have bilateral free-trade agreements (FTA) with Australia although Australia is negotiating a FTA with each of those three countries.

Australia's attitude towards the proposed CJK FTA

Notwithstanding the importance of the proposed FTA and other recent political and economic developments in Northeast Asia and their future impact on Australia's national interests in general, and economic prosperity in particular, there seems to be no serious attention in Australia to the prospects of a CJK-FTA. There appears to be three reasons for this neglect.

First, in Australia there is too much focus on a single economic power, namely China, and its impact on Australia's economic growth. This China obsession overshadows other equally critical issues concerning Asia that are closely linked to Australia's political and economic interests in the region. The most significant development in Australia's trade with CJK over the last decade is the emergence of China. Since 2005, two-way trade between Australia and China has risen 20.2 per cent per annum, compared with 10.2 per cent for East Asia overall. Exports of goods and services to China grew 34.3 per cent to A\$64.4 billion in 2010. The five year trend growth was 27.3 per cent per annum. In 2010 Australia's trade in goods and services with China increased 23.6 per cent to \$105.3 billion. This can be

attributed mainly to the strong growth of China's economy in recent years, leading to high demand for many of the resources Australia exports, combined with strong commodity prices (DFAT 2011a:7).

Second, the current nature of Australia's upper-hand bilateral trading relationship with CJK (monopoly supply structure in the resources sector) leads to the rather simplistic view that bilateral relationships are all that are necessary to secure Australia's future. The following statistics on Australia's ever increasing exports of resources sector to CJK well demonstrates the basis to this argument. In 2010, exports of *Iron ore & concentrates*, Australia's largest export to China, amounted to \$34.7 billion. Other major merchandise exports include *Coal* (\$5.2 billion); *Other ores & concentrates*—mainly *Lead, Zinc and Manganese*—(\$2.1 billion); *Crude petroleum* (\$1.7 billion). In the case of Japan, Australia's major merchandise exports to Japan in 2010 included *Coal* (\$14.8 billion), *Natural gas* (\$8.7 billion); *Iron ore & concentrates* (\$8.6 billion); *Aluminium* (up 86.3 percent to \$1.6 billion) and *Copper ores & concentrates* (\$1.1 billion). And in the case of Korea, Australia's major merchandise exports to Korea in 2010 included *Coal* (\$5.4 billion), *Iron ore & concentrates* (\$4.4 billion); *Crude petroleum* (\$2.4 billion) *Aluminium* (\$848 million) and *Copper ores & concentrates* (\$944 million) (DFAT 2011a).

Third, but equally importantly, many policy makers in Australia doubt the feasibility of this new regional economic architecture in Asia because of the political, historical and cultural differences between the CJK members. There is some validity in this argument given the historical animosity between these countries (Japan's Pacific War with China and its annexation of Korea between 1910 and 1945) and the ongoing territorial disputes between CJK. For example, Korea has recently suspended the signing of agreements on military cooperation with Japan because of public opposition, particularly from the older generations who have bitter memories of Japan's colonial rule. On 10 August, 2012, Korean President Lee Myung-bak visited a disputed set of remote islands called Dokdo in Korea and Takeshima in Japan, which are controlled by Korea but also claimed by Japan. This angered Japan and as a consequence, Japan temporarily recalled its ambassador from Seoul and has said it will submit the Takeshima/Dokdo dispute to the International Court of Justice. Japanese Prime Minister Yoshihiko Noda may cancel a planned meeting with President Lee at the APEC Summit in Vladivostok, Russia, in October 2012 (Spitzer 2012). Japan and China have also long been in dispute over territorial claims in the uninhabited islands in the East China Sea, known as Senkaku in Japan and Diaoyu in China. Clearly this history represents the greatest challenge to both the FTA negotiation and its final ratification.

Policy implications

Notwithstanding the above, Australian policy makers need to realise that this little known but serious move towards a new economic regionalism (CJK-FTA) is based on a variety of factors that extend beyond long standing differences. Five factors stand out. First, CJK is the major global manufacturing region and will continue to be so in the immediate future. Second, a FTA between these three countries is seen as a necessary response against the barriers being put up by others, including Australia. An export-oriented developmental model has helped CJK accumulate more than half of the world's foreign exchange reserves. The complimentary endowments of production factors of CJK has boosted intra-regional trade - Japan and Korea provide sophisticated technology and capital goods while China manufactures a large

percentage of the world's consumer products. Third, CJK economic integration is an essential first step in the formation of a regional FTA and realising the era of East Asia. Fourth, the perception towards each other among CJK members is changing. Given the unpredictable global economic future, an economic partnership among CJK is becoming each nation's priority. A more formal level of economic cooperation such as a trilateral FTA is now seen as a necessity by the political and industrial leadership within each country. Fifth, China's progressive approach to the new Asian regionalism aims to reduce the influence of the U.S.'s preferred Asian regional architecture (TPP – Trans-Pacific Partnership Agreement). In short, there is now emerging a consensus among CJK leaders that despite political, historical and cultural barriers, there is much to be gained from a CJK-FTA which, we predict, will eventually lead to the formation of a region-wide FTA, most probably a CJK-ASEAN FTA.

Concluding remarks

The emergence of this Northeast Asian community and the nascent political and economic cooperation among CJK will require a strategic repositioning of Australia's trade and other economic activities with members of this cluster. Firstly, this economic clustering will lessen the bilateral relations with Australia and lead to a more coordinated approach by these countries towards trade with Australia. Secondly, this new centre of significant economic power as a unified front will rival North America and EU, although this cluster will be somewhat different to that of the EU and North America. The scale of the impact of this emerging Northeast Asian economic integration (e.g., collective bargaining power in international trade) on the regional and global economic geography, and particularly on Australia, will be significant. Australia needs new strategies of economic partnership in the region as CJK might emerge as a customer at a united level. Therefore, Australia will need to make a clear decision beyond bilateral trading arrangements. It is time that Australia re-thinks its strategic engagement with Asia in general, and with its major economic partners in Northeast Asia, namely CJK, in particular. This should start by being aware of what the current state of play is and how well advanced are the plans for regional integration among CJK. New economic (and political) arrangements in Asia and the potential change to Australia's economic engagement in the region should now be taken seriously.

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