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**The Possibility of a China-Japan-South Korea Free Trade Agreement: How Free Trade Developed in East Asia and How It Determined the Economic Growth of the East Asian Region**

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## **ABSTRACT**

Ever since being introduced in the modern economy, Free Trade Agreements (FTAs) have been a fundamental tool for the development of economic integration all around the world. FTAs created a possibility for developing countries to be able to enter the international economic arena, establishing mutually beneficial trade agreements with developed countries. In particular, the East Asian region has been especially prolific with the establishment of FTAs, with China, Japan, and South Korea (CJK) becoming extremely important trade partners for many countries after experiencing a long catching up process which was essential for their economic growth. Additionally, China, Japan and South Korea managed to create a solid trade system, integrating their economies, and becoming each other's main trade partners. However, despite the three countries experiencing a strong economic integration, a trilateral Free Trade Agreement has yet to be established. Discussions regarding a CJK FTA have been ongoing for almost 10 years but there are many obstacles that have been and are still stalling further developments such as economic divergences but also historical and political reasons. This dissertation will discuss why these three pillars of East Asia have yet to accomplish an FTA that will not only expand their economic growth even further but also increase their prestige and importance at the international level, with this bloc of countries becoming one of the influential economic bloc of the world.

## SUMMARY

Con l'avvento della globalizzazione, il regionalismo è diventato un elemento importante per l'economia globale. I Paesi che hanno iniziato a cooperare in blocchi commerciali più ampi, hanno portato a una crescita complessiva dell'economia globale. Gli accordi di libero scambio sono stati un modo per migliorare il regionalismo, la cooperazione e l'integrazione tra i Paesi di tutto il mondo. Infatti, mentre il mondo occidentale, come l'Europa e il Nord America, ha potuto sperimentare prima l'industrializzazione e riuscendo quindi a stabilire accordi sul regionalismo e formare blocchi regionali durante i primi anni dell'era della globalizzazione, per i Paesi in via di sviluppo come per esempio quelli del Sud America e dell'Asia, la situazione era più complicata. Molti degli Stati appartenenti a questi continenti non avevano ancora raggiunto un livello stabile di industrializzazione ed erano carenti anche in termini di crescita economica. Per molto tempo, gli accordi di libero scambio sono stati considerati controversi e molti economisti ne hanno discusso gli svantaggi, come l'aumento della disoccupazione. Tuttavia, gli studiosi hanno anche evidenziato come gli accordi di libero scambio abbiano dato ai Paesi sottosviluppati l'opportunità di creare legami commerciali con i Paesi sviluppati, di aumentare la loro crescita economica interna e di raggiungere un nuovo livello di rilevanza nell'arena internazionale. Oggi esistono una serie di accordi di libero scambio come l'EFTA, il NAFTA e l'AFTA. Soprattutto i Paesi del Sud e dell'Est asiatico sono stati in grado di utilizzare gli accordi di libero scambio come strumenti per il loro sviluppo economico. In particolare, i pilastri del continente asiatico, Cina, Giappone e Corea del Sud, nel corso degli anni sono riusciti a stabilire diversi accordi di libero scambio con Paesi asiatici e non. Tuttavia, manca ancora un accordo di libero scambio tra i tre Paesi. Questo elaborato, dopo un'analisi sugli accordi di libero scambio che viene svolta nel primo capitolo, focalizzandosi sull'introduzione dei suddetti accordi nell'economia moderna; mira a comprendere le ragioni per cui Cina, Giappone e Corea del Sud, colossi del continente asiatico, non siano ancora riusciti a stabilire un accordo di libero scambio, nonostante l'alto livello di integrazione che questi tre Paesi stanno già sperimentando.

Il primo capitolo di questa tesi, come già menzionato, si concentra sugli accordi di libero scambio e su come si sono sviluppati nel mondo, fornendo anche alcuni esempi dei più famosi accordi di libero scambio attualmente in atto. Per quanto riguarda il secondo capitolo, l'analisi



si concentra sul processo di catching-up sperimentato da Cina, Giappone e Corea del Sud, che ha aiutato i tre Paesi a raggiungere un livello significativo di industrializzazione e a favorire la crescita economica e anche l'incremento delle relazioni commerciali con il resto del mondo. Come viene spiegato nel suddetto capitolo, il processo di catching-up, secondo Perez e Soete (1988), consiste nella diminuzione delle disparità tecnologiche e delle competenze tra i Paesi. Analizzando i processi di catching-up di Cina, Giappone e Corea del Sud, si notano differenze significative. Il Giappone è stato il primo dei tre Paesi a sperimentare l'industrializzazione ed è anche considerato il primo Paese asiatico ad aver sperimentato il processo di catching-up. Dopo l'enorme arretramento subito dopo la Seconda Guerra Mondiale, il Giappone è stato in grado di ricostruire la propria economia, con una particolare specializzandosi nel settore della tecnologia e sviluppando anche una conoscenza tecnica interna che ha aiutato il Paese a diventare uno dei pilastri del continente asiatico e anche un'economia importante a livello mondiale. Per quanto riguarda la Corea del Sud, dopo la fine della colonizzazione giapponese del Paese e la guerra di Corea, il PIL del Paese era al livello più basso registrato dal Paese. Tuttavia, grazie agli aiuti e alle conoscenze fornite e acquisite dagli Stati Uniti e poi da una classe di governanti che si è concentrata sulla promozione dello sviluppo economico, la Corea del Sud è riuscita a emergere come nuova potenza economica, in grado di rivaleggiare con Paesi con dotazioni simili come il Giappone ed è considerata da molti studiosi (Bresser-Pereira et al. 2020) l'esempio più riuscito del processo di recupero. È noto che la Cina è il Paese che probabilmente ha registrato la crescita economica più significativa, soprattutto dagli anni '80 al 2017. Per innescare il processo di catching-up che ha aiutato la Repubblica Popolare Cinese (RPC) a diventare una delle economie più importanti del mondo, il governo cinese ha messo in atto una serie di iniziative per aumentare la crescita economica e lo sviluppo. Si è lavorato sia sui sistemi finanziari, con istituzioni come la Banca Centrale, sia sugli aspetti macroeconomici, come l'istituzione di meccanismi di controllo dei flussi di capitale, l'unificazione del tasso di cambio, l'inversione della precedente tendenza al decentramento attraverso la riforma fiscale (Bresser-Pereira et al. 2020). Combinando tutte queste azioni con la nuova politica "open door" promossa da Deng Xiaoping, la Cina è riuscita a diventare un leader sia in Asia che nel mondo occidentale. È chiaro come questi tre Paesi siano quindi dei colossi economici nella regione asiatica ed è ancora più sorprendente sapere che questi tre leader hanno difficoltà a stabilire un accordo di libero scambio che possa non solo dare loro maggiori benefici economici, ma anche aumentare il loro potere a livello internazionale.

Nel terzo capitolo di questo elaborato infatti, l'attenzione viene spostata sui rapporti tra Cina, Giappone e Corea del Sud. In particolare sull'integrazione economica che questi paesi sperimentano e sul fatto che nonostante le loro economie sia ampiamente interdipendenti, ancora i tre paesi non sono stati in grado di firmare un accordo di libero scambio. L'integrazione economica è uno degli strumenti più potenti per costruire non solo l'identità di una certa regione o parte del mondo, ma anche per aiutare i Paesi a raggiungere nuovi livelli di cooperazione e integrazione che, nel lungo periodo, favoriranno la crescita economica e il benessere. Il più grande esempio di integrazione economica è l'Unione Europea, ma quando si parla di Asia orientale, l'integrazione economica è fortemente radicata nei processi produttivi locali e guidata soprattutto da una serie di gravi eventi economici (Pomfret 2011). La RPC, il Giappone e la Corea del Sud stanno vivendo da tempo un alto livello di integrazione economica, in quanto non solo sono i principali partner commerciali, ma anche per quanto riguarda gli investimenti diretti esteri, sono i principali investitori nelle rispettive economie. Difatti, seguendo l'analisi dei dati UNCTAD del 2021, Giappone e Corea del Sud sono i paesi che maggiormente esportano in Cina, mentre la RPC si è rivelata essere la principale fonte di import dei due paesi per quanto riguarda i prodotti completi. È soprattutto per questo motivo che non è chiaro perché questi tre Paesi non abbiano ancora stabilito un accordo trilaterale di libero scambio. Se il livello di integrazione economica e di scambi commerciali è già elevato, incrementare tali flussi tramite l'eliminazione delle barriere commerciali o almeno la loro riduzione sembra essere l'opzione migliore. Questi tre Paesi hanno firmato molti accordi di libero scambio con partner asiatici e non. La Cina e la Corea del Sud hanno anche firmato un accordo commerciale bilaterale nel 2014, entrato in vigore nel 2015, e sebbene abbiano ottenuto vantaggi significativi, tali vantaggi sarebbero maggiori se l'accordo fosse trilaterale con anche il Giappone. Tale accordo infatti non solo porterebbe a un'ulteriore crescita dell'economia e del commercio dei tre paesi, ma sarebbe anche in grado di contrastare l'egemonia economica statunitense.

Nell'ultimo capitolo di questa tesi, viene analizzato il possibile accordo di libero scambio tra Cina, Giappone e Corea del Sud. Nella prima parte del capitolo, l'analisi si concentra su come è nata la proposta di questo accordo, le caratteristiche degli attori coinvolti e le prime fasi della negoziazione di tale accordo. Nella seconda parte del capitolo invece, il focus si sposta sui vari vantaggi derivanti da tale accordo, sui molteplici ostacoli che hanno portato allo stallo delle negoziazioni nel corso degli anni e infine sul ruolo fondamentale che il contesto geopolitico ha sulle relazioni diplomatiche tra i paesi e quindi sulla conclusione di accordi economici. Come già menzionato, l'idea di un accordo di libero scambio tra le tre nazioni è stata oggetto di

negoziati fin dal 2012. Alcuni studiosi (Penhong 2002) vorrebbero anche sottolineare come alcune proposte per tale accordo, ci siano state fin dalla fine degli anni '90 e dall'inizio del nuovo millennio, ma all'epoca la RPC non era interessata a concludere un accordo di libero scambio con il Giappone e la Corea del Sud perché era appena entrata nell'Organizzazione Mondiale del Commercio e preferiva concentrarsi maggiormente sull'arena internazionale. In seguito, dopo uno studio congiunto proposto dal presidente Zhu Rongji e durato dal 2002 al 2009, nel 2010 a Seul si è tenuto un primo incontro tra i leader dei tre Paesi e nel 2012 è iniziato il processo negoziale. Dall'inizio del processo negoziale è passato più di un decennio e l'accordo non è ancora stato raggiunto. Il capitolo analizzerà come nel corso degli anni ci siano stati diversi ostacoli al processo negoziale sia economici che diplomatici, inoltre è importante sottolineare come i tre Paesi, a causa della pandemia COVID-19, non siano riusciti a incontrarsi dal 2019. Gli ostacoli di materia economica riguardano principalmente l'adesione del Giappone al Partenariato Trans-Pacific (PTP), l'insicurezza della Corea del Sud riguardo a un accordo commerciale con il Giappone a causa delle loro somiglianze in termini di risorse e capacità e l'attenzione della Cina a diventare una superpotenza. Ci sono poi ostacoli di materia diplomatica. Ad esempio, Giappone e Corea del Sud non sono ancora in grado di superare alcune tensioni politiche derivanti dalla Seconda Guerra Mondiale e altri disaccordi di materia economica, nonostante la promessa dell'appena eletto president sudcoreano Yoon riguardo il miglioramento delle relazioni diplomatiche tra i due paesi. Un fronte coeso tra i due Paesi è specialmente voluto dagli Stati Uniti, i quali credono ritengono che Giappone e Corea del Sud siano i migliori alleati per contrastare l'egemonia cinese nel territorio asiatico. Le tensioni politiche presenti nell'area dell'Asia orientale hanno sicuramente giocato un ruolo nel ritardo del processo negoziale, insieme all'incertezza dei membri sul fatto che l'accordo trilaterale sia effettivamente vantaggioso o dannoso per le loro economie. Attualmente, oltre alla tensione per l'invasione dell'Ucraina da parte della Russia, il principale alleato della Cina, c'è anche la preoccupazione che la Cina rivendichi i suoi diritti su Taiwan e la possibilità di un'invasione dell'isola simile al conflitto Russia-Ucraina, andando a mettere in una situazione di pericolo l'area orientale asiatica. Sebbene Tokyo e Seul desiderino in qualche modo riuscire a contrastare le minacce di Pechino, temono anche una risposta negativa da parte della Cina con possibili blocchi di import e export che andrebbero a danneggiare le loro economie e creerebbero un'ulteriore crisi economica all'interno dei due paesi. Con la conclusione del Partenariato economico globale regionale (RCEP) nel 2020, entrato in vigore nel 2022, firmato anche da RPC, Giappone e Corea del Sud, si spera di riprendere i negoziati tra i tre Paesi e di raggiungere nuovi obiettivi per l'accordo di libero scambio trilaterale tra Cina, Giappone e

Corea del Sud, anche se le tensioni nell'Asia orientale e nel resto del mondo, assieme agli altri fattori discussi nell'elaborato, sicuramente giocano un ruolo negativo per quanto riguarda la ripresa delle negoziazioni e la conclusione dell'accordo.

## INTRODUCTION

With the advent of globalization, regionalism became an important feature of the global economy. Countries cooperating in bigger trade blocs resulted in the overall growth of the global economy. Free Trade Agreements (FTAs) were a way to improve regionalism, cooperation, and integration between countries all over the world. While the Western world, such as Europe and North America, was able to experience industrialization earlier and therefore these nations were able to reach sooner agreements regarding regionalism and form regional blocs, for developing countries, such as the states of South America and Asia, the situation was more complicated. A lot of the states belonging to these continents had yet to reach a stable level of industrialization and they were lacking in terms of economic growth as well. For a long time, free trade agreements were considered to be controversial, and many economists discussed the disadvantages of said agreements such as the increment of unemployment in the countries' domestic sector. Nevertheless, scholars have also highlighted how FTAs allowed underdeveloped countries the opportunity to create trade links with developed countries, increase their internal economic growth and be able to reach a new level of relevancy in the international arena. Nowadays there are a series of free trade agreements such as the EFTA, the NAFTA, and the AFTA. Especially the countries from South and East Asia were able to use free trade agreements as tools for their economic development. In particular, the pillars of the Asian continent, China, Japan, and South Korea, over the course of the years were able to establish several free trade agreements with both Asian and non-Asian countries. However, what still lacks is a free trade agreement among the three countries. This dissertation, aside from analyzing free trade agreements, aims at understanding the reasons why China, Japan, and South Korea failed at establishing a free trade agreement, despite the high level of integration that these three countries are already experimenting with.

While the first chapter of this dissertation, the focus will be on free trade agreements and how they developed around the world, the second chapter will focus on the catching-up process experienced by China, Japan, and South Korea that helped the three countries reach a significant level of industrialization and also managed to foster economic growth. As will be explained in the discussion, the catching-up process, according to Perez and Soete (1988), is the decreasing of technology and knowledge disparities between countries. This process, as some scholars explain (Lee and Lim 2001), can be achieved through two procedures: path-following and path-

creating. The first one takes a specific model that worked for economic development in an industrialized country and encourages developing countries to follow that same model to obtain significant results. Path-creating, on the other hand, is the evolution of path-following, as it not only can be enacted once the country has reached a significant level of industrial capabilities but also supports the developing country in becoming a new leader that other underdeveloped nations can follow as an example (Choung, Hwang, Choi, and Rim 2000). When analyzing the catching-up processes of China, Japan, and South Korea, there are significant differences. Japan was the first among the three countries to experience industrialization and it is also considered to be the first Asian country to have experienced the catching-up process. After the huge setback suffered after World War II, Japan was able to rebuild its economy, with a particular specialization in technology and also develop internal technical knowledge that helped the country in becoming one of the pillars of the Asian continent and also an important economy for the world. For what concerns South Korea, after the end of the Japanese colonization of the country and the Korean War, the country's GDP was at its lowest level. Nevertheless, thanks to the aid and knowledge given and acquired by the United States and then a class of governors that focused on fostering economic development, South Korea was able to emerge as a new economic power, able to rival countries with similar endowments such as Japan and it is considered by many scholars (Bresser-Pereira et al. 2020) the most successful example of the catching-up process. It is well known that China is the country that probably experienced the most significant economic growth, especially from the 1980s till 2017. In order to trigger the catching-up process that helped the People's Republic of China (PRC) in becoming one of the most important economies of the world, the Chinese government implemented a series of initiatives to increase its economic growth and development. They worked both on the financial systems with institutions like the Central Bank and also on the macroeconomic aspects such as the establishment of capital flow control mechanisms, the unification of the foreign exchange rate, the reversal of the previous decentralizing trend through fiscal reform (Bresser-Pereira et al. 2020). Combining all these actions with also the new "open door" policy promoted by Deng Xiaoping, China was able to become a leader both in Asia and in the Western world. It is clear to see how these three countries are therefore leaders in the Asian region and it is even more surprising to know that these three leaders have a hard time establishing an FTA that will be able to not only give them more economic benefits but also increase their power at the international level.

It is quite odd to realize that these countries have not been able to sign a free trade agreement despite the high level of economic integration that ties them together, as it will be discussed in the third chapter of this dissertation. The chapter will also describe what trade policy China, Japan, and South Korea adopted and how they were able to establish trade deals with countries all over the world. Economic integration is one of the most powerful tools in constructing not only the identity of a certain region or part of the world but also in helping countries reach new levels of cooperation and integration that will overall benefit economic growth and welfare in the long term. The biggest example of economic integration is the European Union but when it comes to East Asia, economic integration is strongly ingrained in local production processes and driven mostly by a series of severe economic events (Pomfret 2011). The PRC, Japan, and South Korea for quite some times now have been experiencing a high level of economic integration as not only they are each other's main trade partners but also when it comes to foreign direct investment (FDI), they are the main investors in each other's economy. It is mainly for this reason that it is not clear why these three countries have yet to establish a free trade trilateral agreement. If the level of economic integration and trade is already high, in order to increase those flows, removing trade barriers or at least reducing them seems to be the best option. These three countries have signed many free trade agreements with both Asian and non-Asian partners. China and South Korea have also signed a bilateral trade agreement in 2014 that entered into force in 2015 and although they experienced significant benefits, such advantages would be higher if the agreement was a trilateral one with Japan. A trilateral CJK (China-Japan-South Korea) has been in discussion ever since 2012.

In the last chapter of this dissertation, there will be an analysis of the possible trilateral free trade agreement that China, Japan, and South Korea could conclude. As already said, the idea of a CJK FTA has been a negotiation topic ever since 2012. Some scholars (Penhong 2002) would also like to highlight how the talks have been there ever since the end of the 1990s and the beginning of the new millennium, but back then the PRC had no interest in concluding a free trade agreement with Japan and South Korea as it had just entered the World Trade Organization and preferred to focus more on the international arena. Later, after a joint study proposed by President Zhu Rongji that lasted from 2002 to 2009, in 2010 in Seoul a first meeting among the leaders of the three countries was held, and in 2012 the negotiation process has begun. More than a decade has passed ever since the negotiation process started and the agreement has yet to be achieved. The chapter will analyze how over the course of the years there have been several obstacles to the negotiation process both economic and diplomatic

obstacles, also it is important to highlight how the three countries, due to the COVID-19 pandemic have not been able to meet since 2019. For example, Japan and South Korea are still unable to overcome some political tensions stemming from WWII. Moreover, the political tensions present in the East Asian area have surely played a role in the delay of the negotiation process along with the unsureness of the members whether the trilateral agreement would actually be beneficial or detrimental for their economies. As of now, along with the tension regarding the invasion of Ukraine by Russia, China's biggest ally, there is also the worry regarding China reclaiming its rights over Taiwan and the possibility of an invasion of the island similar to the Russia-Ukraine conflict. With the conclusion of the Regional Comprehensive Economic Partnership (RCEP) in 2020 which entered into force in 2022, also signed by the PRC, Japan, and South Korea there is the hope that the negotiation between the three countries will be resumed and that new goals regarding the trilateral CJK FTA will be reached.



# CHAPTER ONE

## **Free trade and the global development of free trade agreements**

### 1.1 Free Trade: definition, origin, history, and development

A free trade area is a trading bloc, in which its members established a free trade agreement (FTA) that removes import quotas, preferences, and tariffs on most goods and services exchanged among the countries belonging to the free trade area. Free trade areas are commonly recognized as the following step of economic integration (Sunil and Shanimon 2018). Free trade agreements are determined by the World Trade Organization (WTO) in art. 24 of the General Agreement on Tariffs and Trade (GATT) and art. 5 of the General Agreement on Trade in Services (GATS) and are exonerated from the most favored nation (MFN) principle. FTAs are usually grouped under the term regional trade agreements (RTAs) along with other similar agreements such as customs unions. (Urata 2002)

Regional integration agreements can be classified depending on their level of integration development. Free trade agreements abolish intra-group tariffs and quotas; customs unions set common tariffs for countries outside the group; common markets eliminate limitations in the flow of production factors in the area under this agreement; and economic unions are regulated by macroeconomic policies (Urata 2002). A common feature of multilateral agreements is that they are usually signed and established between neighboring countries. However, there are some special cases such as the World Trade Organization (WTO) agreement and the Trans-Pacific Strategic Economic Partnership (TPP), economic unions that are extended to countries all over the world, whenever these nations fulfill specific requirements (Sunil and Shanimon 2018). The goal of a free-trade area is to lower trade barriers so that trade can flourish through the division of labor, specialization, and most importantly through comparative advantage (Sunil and Shanimon 2018). The comparative advantage theory, elaborated by David Ricardo in 1817, is particularly relevant in free trade areas discussions. This theory entails that in a competitive market, each production will seek to specialize in the activity in which it has a comparative advantage. The result expected from the implementation of the comparative

advantage theory is an increase in income and ultimately wealth and prosperity for the community in the free trade area. It applies only to the distribution of wealth and aggregate wealth (Sunil and Shanimon 2018). Economic advancement nowadays compels nations to liberalize to attract international investment, which greatly contributes to the distribution of global manufacturing, profits, technology, and jobs. Economic advancement also demands countries to challenge each other effectively in international markets rather than just at home. An aggressive process of liberalization has led the trend towards free trade among a multitude of countries in various parts of the world with distinct economic systems, in diverse stages of development, and with contrasting previous philosophies (Bergsten 1996). After the end of the Second World War, the globalization of the world economy has been progressing and evolving rapidly. This improvement was possible thanks to the increase in economic activities, especially foreign direct investment (FDI) and international trade (Urata 2002). Important factors that accelerated the progress of globalization were the cheaper foreign trade costs, the consequence of the technological developments in telecommunications and transports; the deregulation and privatization of national industries; the liberalization of trade and investment; and lastly the multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) (Urata 2002).

Simultaneously with this movement towards globalization, the tendency towards regionalism was also strongly present; Western Europe was the first and most notable bloc able to develop regionalism, demonstrated in 1958 with the establishment of the European Economic Community (EEC) in 1958. Akin actions have also been observed in Central and South America and Africa, but they lacked a solid base in order to be further developed. This process changed in the 1990s, with the introduction of Free Trade Agreements (FTAs) that had a key role in regional integration, being able to include countries from Central and South America, Asia, and Africa in the global economic arena (Urata 2002). Many countries have attempted trade liberalization by concluding bilateral or plurilateral trade agreements to achieve a series of economic benefits coming from the expansion of the market and trade creation effect by removing trade barriers and multiple dynamic effects such as capital accumulation and productivity improvement determined by foreign direct investment (FDI) liberalization and technology transfer between member countries (Okabe 2015). There has been a swift increase in economic regionalism around the world, especially in the past two decades. One of the most visible results of the enlargement is the proliferation of free trade agreements between countries. Some argue that multilateral trade negotiations have been stalled by the huge number of free

trade agreements that have been implemented and are being negotiated (Levy 1997). Others argue that free trade agreements are a positive means of economic development (Sun and Reed 2010).

Economists have long discussed the benefits of free trade agreements because of their notorious trade diversion capabilities (Viner 1950). On the one hand, trade preference for producers who have to deal with higher costs, with the implementation of FTA, third-party producers can be excluded from the process, resulting in trade diversion and significant efficiency losses, forcing the market to evolve as well. On the other hand, the benefits of a free trade agreement mainly depend on the initial economic structure of the country implementing it (Burfisher, Robinson, and Thierfelder 2001). Overall, FTAs are mechanisms whose goal should be to make all markets able to change, adapt and grow with investment policies, antitrust and general laws, and trade to allow the economies of the world to be able to join the global competition (Bergsten 1996).

The increasing popularity of FTAs was accelerated by the complications the World Trade Organization had to face in promoting greater free trade on a global scale. The main obstacle consists in the violation of the non-discrimination principle, which with FTAs established by regional trade agreements (RTAs) would consistently happen. To avoid such consequences, GATT Article 24 allows FTAs and RTAs to be formed, liberalizing trade among the members of the agreement but at the same time, an increase in trade barriers towards non-members must not occur, to maintain a certain equilibrium in the global economy (Urata 2004). The impact that FTAs have on trade can be divided into two types: static and dynamic. The first covers the creation of trade, the diversion of trade, and the effects of trade conditions. The removal of trade barriers between members would enhance trade between them (trade-creating effect), at times to the detriment of imports from non-members (trade diversion effect). Moreover, if an FTA results in a reduction of imports from non-members, FTA members are likely to experience an improvement in their trade conditions compared to non-members (trade effect conditions). The effects of trade creation and the effects of trade conditions drive the economic welfare of members towards an increase, while the trade diversion effect is likely to reduce the economic welfare of members as imports from the most efficient suppliers in non-members countries are supplied by imports from less efficient member producers. It should be noted that, for non-members, the trade diversion effect and the effect of trade conditions have a detrimental effect

on their economic welfare (Urata 2004). The establishment of free trade agreements also has dynamic effects, such as economies of scale and increased competition, which are profitable for both members and non-members countries. By increasing the size of the market, FTAs offer enterprises the opportunity to profit from greater economies of scale. The pro-competitive effect is also heightened because competition in agreement-members markets is likely to raise due to trade liberalization (Urata 2004). This effect encourages the creation of new goods and technologies. More competition and greater economies of scale result in product improvements and lower prices, which is beneficial to consumers in both member and non-member countries. Increased competition can also be used to promote national reforms (Urata 2004). It is important to highlight that these estimates can be quite conservative as they do not measure the dynamic effects that the introduction of a free trade agreement would inevitably have. The economic impact of the FTA would be further strengthened if the reform included additional integration measures, such as economic cooperation, foreign direct investment (FDI), and trade facilitation (Urata 2004). The following paragraph will elaborate on the advantages and disadvantages of free trade agreements, taking into consideration the various perspectives of different economic scholars. There will be an explanation regarding their reasons as to why free trade agreements can trigger significant economic growth and bring more economic stability and benefits or why such agreements could actually have the opposite effect and put a country in a situation of even more severe economic backwardness.

## 1.2 Advantages and disadvantages of Free Trade Agreements

Once the theory regarding FTAs started being discussed by multiple scholars around the world, economists divided into two main sections: on the one hand, the ones that believed that free trade agreements were an innovative economic tool that would have allowed even the economies of the poorer countries to be able to compete in the global arena; on the other hand, other experts are convinced that free trade agreements will just hinder the global economy with the world economy progressively stalling and collapsing. This paragraph aims to analyze and examine the advantages and disadvantages of free tree agreements to understand how such different views originated and gained consensus.

FTAs lead to specialization and division of labor for the benefit of all member states, along with the expansion of the world supply of goods and services because they limit supply chain costs and access to new markets. Thanks to the free trade agreement, funds for companies could be equally distributed all around the world (Sunil and Shanimon 2018). There was the formation of a diverse area able to both mitigate the economic risk and reduce the unit production costs through economies of scale, attracting investments to improve the efficiency of capital, labor, and technology, to successfully compete with low-cost imports. With the introduction of free trade agreements, there was the creation of additional incentives for agricultural exports to Europe, the United States, and other developing countries. A significant increase in the exports of services has also been registered in the IT sector ever since more countries have been signing free trade agreements with each other. It is also believed that thanks to the inflow of FDI, following, once again, the establishment of FTAs, in multiple industrial units will increase the viability of the economy (Sunil and Shanimon 2018). For FTAs supporters, not only the world economy was able and will continue to benefit from the institution of FTAs but also the population around the world will continue to experience the positive effects of the above-mentioned agreements. Most importantly there is a boost in job opportunities: when productivity increases in exports and imports, employment and wages tend to rise. Additionally, FTAs are also a chance to adjust or improve the political and diplomatic relations between countries. In fact, if countries strive together towards a common goal, respecting the rules set by a concrete agreement, mutual respect for the customs and cultures of countries deepens, making the onset of a conflict less likely to happen (Sunil and Shanimon 2018).

It should also be highlighted that aside from the above-mentioned benefits regarding the implementation of free trade agreements, there are many economists, as it was already remarked, strongly against free trade and free trade agreements. For these experts, FTAs invite companies to open manufacturing, warehouses, and locations outside their countries, causing huge job losses for domestic workers. These agreements are often based on the comparative advantages theory as countries arrange trade agreements to commensurate with their natural resources (Sunil and Shanimon 2018). On the one hand, this is possible because countries have access to products, but they are unable to produce themselves and receive them at a reduced price. However, it also builds a significant dependence on foreign goods, making domestic products unable to compete against them (Sunil and Shanimon 2018). Some also think that FTAs are just another form of colonization, especially when trade between the two countries is not equal with one country profiting off the other with the excuse of the agreement. Just as for the advantages, free trade disadvantages not only affect the country's economy but the population as well. In fact, enterprises competing in global free trade often open new factories in countries where labor laws are not as severe as they are in the domestic country; when this happens, workers have to work more hours for a significantly smaller wage. This creates a toxic environment because to keep their jobs, workers are obliged to accept lower wages, and by accepting the lower wages they will be more inclined to renounce the rights that were once granted to them under better economic conditions (Sunil and Shanimon 2018).

During the 1990s, the main barriers to the proliferation of FTAs were market failures. With the new millennium, two new challenges to the expansion of free trade agreements emerged. On the one hand, a new fear is generated in developed countries, especially in the United States: that free trade with developing countries will inexorably hinder real wages for unskilled labor (Bhagwati 1994). With the state of distribution everywhere in check, market-driven wage results have become more essential than ever. In fact, while free trade is better in a potentially compensatory way, its negative impact on income distribution in the lack of effective compensation makes it an unappealing policy. In the United States, the stagnation of unskilled workers' real wages is often blamed on free trade (Bhagwati 1994). Moreover, according to Bhagwati (1994), if the significant increase in domestic policies in industrialized countries, such as environmental laws and labor benchmarks, will not be coordinated, the competition under free trade will result in unfairness, and free trade is going to be perceived as a threat to growth instead as an opportunity. It is undeniable that the theory of imperfect competition significantly hindered free trade and its policies, as it pushed the already skeptical experts

towards more protectionist measures, especially after seeing how the stagnation of wages of unskilled workers increased along with unemployment.

It is largely believed that the most advantageous way to accomplish economic growth is through the expansion of world trade as a result of multilateral free trade negotiations within the WTO. However, the issue revolves around whether free trade agreements support or block trade liberalization, especially under the WTO system. Some scholars, as Urata (2002) states, claim that FTAs are an obstacle to the liberalization of multilateral trade because they establish exclusive trade agreements, restricting opportunities for third-party countries. Others indicate that the current rise in free trade agreements could complicate the global trading system and delay trade (Urata 2002). On the other hand, free trade agreements support liberalization and the extension of FTAs will effectively ease the liberalization of trade at the global level. According to the report of many experts, efforts to liberalize multilateral trade, under the WTO, are becoming increasingly difficult, therefore it would be extremely challenging to obtain multilateral trade liberalization without the help of FTAs. Moreover, some argue that multilateral trade liberalization negotiations will intensify because FTAs will strengthen the prominence of trade liberalization (Urata 2002). One of the main controversies, following Bagwell and Staiger's studies (1993), revolving around the establishment of free trade agreements concerns bilateral trade agreements. Although it was proved that once FTAs are implemented, tariff levels between the members of the agreement and the non-members do not rise but remain, bilateral trade agreements are one of the biggest obstacles to the institution of free trade agreements (Levy 1997).

Bilateral trade agreements may sabotage multilateral liberalization achieved through FTAs in two ways: countries could either halt multilateralism negotiations foreseeing possible bilateral agreements in the future; or countries could secure bilateral agreements before a multilateral one, losing the will to further engage in multilateralism (Levy 1997). Normally, according to Levy (1997), bilateral agreements are adopted only if they are preferable to a multilateral accord or if the bilateral agreement will not stop the institution of a preferred multilateral agreement. However, the theory of the median voter guarantees that no proposal that reduces the usefulness of the median voter will ever be approved. Hence, if a multilateral free trade proposal is not politically attainable under the conditions of autarchy because the median voter and consequently if at least half of the population is against the said proposal. Thus, that specific multilateral proposal cannot be made possible by any bilateral free trade agreement. If a bilateral free trade agreement is politically attainable, it will only increase the median value of

voter reservation to which the multilateral agreement will be compared to (Levy 1997). Bilateral free trade agreements may weaken the support for multilateral free trade by giving the median voter incommensurate large gains with small losses. If such a combination increases the utility of the median voter above the level presented by a multilateral FTA, in that case, the multilateral agreement will no longer be politically valid (Levy 1997). Levy (1997) claims that this possibility is more likely to happen in bilateral agreements concerning countries with comparable capital working conditions and reasonably indifferent median voters. A bilateral agreement with an equal partner country will result in a variety of gains without any price changes. The remaining gains provided by the transition from the bilateral agreement to free multilateral trade could be inadequate to balance the median voter for the factor price losses, blocking the multilateral agreement from being implemented. The only type of bilateral agreements that produce minor harmful consequences to the political opportunity of multilateral free trade is the one that leaves the median voter's capacity stable with the combination of price changes and a variety of profits (Levy 1997). This combination is especially popular between partner countries with a ratio of capital to labor as opposed to the one from the home country. These agreements would also generate the most political resistance to any possible bilateral agreement, as they do not do much to raise the well-being of swinging voters (Levy 1997). If the majority of voters in a country favors a bilateral trade agreement with a particular partner rather than a multilateral free trade one, the majority of voters in the partner country will favor multilateral free trade over the bilateral arrangement (Levy 1997). This result stems from the narrow convexity of indirect utility as a function of the relative price; if a change in relative prices raises a voter's capacity, an additional change in the same direction will further enhance capacity. Bilateral free trade can only exclude multilateral free trade when multilateral free trade would reach the same relative price as bilateral free trade, resulting in no incentives to trade on a multilateral basis once the bilateral agreement had been signed (Levy 1997).

If free trade agreements are to encourage trade liberalization globally, the discussion over the role of the WTO and FTAs strengthens multiple major challenges for WTO members. Firstly, to approve the participation of nations outside the established free trade agreement, to extend the membership of those areas (Urata 2002). To join an existing FTA, a country must meet the criteria for regional integration such as the strengthening of trade integration in the area. Secondly, there needs to be the maintenance of the dynamism of multilateral trade negotiations within the WTO. All the WTO members must understand that extending global trade through multilateral trade liberalization will be profitable for all countries (Urata 2002). Following this



recognition, each country's concerns need to be synchronized accordingly to not generate unfair competition and unfavorable trade conditions. The effect of signing a free trade agreement with another country on a country's trade surplus can be further divided into two results: one is the trade surplus between the two countries, called the direct surplus effect, and the other is the trade surplus with third countries, namely third-country effect. The latter outcome is always positive as the country's exports to third countries are not influenced by the FTA, meanwhile, imports from them lower as their goods become more expensive after the establishment of the free trade agreement. Therefore, the third-country effect always pushes countries to sign FTAs at the expense of third countries since all other countries, including existing FTA partners, are harmed by these new FTAs. Conversely, the direct surplus effect depends on the characteristics of the two countries, such as the size of the market and industry, and the characteristics of their current partners (Bhagwati 1994). The next paragraph will analyze in depth the development of some of the most successful free trade agreements present in the worldwide economy, for example, the North American Free Trade Agreement (NAFTA), and how these agreements influenced the economic development of some of the most backward areas of the world.

### 1.3 Examples of implementation of Free Trade Agreements

Free trade agreements are now widely used and established all around the world. As examined in the previous paragraph, although there are serious disadvantages to the institution of FTAs, there are also a lot of advantages, especially for third-world countries that with FTAs see the possibility of growing their economy and engaging in the global arena. FTAs also help with industrialization, and modernization and significantly contribute to the population's well-being as well. As already stated, free trade agreements are now utilized by numerous countries, but what are the factors that need to be considered when establishing FTAs? What do these countries value and observe when discussing such a tedious agreement? Baier and Bergstrand (2004) labeled three sets of factors that influence the formation of FTAs: economic geographical factors (e.g., distance), intra-industry trade factors (e.g., country size), and inter-industry commercial factors (e.g., relative capacity of factors). Meanwhile, in Hur and Qiu's perspective (2020) important factors that also need to be considered are the total welfare views adopted by the governments for what concerns FTAs decisions instead of simply the consumer's welfare, the oligopolistic competition instead of the monopolistic view usually analyzed, and lastly tariffs. In addition, Chen, and Joshi (2010) believe that another important determinant in the establishment of free trade agreements is an already existing FTA between two countries that might increase the possibility of the creation of a new FTA or disincentive the institution of a new accord.

Overall, two types of analysis are used to examine the impact of FTAs on trade in goods and whether the formation of an FTA is going to be profitable or not. The first type of analysis is called "ex-ante" analysis and it consists of a simulation analysis using the computational general equilibrium (CGE) model, which allows scholars to study the impact of a free trade agreement on different aspects of the economy, such as trade value, production, and economic welfare (Okabe 2015). In the CGE model, the fulfillment of an FTA is quantified by the reduction or elimination of tariffs. The model can address various trade liberalization measures implemented with tariff reduction or elimination under the FTA, such as trade and investment facilitation and trade liberalization in services (Okabe 2015). Therefore, we can evaluate both the direct and indirect consequences of different types of free trade agreements on different aspects of the economy. Following Okabe's discussion (2015), this type of analysis is usually applied when assessing the impact of an FTA before applying it. The second type of analysis

called the “ex-post” analysis is empirical research that implies the use of a business data severity model at an aggregated or disaggregated level (Okabe 2015). Said model is called the gravity model, elaborated by Tinbergen and Poyhonen in the 1960s and it has been widely used to explain business models and the impact of FTA on trade in goods for over 50 years. From the 1970s onwards, several studies examined the impact of major regional free trade agreements, such as the European Free Trade Association (EFTA), and the Latin American Free Trade Agreement (Okabe 2015). These investigations used dummy FTA variables to capture the outcomes of FTA on trade movements. If the analyzed dummy FTA factor is notable and positive, the FTA has a positive effect on trade between members; in other words, the free trade agreement has a trade creation consequence. With the rapid expansion of FTAs around the world since the 1990s, numerous scholars and experts are trying to study the impact of FTAs by applying different types of gravity model coefficients (Okabe 2015). Okabe describes (2015) how the gravity model has been applied to a growing number of trade studies, but it appears to have two main concerns that challenge the efficiency of said model. The first one deals with the endogeneity of the gravity model. In fact, some explanatory variables in the mentioned model can be regarded as endogenous, for example, the gross domestic product (GDP). Furthermore, FTA dummies can become endogenous variables seeing how trade relations are an important factor in the establishment of a free trade agreement between two countries (Okabe 2015). The second problem concerns the fact the estimation factor in the gravity model equals to zero trade flows. Many country pairings do not have bilateral exchanges. This is the case, according to Okabe (2015), for disaggregated trade data. The dependent variables in a standard gravity model are converted into logarithms of bilateral trade values, while the log of zero bilateral trade flows is unclear.

According to the World Trade Organization, there are 420 trade agreements, almost 70 percent of which are free trade agreements. Furthermore, the majority of global trade takes place on the basis of preferential agreements (Hayakawa et al. 2013). The number of countries that do not enjoy preferential agreements keeps decreasing, and countries like Mexico and Singapore have duplicated the number of free trade agreements they are part of in the past 10 years. The path to the establishment of all these FTAs has not been easy. In fact, there has been a sharp rise in anti-trade rhetoric along with the launch of some protectionist measures has shaken the consensus on free trade (Hayakawa et al. 2013). This especially happened in developed countries, with the United States halting their support for the Transatlantic Trade and Investment Partnership (TTIP) and Trans-Pacific Partnership (TPP), and the United Kingdom,

leaving the common European Union market. Despite these obstacles, free trade agreements continue to be instituted and signed, covering all regions and nearly all countries of the world (Sopranzetti 2018). This boost in the number of free trade agreements created the so-called "spaghetti bowl" (Baldwin 2006, Bhagwati 2003). The spaghetti bowl describes the complexity of interactions between different and frequently overlapping free trade agreements. This complicated structure can turn some countries into hubs and others into spokes, depending on the number of FTAs in each country (Hayakawa et al. 2013). Various factors have been used to interpret the development of this phenomenon, but there are two main aspects to focus on. The first has to do with the complications related to the multilateral liberalization negotiations under the WTO with different members, as opposed to regional or even bilateral agreements. Negotiations take a longer amount of time to be completed if more countries participating in the agreement, and the time increases even more especially when said countries do not belong to the same region. Furthermore, because trade agreements are, in general, expanded in scope, the costs of multilateral trade have risen, due to the complexity needed to reconcile all these aspects. The second aspect is linked to the so-called "domino effect" (Baldwin 1993). According to Baldwin (1993), if the number of countries involved in an agreement grows, countries outside this agreement will experience more discrimination, pushing them to sign new agreements to diminish said discrimination. The terror of being excluded may drive hesitant countries to make an independent free trade agreement even if that was not their first goal.

Some cases of free trade agreements comprise the Free Trade Area (AFTA) under the Association of Southeast Asian Nations (ASEAN), established in 1992, and the North American Free Trade Agreement (NAFTA), which entered into force in 1994. The agreement between Japan and Singapore was the first regional trade agreement for Japan. Meanwhile, the European Economic Community (EEC) and the Southern Common Market (MERCOSUR), which includes four South American countries, Argentina, Brazil, Paraguay, and Uruguay, are examples of customs unions (Urata 2002). Since the 1990s, the number of established free trade agreements has been steadily increasing. What it is important to highlight is that all these regional trade agreements have in common peculiar features (Urata 2002). Another element that should be noticed is that these agreements keep expanding. The European Union is a great example of how a regional agreement gradually enlarged, starting from 6 members, and counting now 27 members. The Free Trade Area of the Americas (FTAA) is also another case of the expansion of free trade agreements. The FTAA unites the members of NAFTA and

MERCOSUR passing through the entire American Continent and including the Caribbeans apart from Cuba (Urata 2002).

Another reason why FTAs ever since the 1990s have been becoming more popular is because of the increasing depth of these agreements. Many agreements started as customs unions or as another type of agreement and then evolved into an FTA (Okabe 2015). The EU is a perfect example of this trend. In fact, the European Union at first was a customs union and later developed into economic integration. This development required more than forty years to be accomplished, but after the 1990s, the transition from a common market to an economic union swiftly happened. Free trade agreements usually have the conventional goal of removing trade barriers, but nowadays these agreements are also trying to include dispute settlement agreements, liberalization, and facilitation of trade in services and foreign investment (Okabe 2015). A great example of how these agreements developed from simply eliminating trade barriers to approaching other subjects as well as the Japan-Singapore Free Trade Agreement. This agreement also incorporates policies regarding intellectual property, labor mobility, political competition, radio and tourism, science, and technology (Okabe 2015). The third feature is the increase in the formation of these agreements between countries that are not necessarily neighbors. Initially, RTAs were between neighboring nations such as members of the EU and NAFTA. In recent years, however, geographically distant countries, for example, Chile and Canada, Singapore and New Zealand, the United States and Jordan, and Australia and Japan have established several economic integration agreements (Okabe 2015). An increasing interaction between different RTAs has also been registered. Also relevant to this trend is the growing interaction between different RTAs. For example, the negotiations between the EU-Mexico FTA increased both the interactions with the other members of NAFTA and MERCOSUR. Other countries, such as Chile, followed the example set by Mexico, establishing new ties with several other countries (Okabe 2015). Another factor that should be noted regards the growing number of countries around the world that were once skeptical about joining RTAs and are now extremely inclined to join said agreements, having experienced how beneficial they can be. The last factor that triggered the proliferation of FTAs is the tendency towards the informal regional framework (Okabe 2015). The most famous example of this tendency is the Asia Pacific Economic Cooperation (APEC). When first created in 1989, APEC was a conference on economic cooperation between Asian and Pacific nations, and later it was promoted to a summit cooperation, although for unofficial purposes. The objectives of the APEC are investment and economic and technical cooperation, liberalization, and facilitation

of foreign trade. Since the goal of liberalizing and facilitating trade and investment is extended to non-members as well, APEC is not categorized as an RTA according to the GATT and WTO regulations, having the features of an RTA it is classified as one, because through it both industrial nations and developing members of the APEC reached unprecedented goals regarding liberalization of foreign trade and investment (Okabe 2015).

Nowadays there are various examples of FTAs all around the world. One of the most notable that has already been mentioned in this chapter is the North American Free Trade Agreement (NAFTA). NAFTA, signed by President George H.W., Bush on December 17, 1992, and approved by the American Congress on November 20, 1993, was implemented on January 1, 1994. NAFTA's economic impact is hard to measure because trade and investment trends are affected by many other economic variables, for example, currency volatility, inflation, and economic growth (Villareal and Fergusson 2017). It is likely that the agreement also intensified and secured the trade liberalization already underway in Mexico. NAFTA was important, as it was the most complete free trade agreement bargained at the time and it enclosed several revolutionary propositions. The NAFTA agreement was presented as a model for the new generation of free trade agreements that the United States eventually arranged in the following years, and it also posed as a model for several propositions that were included in multilateral trade negotiations under the Uruguay Round (Villareal and Fergusson 2017). When the NAFTA arrangement was first being discussed, it generated a huge controversy. One of the main reasons for the controversy involved the members of this agreement: NAFTA, in fact, was the first FTA to include two rich and developed countries and one developing country. The political discussion regarding the accord has divided into two main factions: supporters who claimed that the agreement would help create thousands of jobs and lower income inequality in the region, while objectors were alarmed that the arrangement would lead to massive unemployment in the US as companies were going to transfer manufacturing to Mexico to cut costs for production (Villareal and Fergusson 2017). However, NAFTA did not cause the tremendous unemployment that objectors were afraid of nor did the huge economic profits forecasted by supporters. NAFTA's effect on the US economy was and still is pretty moderate, especially since trade with Canada and Mexico costs a small percentage of the United States gross domestic product (GDP). Nevertheless, there were labor and corporate adjustment costs as the three countries adopted a more open process regarding trade and investment (Villareal and Fergusson 2017). NAFTA remains extremely important to the Congress because of the importance of Canada and Mexico as trading partners and the consequences of NAFTA for U.S.

trade policy. NAFTA was particularly discussed when Donald Trump became president. President Trump expressed his desire to renegotiate NAFTA during his election campaign and he promised he would consider the possible effects of withdrawing from the agreement after settling into office. Furthermore, President Trump advanced the possibility of imposing tariffs or border taxes on goods from Mexico (Villarreal and Fergusson 2017). Trade policy experts and economists believe that thanks to NAFTA and other free trade agreements (FTAs) trade and economic relations between countries expanded, generating a better production process, enhancing the availability of cheap consumption goods, and improving working standards and living conditions (Villarreal and Fergusson 2017). Other scholars hold FTAs responsible for failing employment flows, especially seeing how wages fell in the United States. In addition, these experts think that NAFTA and other FTAs are not working towards the improvement of labor qualities and environmental conditions abroad (Villarreal and Fergusson 2017). Aside from impacting the other FTAs established by the United States, as Villarreal and Fergusson explain (2017), NAFTA also introduced a new generation of trade deals in the West and other parts of the world, affecting negotiations in areas such as dispute resolution, employees' rights, foreign investment, intellectual property rights, market access, terms of origin, and protection of the environment.

Free Trade Agreements (FTAs) have spread in East Asia. More than 30 regional trade agreements (RTAs) involving East Asia are currently in place, 14 of which are intra-regional accords. Thanks to ASEAN, regionalism in East Asia has been gradually expanding. In particular, there was a significant change when the ASEAN Free Trade Area (AFTA) was created. ASEAN Free Trade Area (AFTA) is an agreement that eliminates import duties on all products located on the normal ASEAN-6 track (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) (Hayakawa et al. 2013). AFTA has grown from its initial 6 members in 1992 to 10 nowadays (Urata 2002). The main purpose of AFTA is the liberalization of trade under the Common Effective Preferential Customs Arrangement (CEPT) removing tariffs on intra-ASEAN trade, which have been in force since January 1993. AFTA's objective was to lower tariffs on products on the Inclusion List (Okabe 2015). The tariffs on the products included in the Inclusion List were meant to be erased to zero percent in 2010 for the six ASEAN countries and in 2015 for the remaining four countries, Vietnam, Laos, Myanmar, and Cambodia. AFTA was able to reduce tariff lines with a zero percent rate of around 99 percent in the six main countries, and around 95 percent in the remaining four countries. In the last 30 years, the abolition of tariffs under AFTA has been almost completed (Okabe 2015). AFTA has

not only intensified intra-regional trade among its members but also trade with non-members. When analyzing these agreements, not only there is to take into consideration intra-ASEAN trade, but also the impact that AFTA has on trade between ASEAN members and non-members. Whilst the ASEAN regional trade blocks had little influence when AFTA was first introduced, recent studies have observed that with the development of AFTA, ASEAN had an impressive and positive effect on trade (Okabe 2015). In East Asia, the utilization rate of free trade agreements for what concerns imports remains at an objectively low level. Hiratsuka (2008) highlights that Japanese companies and their associates working in ASEAN are not familiar with the FTA, to begin with. The use of AFTA was also on the low side for what concerns export, a matter of fact from 2003 till 2006 the value of exports under AFTA was around 20 percent, a value, that despite being on the lower side, is still higher than the import value in that period which was around 11 percent. In addition, the AFTA utilization for both exports and imports is inferior compared to the international standards. Jongwanich and Kohpaiboon (2008) specified that the rate of AFTA utilization was lower than NAFTA's; NAFTA's utilization rate for Mexican exports to the United States was around 60% in 2004-2005. The utilization rate of Chilean exports to the United States was around 55% in 2005-2006 (James, Martinez, and Iglesias 2006).

AFTA is a sort of strategy to give ASEAN a modern interpretation since existing security threats in the region have disappeared with the end of Cold War antagonism and reconciliation with Vietnam (Collins 1996). As already mentioned, AFTA's goal is to liberalize and develop intra-regional trade, attract foreign investment by creating a single market in Southeast Asia, and enable ASEAN states to jointly tackle international challenges. In order to comprehend how AFTA works and why it was formed, it is essential to understand the wider economic context in which the economies of Southeast Asia work (Collins 1996). In recent years there has been a surge in the creation of exclusive trading blocs and in the need for other systems for regional economic cooperation. This surge might seem odd at the beginning because of the traditional economic debate stating that all forms of protection and attempts to control trade, such as trade blocs, have generated suboptimal outcomes in comparison to completely free and open trading arrangements. In addition, protectionist measures restrain countries from specializing in fields where they have a comparative advantage (Ethier 1988). Economic regionalism and the establishment of trading blocs are the outcomes deriving from the fear that the level playing field described by economists cannot be obtained and that the instruments of the global multilateral trading system are threatened. Furthermore, if a certain country wants to



live in a protectionist world, it needs to belong to some regional group or arrangement (Collins 1996). After 1993, following the successful settlement of the GATT Uruguay Round and the institution of the new World Trade Organization some of the above-mentioned fears subsided, but ASEAN leaders continued to be worried about these issues (Far Eastern Economic Review 1994). In these situations, developing contingency plans to deal with a potentially hostile international environment is a rational measure. This is especially accurate when one takes into consideration that, aside from Japan and China, the world's most important economies are already members of well-defined economic blocs: the European Union (EU) and the North American Free Trade Agreement (NAFTA) (Collins 1996). However, as Collins (1996) highlights, one of the unplanned results of these contingency plans is to form an environment where mutual assurance is required for the maintenance of a multilateral trading system and such actions might entail the risk of sabotaging what should be the first wishes of the state actors. The fear regarding economic exclusion, for this reason, is particularly strong in smaller countries with export-oriented economies such as the ASEAN states that are heavily dependent on trade. The creation of AFTA is one way to address and try to overcome this fear (Collins 1996). With small countries participating in regional trading blocs, there is also the possibility of said countries adapting to foreign competition in a slower and more regulated way, contrary to what would happen if they were to face the big industries that have developed in bigger countries. The mentioned competition is already something that is expanding at a rapid pace seeing how countries like China and India were able to develop in a significant way compared to other Southeast Asian nations. These two big countries are now not only creating a huge competition with their export markets but also attracting more foreign investments (Collins 1996).

Another reason why regional economic cooperation intensified in East Asia was because of the currency crisis in 1997 when the leaders of the ASEAN countries and the leaders of the People's Republic of China (PRC), Japan, and South Korea held a meeting to debate the seriousness of the situation and to attempt finding possible resolutions to the crisis. During this meeting, which took place in 1998, following the proposal of South Korea's President Kim Dae-Jung, the East Asia Vision Group was established. This experiment had the purpose of analyzing and preparing a possible long-term procedure for economic cooperation in the Asian region. One of the group proposals regarded the creation of an East Asia free trade area (EAFTA), involving the ASEAN+3 countries (Urata 2014). The most important feature of the free trade agreements

developed in East Asia is the comprehensive coverage of said agreements. Moreover, East Asia saw the development of new types of FTAs. There are economic partnership agreements such as the Japan–Singapore Economic Partnership Agreement (JSEPA) established in 2002 or there are closer economic partnership arrangements such as the PRC–Hong Kong, China Closer Economic Partnership Arrangement (CEPA) signed in 2003 (Urata, 2014). These new varieties of free trade agreements involve the facilitation of foreign trade, the facilitation and liberalization of foreign direct investment, and technical and economic cooperation. All these new features are alongside trade liberalization, which is the main characteristic of traditional FTAs. What it is important to highlight is that these new accords in terms of structure and features are similar to the agreements established under the Asia-Pacific Economic Cooperation (APEC) forum. APEC’s main points are, in fact, business facilitation, economic and technical cooperation, and trade and investment liberalization (Urata 2014).

For the free trade agreements established in Asia, the question regarding economic and technical cooperation is particularly relevant. In Asia, there is a huge discrepancy between high-income and low-income countries and to be able to reduce the gap, the Asian region needs to be able to reach economic success along with political and social stability (Urata 2014). It is for this reason that a common policy inserted in the many free trade agreements signed in Asia includes the support of small and medium-sized enterprises (SMEs). This process, as Urata (2014) explains, would not only help build the construction of a competitive and strong economic structure, but it would also improve the population’s living conditions. SMEs are extremely substantial for many economies of Asia which concerns production and employment. It is important to stress that Japan and the PRC, the two countries that are aiming to endorse a leading role in the construction of regional integration, have taken advantage of economic assistance from FTA partners to receive support for FTAs (Urata 2014). Japan stresses the relevancy of facilitation and liberalization of investment and services trade. Experts believe that such measures would contribute to the creation of a free, unambiguous, and solid business environment for Japanese companies that have considerably ventured into investments regarding production networks in Asia (Urata 2014). Japan is also quite predisposed to arranging a well-functioning intellectual property rights protection system. On the other hand, developing countries such as ASEAN members and China are not truly interested in this kind of policy. In fact, ASEAN and the PRC have managed to gradually coordinate and work together when it comes to trading goods, services, and investments. They manage to work

independently from one another and move at their own pace, focusing on the liberalization of trade in goods first, and later on the liberalization of services and investment (Urata 2014).

East Asian countries have developed different strategies when it comes to the construction of FTAs. One of the main reasons for that revolves around the discrepancy of importance among the countries, but it is not the only motive. First, seeing the rapid development of FTAs around the world, Asian economies understood the importance of establishing FTAs to sustain and develop their export opportunities (Urata 2014). Second, free trade agreements can also be used by countries to pursue a structural domestic reform that would also trigger economic advancement. These countries by putting pressure on the opposition to structural reform may be able to complete the institution of a domestic structural reform. South Korea through the promotion of a domestic reform, while being pressured by China and Japan, two huge economic titans, was able to sign an FTA with the US, managing to maintain and improve its competitiveness (Urata 2014). Third, the strong rivalry among Asian economies regarding the attainment of a leadership role in the region has triggered their FTA strategies. As already stated, the PRC and Japan, are competing to obtain the leadership role in the region, and are eager on using FTAs to enforce their relationships with ASEAN, South Korea, and other countries. It should also be mentioned that ASEAN, South Korea, and other countries consider FTAs as a way to preserve and improve their influence in Asia. In ASEAN's FTAs with major countries are signed for them to take the lead in regional integration in Asia, while for South Korea the formation of FTAs is important to participate as well in the leadership role of the region along trying to reach and then surpass Japan and the PRC for the leadership role (Urata 2014). Lastly, countries with active outward foreign direct investment use FTAs to enhance the business environment in FDI recipient countries, so that multinational corporations (MNCs) can fulfill their goals in an efficient way. This is the reason FDI liberalization and facilitation are two of the main policies included in these new types of FTAs. This target will significantly become more relevant for other Asian countries in the future since the number of countries in East Asia with active outward FDI will probably increase. (Urata 2014)

Another reason why free trade agreements were able to proliferate in Asia the way they did in the 1990s is also thanks to the ongoing catching-up process that started during those years as well. The catching-up process is a procedure that has affected the whole world at a certain point. However, some countries were able to catch up only in the last 35 years and therefore their

development process has been significantly different compared to the already developed countries. The catching-up process focus is capital accumulation, and this mechanism was of fundamental importance in Asia, especially during the area's first phase of growth and development. The East Asian area in particular thanks to this process was characterized by rapid industrialization, allowing the region to develop and reach the already developed countries at a significantly faster pace. Secondly, human capital formation was also of particular importance in Asia since it supported technology adoption and growth. Third, innovation has also been crucial in the facilitation of the recent expansion of Asian economies (Kunieda et al. 2021). With free trade agreements being a new and innovative process to expand the economies 'growth, it is not surprising that they were able to become a part of the Asian countries' new economic strategies and be established throughout the whole region. Free trade agreements helped develop regional integration within the area which allowed these countries to use the comparative advantage theory, with specialization and division of labor, reconstructing their own economies thanks to that. FTAs were also able to improve labor conditions and that helped with the human capital formation of the catching-up process, with workers and population living in better conditions, economic growth increased even more. As already mentioned, these countries also needed a significant political and domestic reform to be able to sustain the economic changes that were happening all around the world and FTAs by putting pressure on the economic structures would be able to provide that. This can also be seen as a part of the catching-up process, evolving towards a different and perhaps better domestic and political situation, in addition to capital and human accumulation can also trigger significant economic growth. FTAs can also be regarded as a tool for the catching-up process as they allow underdeveloped countries with low income to participate in the global arena and be able to stand almost at the same level as the developed countries. Free trade agreements also promote the development of political relationships among the countries, which can always be useful in a situation of conflict as well, when the interests of the members of the agreement are threatened. The catching-up process particularly affected countries like the PRC, Japan, and South Korea. These three countries as stated above are all trying to overcome one another to pose as the leader of the Asian region. It is also another reason why they have joined other free trade agreements with other countries, some of which not even belonging to the Asian region. Perhaps this is also one of the main reasons why these three countries have yet to reach an agreement for what concerns their own free trade agreement. While they have all ratified the Regional Comprehensive Economic Partnership (RCEP), the over 10 years of ongoing FTA discussion among these countries is still in a deadlock, despite said countries being already well integrated

into each other's economy. In the next chapter, the discussion will focus on the catching-up process that happened in the East Asian region, with a particular focus on the catching-up process of the People's Republic of China, Japan, and the Republic of Korea and how this process was able to make them grow into the economic pillars of East Asia and the world as well.

## CHAPTER TWO

### The catching-up process in East Asia

#### 2.1 The catching-up process: definition, features, and development

In the previous chapter, the analysis focused on how the catching-up process was one of the main components pushing economic development forward around the world. This whole process worked particularly well in East Asia where we witnessed the rising of new economic powers such as the People's Republic of China, Japan, and South Korea. But what does it mean to “catch up” in an economic context? The catching-up process is described as the progressive reduction of differences in knowledge and technological capabilities between countries (Perez and Soete 1988).

A way to explain the catching-up process, according to Kim (1997), involves the analysis first of the dynamic model of innovation created by Utterback and Abernathy in 1975 and secondly of the model of the technology development process elaborated by Lee, Bae, and Choi in 1988. Having completed the said analysis, scholars discovered that developing countries go through several different stages before being able to reach or at least get closer to the economic power of advanced countries (Jun 2011). Usually latecomers, during the industrializing phase, must first secure knowledge and the most prominent designs from developed countries as they need to acquire the capabilities to move forward with their economic development (Jun 2011). Why do they need to focus on the prominent designs? As Jun (2011) answers, simply because those are the ones favored by the customers and if developing countries want to experience growth in their market share, following an already established pattern is the best way to achieve that. There is also another alternative that can be confronted with the above-mentioned “path-following catching-up” one (Lee and Lim 2001). The other suggested approach discussed by Lee and Lim (2001) is the “path-creating” one, and according to them, this process can be used once a significant stage of technological capability has been achieved. This new approach is

important because it can overcome the limits of the path-following procedure: path-following, in fact, is mainly dominant when developing countries are first industrializing because it already gives them a model to follow. Path-creating, however, becomes important when a developing country believes to have reached a notable industrial level and its new goal is now to become a leader (Choung et al. 2000). The risks of implementing this second model are either isolation from the rest of the economic block or becoming outdated once latecomers decide to embrace a new path and consequently choose a new leader for the new model since coordination and alignment with the leaders' approach are essential for the survival and growth of developing countries following a new path (Lee and Lim 2001).

Manufacturing industries are considered to be one of the main assets of the catching-up process as they are essential to generate productive capabilities. Productive capabilities are necessary to acquire new specialized and executive results, integrating these new-found results into the manufacturing production while arranging resources in the best way possible, favoring these new results (Andreoni, Chang, and Labrunie 2021). Capabilities can only be fully developed when the industries have gone through several types of changes starting with the creation of a specific sector where these new capabilities will be implied, then there is the need to reorganize these capabilities and the structure of the industry and lastly, there is also the urge of an institutional change (Andreoni, Chang, and Labrunie 2021).

Many scholars emphasized how economic development in East Asia progressed following certain elements: first of all, there was the central role of the state for what concerned with the coordination and development of an industrial policy, through which it is possible to achieve the state's development strategies; secondly, there was the creation of business agglomerations with industries belonging to both the private and the public sectors; thirdly the ever-present restrictions hindering the technology sector where finally bypassed by new procedures involving exports with a continuously growing value; and lastly the creation of well-instructed authorities linked with both the state system and the administration of the business classes (i.e chaebols in South Korea, the zaibatsu and keiretsu in Japan and the powerful state-owned businesses in China) (Evans 1993). According to Bresser-Pereira et al. (2020), scholars belonging to the new-developmentalism movement also include one more factor in the analysis of economic development in East Asia: a strenuous macroeconomic program, which was essential to clarify why East Asian economies were able to rise to success from the 1980s

meanwhile Latin American economies' economic growth, during the same period, reached a sudden stop (Bresser-Pereira et al. 2020).

What is also important to highlight when discussing the catching-up process is the correlation and also the difference that there are between catching-up and convergence. Catching-up, as already mentioned above, refers to the capacity of a developing country to diminish the gap in productivity and profits when compared to a developed country (Fagerberg and Godinho 2006). On the other hand, convergence is more of a tendency to reduce the dissimilarities in productivity and profits considering the whole world and not just as a country in comparison to another (Fagerberg and Godinho 2006). Catching-up and convergence are correlated in the sense that if all countries manage to catch up evading the differences, then convergence will most likely happen. However, if only a group of countries can catch up while the rest struggles to reduce the gap, reaching convergence will not be possible (Abramovitz 1986).

In East Asia, the catch-up process happened in a very rapid way, especially for what concerns structural change and East Asian countries ability to become some of the most important manufacturers around the globe, particularly in the technology sector (Fagerberg and Godinho 2006). Governments also had a fundamental part in the catching-up process. In some countries such as Japan and South Korea, the governments also enforced a credit rationing procedure to prompt private companies to follow the state's goals (Fagerberg and Godinho 2006). These governments not only implemented economic policies such as financial support for the development of industries and tariff protection, but they also strongly campaigned for the growth of education, with a focus on engineers (Lall 2000). Nevertheless, education is not regarded as a substantial instrument for the catching-up process. In fact, there are examples of countries that despite having done consistent investments in education, they were unable to achieve the same level of catch-up as the East Asian countries, for example, the Argentine Republic (Fagerberg and Godinho 2006). When dealing with education it is not enough to make it more accessible to the population, what is also important is what added value education is going to bring to your country. Furthermore, you cannot just expand education and not increase the employment opportunities for the high-skilled industry. In fact, in East Asia, the spread of education was complementary to the increase of employment opportunities in the technological and scientific sectors (Fagerberg and Godinho 2006). Therefore, it can be said that having a proactive government able to execute successful economic actions is a fundamental feature



belonging to countries that were able to fully profit from the catching-up process, specifically the East Asian countries (Fagerberg and Godinho 2006).

The rising of the East Asian economic power was not the triumph of a single economy prevailing, but it was the culmination of the consequences of the constant and remarkable growth of the countries belonging to that area. Especially important were the rapid industrialization processes that expanded first in Japan in the 1950s, and later, during the 1960s and 1970s, in Hong Kong, Singapore, South Korea, and Taiwan. Lastly, during the 1970s and 1980s when these processes took place in the People's Republic of China, Indonesia, Malaysia, and Thailand (Drysdale and Huang 1997). This outstanding growth experienced by the East Asian economies, along with relocating a new center of the world in the Western Pacific hemisphere, has transformed these new strong economies into one of the most important economic forces of the 21st century (Gamaut 1989; Hughes 1993 and 1995).

Many factors contributed to the rapid development of the East Asian economies such as high domestic savings rates, large inflows of foreign direct investment, outward-facing development strategies, technological catch-up, relatively low-income inequality, and a stable macroeconomic environment (Drysdale and Huang 1997). According to Krugman (1994), the rapid expansion of the East Asian economies was based on extensive growth mainly depending on the mobilization of capital, extra labor, and other assets, signifying that the actual total factor productivity was not anything extraordinary. The East Asian economies have indeed grown significantly faster compared to the industrialization and growth period of the rest of the world, but their growth is far from being the miracle defined by some scholars (Krugman 1994). Until the 1950s, East Asian economies had the lowest income standards, yet between 1950 and 1988-90, their economies grew at the highest rate. Some findings (Drysdale and Huang 1997) provide some crucial details on the economic growth trends in the Asia Pacific region. Over the course of four decades, investment and workforce expansion played a significant role in the region's economic growth. Over the span of four decades, productivity growth has been a key driver of rapid economic expansion in the majority of East Asian countries. Undoubtedly, capital accumulation had a significant part in East Asia's economic expansion (Drysdale and Huang 1997).

The straightforward notion of catching-up requires some attributes: first of all, having a severely underdeveloped economy is not pleasant, as moderately developed economies seem to be able to adapt to new technologies at a faster rate than the least developed ones (Heitger 1993).

Second, the ability of a nation to allow the successful exploitation of best-practice technology is known as its "social competence," and it appears to be highly related to catching-up (Abramovitz, 1986). Regarding potential technological adaptability, a nation's population's level of education appears to have a significant influence (Heitger 1993). A less developed economy that is relatively well enriched with human capital in comparison to the level of development already attained will be better at introducing foreign technologies than nations that also need an experienced labor force. This could be the case for many of the least developed states, where a high proportion of illiteracy precludes a higher rate of technological adjustment and, consequently, a faster degree of economic progress. The country's capital stock's technical age and, subsequently, investment activities are key components of another essential factor of technological adaptation prospects (Heitger 1993).

The relative significance of these individual factors for a social capability can only be presumed, but the post-war evidence of prosperous European nations, with the addition of Japan, can provide some insight into how social capability and technological opportunities interact with economic growth and the ability to compete or fall behind (Heitger 1993). The postwar economic developments in East Asia are especially noteworthy because they have produced considerable advancements in social benchmarks and not all periods of rapid economic expansion have produced such results. These economies have a very impressive track record when it comes to reducing infant mortality, increasing life expectancy, educational level, and other metrics of human development (Chang 2006). The situation in these nations has not, of course, been perfect. Corruption, gender injustice, harassment of ethnic minorities, political authoritarianism, restriction of unions, violations of human rights, and other issues have all been present in most of these economies to various extents. Nevertheless, it is reasonable to state that amidst these flaws, the residents of East Asian countries have witnessed income and general well-being enhancements that are unmatched in human history throughout the second half of the 20th century (Chang 2006). It is fundamental to add that the claim that the East Asian model cannot be applied elsewhere due to its distinctive institutions undervalues the potential for institutional transmission, adaptation, and innovation and treats institutions as fixed entities. In fact, what is important to learn from the East Asian economies' development process, is that a late-developing nation's ability to successfully import, adapt, assimilate, and innovate institutions, rather than just technologies, is crucial to the nation's ability to advance economically (Chang 2006).

In the following paragraphs, there will be an analysis of the catching-up process that occurred in Japan, South Korea, and the People's Republic of China which resulted in the main countries that benefited the most from the whole industrialization operation, becoming some of the most important economic powers of the world.

## 2.2 Japan's catching-up process.

It is well known that Japan has one of the most ancient histories in the world, consisting of the succession of multiple dynasties that each contributed to the formation of the incredible and unique culture and identity of the country. Japan is also considered to be the first pioneer in the East Asian region to experience the catching-up process. The country was able to transform itself from a more rural type of nation to the industrial power that is nowadays, achieving if not surpassing, the economic industrialization present in Western countries.

For what concern its economic development, Japan's major turning point begins in 1868 with the Meiji Restoration. The Meiji administration started Japan's modernization process by encouraging capitalist growth from above. The government's next task was to amend unfair agreements that the Western superpowers had enforced on the country. Japan was able to resolve its issues with unfair treatment by the great powers from the late 19th to the early 20th centuries. As a result, Japan was able to dodge the threat of colonization, unlike what happened to some of its neighbors. Japanese people have tried to catch up with developed nations in the West, and in the 1930s, Japan came close to achieving this objective (Koyama 2008).

In World War II, as reported by Koyama (2008), Japan suffered a terrible defeat. Japanese people experienced severe harm. Nevertheless, in the 1980s, Japan emerged triumphantly from its ashes to rank second globally in terms of industrialization.

Japanese industrialization, which lasted over a century, is divided by Ehrlich (1984) into two phases: the first stage goes from the 1880s to the start of World War II meanwhile the second stage starts between 1946 and 1950, immediately after the end of the war. According to Ehrlich (1984), the first stage of industrialization was largely dependent on domestic resources and only marginally on capital borrowed from economically developed nations. The second stage of industrialization was marked by peace, in the absence of conflict and colonial expansion; an almost unprecedented rate of growth; a significant reliance on foreign capital; and, in terms of technological advancement, the adoption, dissemination, and advancement of the best practices currently in use in the economically developed nations (Ehrlich, 1984).

The Japanese economy, which by the middle of the 19th century was built on a large division of labor and was already generating commodities to a significant level (approximately 25–30% of production may have become commodities), came into direct conflict with the political and social order. As a result, there were various industrial projects present in the communities at

that time. This industrial activity, which was exhibited by primarily agriculturalists, was in part intended to satisfy the needs of the town as well as those of the village (Ehrlich 1984). The emergence and decline of businesses marked the second half of the 19th century. Only 20 of the 231 rich families who lived through the middle of the 19th century survived 50 years later in the early 20th century (Ohno 2004). Anyway, Japan was keen to adopt cutting-edge methods and institutions from the West with the beginning of industrialization. According to Ehrlich (1984), the banking system was created inside a framework set up by the government on the lines of American and European banks, while the British-style postal service and the German educational system were implemented.

When Japan entered the global labor market, its industrialization was heavily reliant on imports, and the country's modernization was first followed by the export of raw agricultural products and products from the extractive industry (green tea, coal, copper ore, and copper blocks) (Ehrlich 1984). This export profile did not last as long, though. It underwent a recognizable transformation when agricultural and industrial products, which required rather advanced working methods and were suited to the unique conditions of Japan, gained a crucial position in exports. The fact that Japan lacks natural resources for export is widely acknowledged. Instead, the so-called traditional industry had become quite important as it produced more for the global market than was necessary for the export and sales of the agriculture sector straightforwardly (Ehrlich 1984).

Japan suffered a terrible setback after WWII, and its territory was mostly reduced to four large islands. A fourth of the country's wealth was destroyed. The implementation of postwar reforms including democratization, the breakup of Zaibatsu, land reform, etc. was crucial to Japan's postwar economic recovery and progress (Koyama 2008). Postwar reforms were significant for multiple reasons: they put an end to the absolute Emperor system and established the principle that sovereignty belongs to the people; the reforms detailed the principle of forgoing the use of force to resolve international disputes; established fundamental human rights like freedom of speech, freedom of assembly, freedom of association, and equality for all sexes; workers were granted the freedom to organize, engage in collective bargaining, and go on strike. Additionally, these reforms also eliminated the parasitic landlord system in agriculture and eliminated the last vestiges of semi-feudal social structures (Koyama 2008). After the war, Japan could take advantage of a significant technology gap and put into production a significant backlog of technologies developed by the technological leader. The shining example of the Japanese was defined by favorable socioeconomic conditions for Japan's "social competence" to successfully

exploit best-practiced technologies as well as robust investment initiatives (Heitger 1993). Despite the outbreak of the Korean War, Japan's economy kept growing. After World War II, 1955 marked the most significant turning point in Japanese economic history. By that year, the economy had nearly fully recovered, and mining and industrial production had surpassed their peak levels during the conflict (Koyama 2008). The period of strong economic growth lasted for 19 years, from 1955 to 1973. Because of its rapid economic expansion, Japan's economy has undergone significant change. The Japanese scenery, social elements, manner of life, and way of thinking have all altered drastically because of this economic change (Koyama 2008). The following factors are what led Japan to achieve rapid economic growth. First, there was quick technological advancement. Many engineers were sent from their companies to the United States following World War II. They had assimilated the most recent advances in science and technology, and because of those discoveries, they created Japanese-specific technology (Koyama 2008). Then there was the energy revolution with the switch from coal to petroleum as the primary source of energy; the massive exodus of labor from rural areas; the reduction in military spending to about 1% of GDP; and the three pillars of the Japanese management style: the seniority-oriented wage system, the lifelong employment system, and the company-wide trade union (Koyama 2008). These three pillars have helped to foster employees' loyalty to businesses and develop Japanese workers' diligence and average workers' higher educational attainment (Koyama 2008). Additionally, research institutes, universities, and colleges were established, frequently with an emphasis on engineering and applied science. While the public sector was crucial, especially in the beginning, private initiatives and collaboration between public and private players eventually gained importance (Fagerberg and Godinho 2006). Japan's per capita income was roughly 18% of that of the United States in 1950. Thus, Japan had the chance to profit from a significant technology gap and replace superannuated technologies with internationally best-practiced methods. As a result, the growth rate in the ensuing decade was much above normal, coming in at above 7% annually. Japan was able to catch up and achieve a relative per capita level of roughly 30% in the early 1960s. When Japan also made significant investment efforts in the 1960s, the nation was able to achieve an even higher growth rate of more than 9 percent annually and make a spectacular leap forward in economic development: up until 1970, the income level converged to nearly 60 percent of the global average (Heitger 1993).

High economic development was put to an end in 1973 by the first oil shock crisis, but Japan was able to overthrow the crisis thanks to the adjustment in employment, energy consumption saving technology, Technology Revolution, and government support. Incentives to labor,

investments, and developers were not distorted by the comparatively low levels of government ownership and the correspondingly low levels of taxation by Western standards (Heitger 1993). A relatively high level of openness, as measured by export shares, along with the fact that large countries have low export shares, undoubtedly had a role in the development of a social capability that is conducive to catching-up (Heitger 1993). Japan has worked hard and been successful in achieving economic progress with a focus on microelectronics. Japan has advanced to become the second-most industrialized nation in the world. The Japanese economy continued to grow, but at a slower rate than before the initial oil shock (Koyama 2008). In the years following World War II, Japan's economy grew rapidly. When the high-value-added tertiary industry gained control of the major sector, accounting for close to 70% of GDP, the Japanese economy's structure underwent fundamental changes. Japan's economy maintained consistent growth for a considerable amount of time despite the Japanese yen's appreciation, which was aided by significant productivity growth and an improvement in economic quality (Feng and Wu 2008). The growth stopped in 1991. Japan has been in a stagnant state for ten years since that year. Japan has made progress in catching-up to the West thus far. Japan missed the mark and needs to make up ground. Rather, lagging nations like South Korea are catching-up to Japan. Japan must create a new framework for its own development (Koyama 2008). The crisis may also be seen as a contentious depiction of the crucial idea that institutions and policies that worked well during the catch-up phase may not be equally well suited once this phase is complete and the former catch-up country is forced to compete with other developed countries on an equal footing (Shin and Chang 2003). By having the most advanced technology in the region, becoming the principal commercial partner, and a source of foreign direct investment (FDI) for other countries, Japan has contributed significantly to the economic growth of East Asian nations (Widodo 2008).

## 2.3 South Korea's catching-up process

From 1910 until 1945, Korea was governed by the Japanese Empire as a colony. In contrast to the north of the Korean peninsula, where natural resources were more plentiful, the south of the peninsula did not see the same level of industrial development under Japanese control (Lee 1980). Even though the Korean nation earned its freedom following World War II, the Korean War (1950–1953) immediately started. Korea was split into North and South at the 38th parallel because of the conflict. According to Watanabe (1996), the amount of physical damage was equivalent to two years' worth of South Korea's GDP at the time. The USA provided aid as a last resort for South Korea. Washington's assistance mainly consisted of the supply of goods, mainly unprocessed goods such as wheat, raw sugar, and unprocessed wool (Koyama 2008). The government sold the donated commodities to fund domestic production. A portion of the revenues went toward the general budget, and another portion was used by the Korean Industrial Bank to finance businesses. Only the industries of flour milling, sugar refining, and textile manufacturing were active. These large corporations were able to secure these government-approved disposal items not because of their own business acumen but rather by acting like politicians with connections in the business world. While a few large corporations benefited from privileges and prospered, the government had no economic strategy for reducing poverty (Koyama 2008). The public's frustration and disillusionment with the government and these businesses grew daily. On May 16, 1961, a military coup under the direction of General Park Chung Hee happened. In 1963, General Park ran for President and defeated a seasoned and senior politician (Watanabe 1996). The presidential election was held in December of the same year as the declaration of democratization, which was proclaimed in June of that same year, but because General Noh Tae Woo was elected president, the military regime essentially persisted until 1993 (Koyama 2008).

Civil bureaucrats, in the opinion of Watanabe (1996), thought and behaved in a formalistic, abstract, and conservative manner that was antithetical to an entrepreneurial mentality. The military itself does not appear to be the only impetus behind South Korea's modernization. However, the military administration also appointed young, capable bureaucrats to senior ministry positions. Young bureaucrats in their thirties, with young economists educated in the USA as a center, made up the bulk of economic-related ministries (Koyama 2008). The goal of



the new government, according to Watanabe (1996), was export-oriented industrialization. Its pursuit necessitated the abolition of protective policies. Most of South Korea's exports were labor-intensively processed and assembled commodities. With the aid of machinery and equipment that were also imported from industrialized nations, South Korean businesses assembled and processed materials and intermediate products before exporting the finished goods (Koyama 2008). Despite its growing heavy and chemical industrialization, the nation nevertheless had a shaky production base for both capital goods like large equipment and intermediate products like parts (Koyama 2008). The nation must work to increase exports while relying on capital and interim goods imports. The government's response to the growing trade deficit was not a new equilibrium through import reduction, but rather a proactive and audacious entry of foreign capital. South Korea's rapid economic growth would not be conceivable without expansionist economic management in that way. Most of the foreign cash arrived as loans. Up until the middle of the 1960s, a significant portion of all foreign money was made up of government-based official loans (Koyama 2008). Foreign technology was primarily introduced to the spinning and weaving sectors up until the middle of the 1960s, but as early as the second half of the 1960s, this practice was completely halted. Korean industrial strategy, which encouraged import substitution in the non-durable consumer goods industry, was primarily inward-looking until the 1960s. Korea shifted to an export-driven, outward-looking industrialization and economic strategy in 1962. Korea had a significant competitive advantage in several industries in 1985 and was a net exporter of goods from them (Widodo 2008). According to Woo (2001), one key factor in Korea's success during the outward-looking phase was the deliberate focus on sectors with minimal capital requirements or unskilled labor-intensive sectors (such as apparel and wigs) with positive and growing foreign demand. In this instance, Korea has given other East Asian nations access to these sectors.

The total amount of foreign technology introduced into the shipbuilding and petrochemical industries has significantly dropped since the middle of the 1970s. While introducing foreign technology, other heavy and chemical industries maintained a high level for a while. The introduction of foreign money to the machine, electrical, and metal industries surged at the same time (Koyama 2008).

Early in the 1970s, the South Korean military administration pursued heavy and chemical industrialization as a means of creating a true self-sustaining economy. To exploit the accumulation procedure, the government set up industrial parks based on priority industries through regional collectivization. The government encouraged businesses to these industrial

parks after preparing the necessary infrastructure, including ports, roads, water supplies, power, etc. When importing capital items like machines and equipment, businesses based in these industrial parks were granted the right of exemption from custom charges and excise as well as special tax and financial measures (Koyama 2008). The US Army's presence in South Korea gradually decreased starting in the 1970s. This increased both civilians and the military's awareness of the pressing need to build economic and military independence. The growing industrialization of heavy industry and chemicals has been supported by people's patriotic impulses and fears of danger. Rural areas have undergone significant change. Up until the early 1960s, South Korea's rural communities were in abject poverty. However, by the middle of the 1970s, peasants' income had nearly caught up to that of urban workers' households. South Korea's industrialization has attracted so many jobs that migration from the countryside has started (Koyama 2008). The trend of a decline in the rural population and the number of peasant families was notable from the second half of the 1960s. Rural labor markets grew competitive. As a result, peasants worked longer hours on average, there were fewer people working part-time in agriculture, and more women were participating in the labor force. At the same time, agricultural real incomes were rising quickly. The government led Semaul movement sought to modernize communities, improving peasants' living conditions (Koyama 2008). Three main objectives of the movement were: The initial objective was to dispel the notion that peasants should accept their situation with resignation and encourage assiduity, self-support, and cooperation (Koyama 2008). The second objective was to enhance the environment. To do this, peasants should collaborate on local initiatives to improve their environment, such as repairing the banks of small rivers in their villages and building public wells (Koyama 2008). The third objective was an increase in the income of peasants. This included government-sponsored programs like the electrification of rural regions, the upgrading of village structures, the installation of water supply facilities, and the national land improvement plan (Koyama 2008). Despite being 10 years behind Japan in terms of economic development, South Korea has seen rapid growth. The rate of capital formation in South Korea climbed from 7% in 1953 to 33% in 1980. High economic growth and industrial development emerged with the increase in capital stock. Manufacturing experienced an average annual growth rate of 12% from 1953 to 1961, 15% from 1962 to 1966, and 22% from 1967 to 1971. Despite the 1973 oil shock, manufacturing continued to expand at an average annual pace of 18% (Koyama 2008). According to Hattori (2001), there are significant discrepancies between Japan and South Korea's starting conditions during their industrializing process: there was no other option for Japan to catch up to the Western sophisticated nations than to develop the necessary skills on

its own. Japan had time to catch up because technical advancement at the time was occurring slowly. Japan's development can be described as the accumulation of technology and skills when compared to late industrializers like South Korea. Conversely, in the era of microelectronics, the late industrializers are unable to catch up adequately through the improvement of skills as Japan did in the past (Hattori 2001). Despite the backwardness and the terrible situation South Korea experienced after WWII, the country still managed to achieve a successful catching-up process and became one of the most industrialized and modern economies in the world (Koyama 2008).

Because of its rapidity and the fact that it coincided with a significant structural transformation, South Korea's catching-up process might be viewed as the richest and most remarkable catching-up process of the last quarter of the 20th century (Bresser-Pereira et al. 2020). This incredible result was not achieved through just one factor. The South Korean catching-up plan, according to Bresser-Pereira et al. (2020), included the following element: capital concentration and centralization in the form of large conglomerates, or chaebols, similar to the Japanese case; a significant government involvement in the development of economic infrastructures through public funds and government-owned companies in the 1960s and 1970s and the nationalization of the financial system and the utilization of the Korean Development Bank and the commercial banking system to leverage specific industrial sectors. The South Korean government, especially during the 1960s, not only implemented an active foreign exchange policy but also built a formal export-stimulus apparatus. The degree of added value in the nation's exports still reflects this system, which depended on policies aimed at increasing the complexity of the country's own productive chains and safeguarding the domestic market with import tariffs (Bresser-Pereira et al. 2020). The catch-up process that South Korea has been experiencing is more significant in industries that classify as having an intermediate technological level, like basic metals, chemicals, transportation, and rubber products. By the end of 1999, South Korea's productivity growth had nearly caught up to Japan's in industries including basic metals and transportation facilities, and it was approaching the USA in chemical products. This rise in productivity can be attributed to both the significant expenditures made during the Heavy and Chemical Industry Plan (HCI) in the 1970s and 1980s and the more effective use of all the resources (Guarini et al 2006). Furthermore, employment in these three industries increased modestly in the 1980s and 1990s, in contrast to what happened in the manufacturing industry, which has seen a decline in employment since the 1990s. The growth in exports and the sustained domestic consumption, which were successful in offsetting the decline in

employment caused by the general introduction of labor-saving technologies, as is common in all mature economies, may be responsible for the different employment trends experienced in these sectors (Guarini et al 2006). Korea used its cheap wages to compete in labor-intensive industries at the start of its economic phase, similar to many other industrializing nations. The high rate of wage compression and, as a result, the high rate of capital compensation were characteristics of South Korean growth. Korea was able to grow its workforce while maintaining low salaries and minimal changes in the functional distribution of income, ensuring high profits for business owners (Guarini et al 2006). Moreover, the government assisted in directing profits into investments, resulting in a very high rate of reinvestment that allowed Korea to enter more advanced industries that required a higher intensity of capital (Seo 2000). At the same time, investments shifted toward more capital-intensive and higher value-added businesses while the lesser value-added industries were gradually abandoned since they could not ensure high levels of profits (Guarini et al 2006). South Korea is one of the few growing economies, according to Lall (1996), that has discovered how to compete in high-value-added industries. Moving quickly from the exploitation of cheap labor to the development of a skilled labor force and competitive capacities was South Korea's strategic advantage. Korea was able to close the productivity gap with more developed nations, but unlike Japan and the USA, where increases in labor productivity are consistently accompanied by increases in labor compensation, Korea has maintained relatively low wages, keeping the productivity and compensation gap at 40% during the early stages of economic development (Guarini et al 2006). To meet a significant and growing demand for medium-skilled workers, Korea has made significant investments in secondary technical education. The resources were then more heavily focused on postsecondary technical education at later phases of development in order to assist the growth of medium and high-tech sectors (Guarini et al 2006).

It is questioned whether South Korea's current downturn is a sign that its growth potential has permanently declined (Lee 2016). According to some academics, Korea's economic downturn will worsen, eventually creating a situation similar to Japan's stagnant decades (Cho 2014). Others, however, believe that Korea may continue its strong economic trajectory with the help of the right policies thanks to the dynamic forces that have supported Korea's quick growth (Sharma 2012).

### 2.3 China's catching-up process

China's economic development from 1980 to 2017 was exceptional, with real GDP growing an average of 9.2% yearly during that time. As a result, the nation has grown faster than the global average for more than 40 years, nearly without interruption. The average annual growth rate of China's per capita GDP over the past 35 years has been close to 9.0%, and the country's per capita income, measured in US dollars, increased from just US dollars 250 in 1980 to US dollars 8,827 in 2018. The approach was accompanied by a high investment rate that topped 40% from 2004 until the present day and averaged 36.9% of GDP on average from 1982 to 2011 (Bresser-Pereira et al. 2020). Since 2013, China has had the highest amount of international trade, a performance that has significantly impacted practically every country's economy. Through foreign direct investment, it also expanded into a significant capital exporter, from US\$ 0.8 billion in 1990 to US\$ 101.9 billion in 2017. Foreign direct investment (FDI) as a beneficiary of foreign capital increased from US\$ 1.4 billion in 1984 to US\$ 168.2 billion in 2017. Since 1991, a growing portion of foreign direct investment (FDI) in the form of joint ventures has been directed toward the construction and expansion of production capacity geared toward the domestic market. Until recently, FDI in China had been exclusively targeted at exporting industries, with a high concentration in Guangdong (Bresser-Pereira et al. 2020). In order to avoid its currency's appreciation and its companies' loss of competitiveness, China chose not to make the error of trying to develop with foreign savings. The scale and increasing complexity of the nation's industry are reflected in the weight of its global influence. China's exports increased from about US\$9.75 billion in 1978 to US\$2.42 trillion in 2017 (Bresser-Pereira et al. 2020). How was China able to achieve this incredible level of economic growth in the span of a little more than 30 years?

The People's Republic of China in order to trigger and foster economic development over the last decades implemented a series of procedures that helped the country grow into the economic power that it is today. One of the first steps of the process had to deal with the People's Bank of China which from 1978 until 1984 was in charge of the financial system of the country. During this time, a number of national and regional banks with various forms of ownership evolved to address the needs of agriculture, urban development, infrastructures, exports, and imports funding. Furthermore, the Chinese capital markets also gradually expanded. This

demonstrates unequivocally that China established a production finance system with the goal of structurally altering the economy, and that this system effectively fulfilled the requirements of the nation's development (Bresser-Pereira et al. 2020). The Chinese financial system permitted financing investment in several industries, businesses, regions, and infrastructure (Cintra and Silva Filho 2015). Since the early 1990s, China has pursued an export-orient strategy to promote its own economic development by taking advantage of decreasing factor prices and policy measures to attract foreign direct investment (FDI) (Lin 2015).

Since 1997, inflation in China has been under intense downward pressure as a result of a stable foreign currency rate, progressive trade liberalization, improving worker productivity, and a significant expansion in productive capacity. There have been two significant state interventions in the Chinese economy since the 1990s. The first one began in 1999 with the introduction of the Great Western Development Program, which swiftly rose to become the largest territorial income transfer in contemporary times (Jabbour 2006). The initiative represented the first significant step towards the economic unification of China, comparable to what occurred in the United States in the second half of the 19th century (Oliveira, 2003). It was also a reaction to the effects on the economy and job levels of the 1997–1998 Asian financial crisis. The expansion of the import substitution policy, which is currently being implemented in new areas related to the heavy mechanical industry, has caused the Chinese economy to make a second qualitative leap in the early 2000s. Its 2001 admission to the World Trade Organization (WTO) contributed to deeper integration into the global economic system. China has over the past ten years gradually become the "World's Factory" in the international markets for a variety of information and communication technology (ICT) products by putting more effort into innovative activities, developing high-tech industries, and assuming the primary production role in the East Asian production network (Chiu 2019).

Since then, comprehensive industrial plans aimed at the main economic sectors have been developed and implemented. The institutional development of the financial system complied with, and in some cases even foreshadowed, the demands of the economic reforms process, including overcoming the severe financial repression (Bresser-Pereira et al. 2020).

The Chinese government's second significant collective operation action was macroeconomic in essence. It was a reaction to the global crisis that started in 2008. The Chinese State Council announced to the world on November 5 of the same year an aggressive economic stimulus program of approximately US\$600 billion or 12.6% of GDP at the time. It was an actual, large-scale government involvement in the economy (Bresser-Pereira et al. 2020). China introduced

procedures centered on its economic strategy beginning in the early 1990s, preparing it for the two significant state involvement steps listed above: firstly with the establishment of capital flow control mechanisms, which were deemed necessary to control the foreign exchange rate; secondly with the unification of the foreign exchange rate, which underwent a significant devaluation in the years 1989–1994, and lastly with the reversal of the previous decentralizing trend through fiscal reform. This new-developmentalism viewpoint is supported by the Chinese experience, which demonstrates the critical roles that the foreign exchange rate and current account surpluses play in the development process (Bresser-Pereira et al. 2020). The behavior of China's real foreign exchange rate from 1980 to 2017 was another crucial factor to consider. It shows a clear and gradual trend of marked real exchange depreciation from 1980 to 1992, relative stability thereafter, and a trend of genuine and progressive appreciation until the mid-2010s when it started to depreciate again. Because of this, managing the balance of payments through a variety of means and especially, a competitive exchange rate, has been a key aspect of China's development ever since the 1990s with a growth process based on two parallel dynamics: one driven by exports and the other by investments (Bresser-Pereira et al. 2020).

Before the beginning of the 1990s, China's economy depended solely on price advantage rather than advances in additional value or production, in contrast to Japan and South Korea. Tradeable goods would have forfeited their competitive edge on foreign markets when salaries increased without being supported by strong productivity growth if the national currency had not declined significantly. Foreign exchange policy is, admittedly, a prerequisite for the exponential expansion of exports and FDI from abroad (Yao 2006). From the end of the 1980s through the beginning of the 1990s, China's economy simultaneously experienced a strong, double-digit growth rate evaluated in domestic currency, which was largely aided by the corresponding period's currency depreciation. The low-cost advantage would have been significantly diminished, and China's economy would have grown at a mediocre rate since there would have been no backing for its labor-intensive industries and export-oriented policy. The accumulation of cheap labor and natural resources has been the main driver of China's economic expansion during the last decades. China's economic growth pattern prior to the middle of the 1990s lagged behind Japan's economic growth pattern between the 1970s and the 1980s in this aspect (Feng and Wu 2008). This form of expansion should have to rely more on productivity growth than on capital formation and low-price competitiveness and, therefore, is projected to be more sustainable if the RMB exchange rate remains consistent or even increases during this time. Regardless of the measure used, China's economic growth rate demonstrates exceptional

vigor and, to some extent, suggests that the country's economy is headed for a significant shift. It demonstrates how the Chinese economy has gradually improved its quality since the middle of the 1990s. The impacts of the export balance upgrade began to become evident in the late 1990s. Beginning in 1998, export items with high value added started to outnumber those with low value-added (Feng and Wu 2008). Statistics from China's customs department show that in 2006, high-technology exports made up 29% of the country's overall exports (China Customs 2007). The majority of exports are increasingly slowly moving away from labor-intensive industries like clothes and textiles and toward high-tech and electromechanical goods. Furthermore, from the year 2000, non-tradable commodities and services, such as real estate, have emerged as significant forces propelling growth. All of these things suggest that the economic structure has changed in some ways (Feng and Wu 2008).

Over the past 35 years, ever since Deng Xiaoping began his economic opening and reforms, China's economy has likewise expanded quickly as it transitioned from a strictly controlled socialist to a market-driven economy. China has experienced robust economic growth over this time, averaging over 9.5 percent yearly, and has quickly closed the gap between its per capita income and that of Korea, Japan, and the USA. Since the 1980s, it has had unheard-of economic growth, which is a reflection of the significant convergence effect brought on by economic reform and opening up. Ample human resources, high rates of savings and investment, and careful macroeconomic management have also aided in the rapid growth (Lee 2016). China now has the largest economy in the world because of its ongoing economic growth. The country now aims to create more technologically advanced sectors as it moves from upper middle-income to high-income status. China's economy has expanded quickly, and the gap between income per capita and the rest of the world has narrowed, yet average growth rates have increased till 2010. South Korea had this accelerated economic expansion in the development's takeoff phase up until 1990, and Japan did so up until 1970. In terms of output per worker and per capita income, China quickly outpaced the USA (Lee 2016). Although China has quickly caught up to other developed countries, there is still a sizable development gap between the two. In comparison to the USA, China's average per capita income in 2010–2014 was lower than that of Korea in 1990 and Japan in 1970. Similar to what it did for Korea, the accumulation of physical capital has been crucial to China's process of catching-up. From 3% in 1970 to 20% in 2010, China's physical capital stock per worker expanded significantly compared to that of the USA. Contrarily, throughout the same timeframe, the relative level of production improved modestly, from 39 to 44 percent compared to the USA (Lee 2016). By expanding factor



accumulation and productivity growth, China needs to have a significant amount of room to overtake the USA in terms of production per worker. Although economic growth can still be steady, the convergence effect will cause it to slow down. In reality, China's economy is currently slowing down. Physical capital accumulation has decreased as a result of the decreased return on investment because it is no longer possible to maintain a historically high investment ratio of above 45 percent. Inputs of labor have decreased as a result of population aging and declining fertility, as well. China is having trouble maintaining rapid technological advancement due to its limited institutional and creative capacity (Lee 2016). A sharper growth rate will be necessary for China in the upcoming decades if the country desires to keep catching-up and reach a level of development equivalent to that of Korea, Japan, or the USA. For this reason, China should learn from Korea's early development experiences, analyzing both its achievements and failures. Understanding the function of convergence, technology, institutions, and the industrial and services sectors in fostering sustained economic growth in particular should assist China in formulating its economic strategies. The Chinese government has enacted policies that promote growth and structural change in a methodical and steady manner. While attaining tremendous economic growth, the economy has successfully transitioned from a command economy to a market economy. Furthermore, China has maintained social, political, and macroeconomic stability (Lee 2016). China currently faces severe obstacles in attempting to proceed with its reforms. The finance, labor, and land factor markets need to continue reforming. Moreover, it must continue to reform state-owned businesses and boost domestic competition, particularly in the services sector, while fending off pressure from special interest groups (Lee 2016). According to Yao (2013), the authoritarian leadership of the nation was able to implement the proper growth-enhancing policies at crucial junctures because it was not excessively influenced by any interest group. It is uncertain whether the government will be able to uphold its objectivity and outperform other regimes. Government initiatives definitely would not function as they did in the past since the economy has grown larger and more unstable (Lee 2016).

As already mentioned above, the People's Republic of China's investments were primarily concentrated in Guangdong and only targeted the export industries up until 1991. But since 1998, a growing portion of foreign direct investment (FDI) mostly in form of joint ventures have been used to establish and develop industrial capacity geared toward the domestic market (Medeiros 1998). Prior to 2008, the Chinese government gave preferential tax treatment to FDI, including lower corporate tax rates and tax bases for foreign investors. This must have been done to encourage the inward flow of capital, and while deregulation policies, fostered

competition at the provincial level to attract FDI, initiatives supporting the development of infrastructure made some provinces or cities more attractive for multinationals in China (Li 2013). However, since the 2000s, the correlation between FDI and economic development has been at the center of China's strategic program for the advancement of research and technology. China has promoted joint ventures and international investment in high-tech manufacturing rather than low-wage assembly to hasten this progress (De Paula and Jabbour 2020). As global financial and productive integration grew, the initial phases of China's economic reforms created the conditions for China to actively choose its development strategy. First off, the process of opening the Chinese economy to foreign investment has been progressive and methodical, with reforms initially being adopted in a small number of cities and provinces before being adopted nationally (De Paula and Jabbour 2020). Second, the implementation of the "contract of responsibility" between the peasant family and the State, which allowed peasants to sell their agricultural surplus, increased both their agricultural labor productivity and their consumption (Naughton 1996). Third, structural changes in China's consumption behavior occurred along with the country's rapid rate of economic expansion between 1978 and 1984, leading to an increase in domestic production of products including refrigerators, television sets, washing machines, and watches particularly in Townships and Village Enterprises (TVEs) (Singh 1993). Ultimately, this transformation helps explain the 1980s decade in China with all of its economic reforms, when consumption predominated over investment and only started to change in 1993. Particularly in the 2000s, when a significant amount of infrastructure investment started to fulfill the requirements of connecting regional markets, and especially since 2008, to implement deflationary policies (De Paula and Jabbour 2020).

Exports and their evolution since the 1990s were also key factors in the structural change that characterized China, especially with the introduction of Special Economic Zones (SEZ). This is an important factor that distinguishes the composition of demand perceived between 1952 and 1980, which was particularly prevalent in the investment-consumption combination, from another combination, established following the economic reforms, with the rising weight of exports and investment (De Paula and Jabbour 2020). Notably, the process of structural change was amplified due to both the expanding trend of economic globalization and the adjustments to Asia's domestic production structures, which profited immensely from China. This process was also a result of the country's reaction to the development challenge, which was based on the Chinese government's plan to switch from exporting labor-intensive goods to capital-

intensive goods and use FDI to increase this country's economic potential (Medeiros 2006). Since the introduction of the Special Economic Zones, China has implemented a wide range of industrial policies through tactics such as state-owned company mergers and acquisitions, import substitution procedures supported by a devalued currency, acquisitions of technological goods, and extensive incentives for the formation of global competitors (De Paula and Jabbour 2020). The integration of China's Western Development in 2000, a modernization strategy oriented to the western regions of the country, which included the expansion of infrastructure, the incentive of foreign investment, increased efforts on environmental sustainability, and promotion of education, is another example of a government proposal and public policy that helped to boost economic growth in China. These efforts were followed by regional development programs in other regions of the country (De Paula and Jabbour 2020). It is important to notice how China is still evolving in terms of economic growth, especially with the promotion of China's industrial long-term plan, "Made in China 2025," which aims to encourage and publicize smart manufacturing technology by utilizing technological devices in production with the objective of slowly substituting foreign with Chinese technology at home (De Paula and Jabbour 2020).

The growth of the Chinese economy has drawn tremendous interest from around the world since its reform and opening to the rest of the world. Though opinions on how well the Chinese economy is doing vary widely. According to official economic figures, China's economy has grown in a stunning and historically unparalleled manner (Herd and Dougherty 2005). However, other analysts are skeptical of how the Chinese economy is doing or are concerned about its future, even the risk of a disaster (Krugman 1994; Chang 2001; Gilboy 2004). Since 2010, the Chinese economy has stalled. Physical capital accumulation has decreased as a result of a lower rate of return on investment. The aging of the population and the decline in fertility have put downward pressure on labor inputs (Lee 2017). Moreover, a lack of institutional innovation and capability has slowed technical growth. China's growth deceleration appears to be unavoidable, due to the slowing speed of convergence. When China's per-worker GDP doubles, its growth is projected to slow down by 2.5 percentage points if the estimated convergence effect from the cross-country regression with the country-fixed effects holds. China's GDP growth rate per worker was 7.3% between 2010 and 2015, resulting in a 1.44-fold increase in per-worker GDP during that time (Lee 2017). In the upcoming years, the rising GDP per worker will put downward pressure on output growth. The increase in per-worker GDP would result in a reduction in the per-worker GDP growth rate to 6.0% due to the convergence

effect. Because it was not too influenced by any interest group, China's authoritarian government was able to implement the proper growth-enhancing measures during crucial periods (Yao 2013). It is uncertain whether it will be able to maintain its neutrality while outperforming other regimes. Government intervention, particularly macroeconomic management, faces increased difficulties and loses effectiveness as the economy becomes bigger and more erratic (Lee 2017). Additionally, the emergence of the middle class would probably encourage political structure development, which may motivate the public to demand that the government concentrate on social welfare measures, which are crucial but do not always support growth (Lee 2017).

In conclusion, a mix of the following can be used to characterize the Chinese development strategy: first, the presence of institutional innovation cycles that allowed for continuity in development solutions; second, a foreign exchange policy linked to a current-account surpluses policy and controlled capital flows to keep the foreign exchange rate competitive; third, a low interest-rate policy that deters capital inflows and encourages, along with rising real wages, the role of consumption as a component of demand; and lastly, the combination of a proper productive environment and institutional innovation cycles (Bresser-Pereira et al. 2020).

With this last paragraph, the analysis regarding the catching-up process of Japan, South Korea, and China is now concluded. In the next chapter, the study will focus on the economic integration of these three countries and how they have been able to collaborate and work together through the years, and how connected they are to one another, even though they lack a Free Trade Agreement that could help them improve their economic performances even more.

## **CHAPTER THREE**

### **Economic integration in East Asia, the commercial ties among China, Japan, and South Korea and their trade policy and partners**

#### 3.1 Economic integration in East Asia: how it started, its development and challenges

Economic integration is one of the most powerful tools in constructing not only the identity of a certain region or part of the world but also in helping countries reach new levels of cooperation and integration that will overall benefit economic growth and welfare in the long term. The main example of economic integration is the European Union, where its members cooperate in terms of not only economic development but also what concerns the individual's rights and well-being. On the other hand, when it comes to East Asia there is a different type of economic integration and regionalism. In fact, Pomfret (2011) defines East Asian cooperation as a form of economic regional integration that is deeply embedded in regional production systems and primarily motivated by a sequence of drastic economic crises. He (2004) claimed that East Asian regionalism involves more nationalism than regionalism and can only be maintained through intergovernmental collaboration. As a result, rather than being established on an already existing collective identity, the diverse regionalisms in contemporary East Asia have been developed as areas to cultivate regional identity. Comparing East Asian regionalism to European regionalism reveals that it is still in the initial stages of establishing mutual trust, which will eventually lead to the development of an East Asian identity and the creation of an East Asian Community (Wang 2011).

East Asia, according to De Grauwe and Zhang (2016), has undergone one of the most significant economic transitions in the past century. Especially in the last few decades, the East Asian area has been transforming into the most dynamic economic region and one of the most interconnected regions on earth. Regional and economic integration, unfortunately, is a relatively recent phenomenon in East Asia, and the institutionalization of the aforementioned cooperation is minimal (ADB 2008). As already mentioned above, regionalism in East Asia follows a very distinct design from that in Europe and other areas, primarily encompassing a

wide variety of economies. East Asia's regional integration has been fueled by market pressures, the emergence of incredibly advanced production sharing, and intra-regional network trade in the lack of a formal institutional framework (De Grauwe and Zhang 2016).

The Association of Southeast Asian Nations (ASEAN) played a fundamental role in promoting regional integration and cooperation. Since the early 1990s, trade liberalization has shifted from a non-preferential to a preferential pattern, and the East Asian region began moving towards more institutionalized preferential arrangements and regionalization (De Grauwe and Zhang 2016). The onset of the East Asian financial crisis in 1997–1998 encouraged regional cooperation and regionalism in East Asia and the growing focus on the area's similar goals and liabilities. One crucial insight these economies have tried to erase from the financial crisis is the necessity of building both a national financial and economic system that is more resistant and one that is more efficient as a means of crisis management (Kawai 2009). Contrary to what happened with European regionalism, East Asia's regional integration and collaboration have mostly been spurred by the crisis itself. To create an Asian area that is regionally integrated and globally connected to increase wealth not just in the region but also in the rest of the globe (De Grauwe and Zhang 2016). Additionally, the region's variety, development pattern, and global connections have greatly contributed to a distinctive Asian concept of regionalism (ADB 2014). East Asian countries' economic integration has morphed into a new style of international specialization as a result of their increasing economic interdependence and close cooperation. This region is known for its complicated worldwide production exchange and intra-regional network business (Athukorala 2010; De Grauwe and Zhang 2012). These connections have enabled businesses to capitalize on comparative advantage by cutting ties with complex production methods and dispersing the production components around East Asia, with China serving as the industrial hub for primarily lower-skilled labor and supply chain exports (Thorbecke and Smith 2010). The regional production chains in East Asia combine outsourcing, independent operations, and complex intra-firm commerce (Kimura and Ando 2005). Following the study made by De Grauwe and Zhang (2016), through increased intra-regional direct international trade and investment, the decentralization of production in East Asia is the main driver of regional economic integration, while rapid economic growth fosters regional economic cooperation and deeper regional integration.

Economic integration in East Asia may not have been progressing as quickly as the region's GDP growth. The issue is whether East Asia's economic interdependence has improved as a

result of its economic development (Fujita 2007). As Fujita (2007) explains, the intra-regional trade share, which measures the proportion of international trade within the region relative to the amount of trade between all of the countries in the area and the rest of the globe, is an acceptable parameter for studying this issue. In particular, East Asia's intra-trade share has been consistently rising, with the exception of the 1997 and 1998 Asian financial crises. East Asia has achieved such a significant level of economic integration, in contrast to the EU and NAFTA, primarily through market forces, with hardly any assistance from regional political structures. Japan played a key role as the region's core economy during this period of East Asia's economic development up to the early 1990s as it was the first country in the region able to experience important economic growth (Fujita 2007). According to Fujita (2007) up until the middle of the 1990s, the WTO served as the primary vehicle for promoting East Asia's regional economic integration through investment and trade. However, after the 1992 agreement to establish the ASEAN Free Trade Area (AFTA), the pursuit of bilateral FTAs involving East Asian nations accelerated significantly. The creation of concepts for an Asian structure model for further promoting regional integration in East Asia, in addition to bilateral FTAs, appeared to be significant. Fujita also (2007) highlights several circumstances that led to such a change in international politics in East Asia. First, East Asian countries recognized the necessity for the establishment of bilateral FTAs while reinforcing the WTO mechanism seeing the poor advancement in the further promotion of free trade under the WTO system. Second, East Asia recognized to be in a disadvantaged position in terms of international commerce and investment ever since the establishment of the EU, NAFTA, and MERCOSUR. Third, the creation of an institutional framework for mutual collaboration across Asia has become crucial for stabilizing and advancing the economic integration that has been mostly accomplished through the market system. Particularly after the Asian financial crisis of 1997, it became critical to develop an institutional framework for financial security across all of Asia. Fourth, several new issues that affect all of Asia have surfaced in addition to the issue of financial stability in Asia. Security, environmental problems, energy, and various types of diseases such as SARS and bird flu challenges are among them; such issues can only be successfully resolved through Asia-wide cooperative arrangements. Lastly, the necessity of Asian cooperation plans for fostering the economic growth and peace, and stability of less developed nations and regions in East Asia had also become painfully apparent (Fujita 2007).

As already mentioned, the Asian 1997-1998 financial crisis was one of the main changes regarding the transformation of the East Asian area, especially for what concerns the financial

department. It was then followed by a transition from the traditional endorsement of a multilateral trading system in numerous Asian countries, such as Japan and Korea (Nicolas 2008). And lastly, the intra-regional structure of interconnectedness gradually started increasing while being dominated by vertical integration. At first glance, these trends appear to be heading towards the same goal, highlighting how East Asia is becoming a more cohesive and independent zone (Nicolas 2008). The Asian economic crisis of 1997–1998 helped to raise recognition of the dangers of propagation and the necessity of regional policy coordination. A variety of other variables also began to support the trend toward active regional integration (Nicolas 2008). Firstly, it is undeniable that the importance of exchange rate cooperation was sparked by the effective introduction of the euro at the end of the 1990s. Secondly, the desire to create financial self-help systems at the local level and to focus on East Asia rather than the larger Asia-Pacific region had been further explained by the dissatisfaction with international financial institutions' monitoring and aid programs, such as the IMF, and more commonly by a deep discontent towards the West and the way it handled the Asian crisis (Nicolas 2008). According to some studies conducted by Nicolas (2008), these diverse causes generated a series of actions, and as a response, there appears to have been a transition from market-led to policy-led regional integration. These programs cover anything from knowledge transfer to finance. In more recent years, governments have also been working to develop regional bond markets with two goals in mind: initially, to prevent the double maturity and currency discrepancy that occurred during the crisis, and later, to protect the local economy from potential negative effects of future erratic capital flows coming from other parts of the world.

East Asia's market-driven implementation has been started by players pursuing economic benefits from greater regional economic cooperation, in contrast to Europe and North America where political will and a geographical hegemon-led organization were the driving forces (Nicolas 2008). Intensifying regional economic interconnectedness has been supported by trade and investment ties within East Asian production networks, as examined by some scholars (Arndt 2001 and Ramondo and Rodriguez-Clare 2013). Additionally, according to Park and Park (2017), the development of RTAs has been significantly influenced by the expansion of industrial connections both within and outside of member nations. There are 195 PTAs with at least one Party from the Asia-Pacific area that are in effect as of November 2021, 19 that have been signed but have not yet been ratified, and 97 that are still in negotiation (United Nations ESCAP, 2021). More precisely, the policy change could be caused by the increased intra-regional trade among East Asian economies. Greater intra-regional trade in the manufacturing industry has generally been the driving force behind the rising trade volume (Park 2020). This



might greatly increase regional market competition, lead to a reorganization of regional industrial structures for the better, bringing additional foreign direct investment (FDI) from outside the region, and ultimately magnifying the dynamic benefits of regional integration (Baldwin and Kawai, 2013).

Analyzing the report by Athukorala (2010), it is evident to realize how the emergence of East Asia in the world economy has been characterized by rapid export growth. Japan controlled the business in the area throughout the 1970s and 1980s, constituting about 60% of imports and exports. Over the past 30 years, the situation has drastically changed, with an increase in the share of developing East Asian nations and a reduction in Japan's relative importance in global commerce. The primary driver of this structural change has been the expansion of the PRC, although other nations in the area, including Korea and ASEAN members, have also seen increases in their global market shares. A noticeable movement in the export structure away from primary commodities and toward manufacturing has supported East Asia's rapid export growth (Athukorala 2010). This structural change has been significantly influenced by industrialization, technology, and transportation equipment, particularly electrical goods and information and communication technology (ICT) products. The continued trend of global manufacturing sharing and East Asian nations' deepening integration into the global supply chain have been the main drivers of export competitiveness in these market segments (Athukorala 2010).

The Asia-Pacific Economic Cooperation (APEC), the first-ever regional multilateral conference, was established in 1989 to take advantage of the East Asian economies' explosive expansion and the regionalization dynamic, which has increased since the mid-1980s. Three events in the late 1980s fueled the development of regionalism in the Asia-Pacific: 1) the rise of American unilateralism; 2) the expansion of regionalism in Europe and North America; and 3) the Uruguay Round of GATT negotiations' sluggish pace (Ravenhill 2001). Australia and Japan worked together to create APEC, which was motivated by a common feeling of crisis among Western Pacific nations. Both nations made extra attempts to persuade ASEAN members that were hesitant to join the Asia-Pacific arrangement (Komori 2006). The Japanese government in particular offered ASEAN countries institutional models so that they could be further convinced of the benefits of joining such a project (Terada 2001). Furthermore, the Japanese government purposefully worked in the shadows while allowing Australia to take the official lead, perfectly aware that Japan's explicit move would trigger ASEAN's skepticism. In conclusion, Japan played a significant role in the progress of economic regional cooperation in

East Asia up until the early 1990s. By establishing industrial networks in the area, Japanese multilateral businesses took the lead in regionalization (Komori 2006). Prior to the emergency, at least three factors caused ASEAN nations to become interested in forging deeper ties with nations in Northeast Asia. Firstly, the conclusion of the Cold War and the ensuing structural changes in the outside world presented a new beginning for the establishment of ASEAN (Komori 2006). For ASEAN to have a voice in the world economy by the middle of the 1990s, insiders in ASEAN policy were beginning to realize that ASEAN had no alternative but to deepen its ties with East Asian great powers (Ba 2003). Moreover, ever since the United States Government started prioritizing liberal reforms as part of its agenda, including the legalization of APEC, several ASEAN states have grown exceedingly concerned about APEC's development in a path they previously opposed (Komori 2006). Ultimately, and most importantly, according to Komori (2006), ASEAN members' significant doubts about China's rise led ASEAN to look for a mechanism to contain China within a regional framework. ASEAN leaders tried to adopt a balance-of-power strategy between Japan and China as a counterbalance against one another inside a regional body in response to the expanding Chinese competition.

Economic integration has been an extremely important process for the development and growth of the East Asian region. Moreover, it is clear to see how fundamental the roles of Japan and the PRC were in the improvement and stabilization of East Asian economic integration. It is not surprising then to see how these two countries, in different historical moments, took the lead of the region towards greater economic growth and development. In the next paragraph, the analysis will focus on how China, Japan, and South Korea were able to establish their trade policy, how they created their first free trade agreements, and which are their most important and significant trade partners.

### 3.2 China, Japan, and South Korea's trade policies and trade partners

China, Japan, and South Korea have been developing and establishing new commercial ties and Free Trade Agreements with countries all around the world, from third-world countries such as the Southeast Asian ones to the more advanced European and American countries. One of the main propellants for these three countries' new cooperative trade policy was the 1997 Asian financial crisis.

For instance, the Asian policymakers had been forewarned by the financial crisis of 1997 to build a more collaborative structure among the states in the area to avert potential economic instability. The three administrations of China, Japan, and South Korea especially saw the need to strengthen institutional ties to work together more effectively on economic challenges. The Association of Southeast Asian Nations (ASEAN) members' economic strength was very much in their concern given the size of their trade and investment with ASEAN. The ASEAN+3 leaders met in Chiang Mai, Thailand, in May 2000 and declared they would establish the Chiang Mai Initiative, a system of bilateral currency exchange deals (Chiang 2013). Nevertheless, the China-Japan-South Korea alliance centered on ASEAN+3 did not make much progress in the years that followed. The main cause was the conflict between China and Japan about the development of ASEAN in the future. From China's standpoint, greater ties with ASEAN might not only lessen East Asian nations' concerns about the "China menace," but also threaten Japan's hegemony in Southeast Asia (Choi 2008). Japan, however, could not afford to allow China to seize unchallenged control of the region. While Japan supported a larger organization that would include India, New Zealand, and Australia and a reduction in China's power, China supported the original East Asian Vision Group (EAVG). China, Japan, and South Korea are collaborating to address the Asian Financial Crisis because of the significant economic issues that were pressuring them (Chiang 2013). Through trade negotiations, China, Japan, and South Korea have all sought to further their strategic interests. Neither of them, however, has ever joined forces to fight one another. Conversely, the level of mistrust among the three nations is so great that they have all sought alliances with other foreign powers, such as ASEAN (Chiang 2013). Japan and China have both attempted to stop the other from legitimizing economic ties with ASEAN to take a leading role throughout the region. To offset China's growing influence in the region because of its ASEAN ties, South Korea was also enticed to the Southeast Asia

FTA (Lee 2008). As a result, all three nations have a separate Free Trade Agreement with ASEAN, although China, Japan, and South Korea still do not have a trilateral FTA. Ironically, none of them is willing to take the initiative to provide numerous public commodities that will foster regional integration while simultaneously avoiding the other from turning into the region's leader (Choi 2008).

The three biggest economies in East Asia—China, Japan, and South Korea—remain export-driven. To maintain economic expansion, they are dedicated to increasing their proportion of international trade and their involvement in worldwide supply chains and industrial networks. To liberalize trade, FTAs are particularly important for these three nations. These three nations have been the most involved in the development of the Asian FTAs during the past few decades. The three nations are both the most important and involved parties in the creation of the Asian FTAs. As of January 2012, China, the biggest market in Asia, has signed 17 free trade agreements (Cui 2013). China also negotiated Free Trade Agreements (FTAs) with its most significant trading stakeholders, the ASEAN and some ASEAN member states, in addition to the "Closer Economic Partnership Arrangement" with Hong Kong and Macau (signed in 2004) and the "Economic Cooperation Framework Agreement" with Taiwan (2010). China also concluded non-Asian Free Trade Agreements with Chile (2006), New Zealand (2008), Peru (2010), and Costa Rica (2011). Japan tends to give ASEAN member states more consideration. Eight of Japan's sixteen Free Trade Agreements (FTAs) or Economic Partnership Agreements (EPAs) are with ASEAN and ASEAN member nations. Furthermore, Japan implemented EPAs with Mexico (2005), Chile (2007), Switzerland (2009), and India (2011) (Cui 2013). Despite South Korea being significantly behind at first in the conclusion of FTAs, with only nine FTAs established in 2013, as of 2021, South Korea has signed 18 free trade agreements with countries all over the world. The world's two largest markets, the US, and the EU have active FTAs with South Korea. As the two largest importers, both the US and the EU are significant commercial partners for Asian exporters like Japan and China. According to Urata (2004), active FTA policies have been undertaken by China, Japan, and South Korea. This is partially due to the fact that the three nations have used FTAs as a tactical instrument to improve their connections with their commercial partners, such as ASEAN members. If any two of these three nations entered into a bilateral FTA, the third nation would be compelled to do so in order to not be excluded from the regional market (Cui 2013).

East Asian nations, however, were compelled to enact unequal Regional Trade Agreements (RTA) because of growing regional interconnectedness through investments and trade as well as the necessity to sustain and revive the regional economy in the wake of the East Asian financial crisis of the late 1990s. Ever since they have taken a proactive role in free-trade discussions with nations both inside and outside the area. RTAs that include East Asian nations have several things in common. First of all, East Asia has just recently begun to try to lower or erase trade obstacles among members. It was once known that the majority of East Asian nations, particularly in Northeast Asia, preferred non-discrimination unilateral or multilateral liberal measures over selective regional liberalization (Park 2020). East Asian countries diplomatic posture moved from favoring a multilateral policy to preferring a regional strategy after appreciating the value of regional economic integration in the wake of the East Asian financial crisis and the failure of the Doha Round of multilateral WTO negotiations. The majority of RTAs between ASEAN+6 nations were created shortly after the financial crisis. Secondly, the majority of RTAs in East Asia have been bilateral agreements, this is consistent with the global trend of choosing simpler, reduced talks. Just a third of the intra-ASEAN+6 RTAs are multilateral agreements. Thirdly, a complex web of intersecting RTAs covers the area since most East Asian RTAs have several ramifications. Fourth, even while far higher economic benefits are anticipated from regional trade blocs like the projected China-Japan-Korea trilateral RTA, ASEAN+3 RTA, Regional Comprehensive Economic Partnership (RCEP), (ASEAN+6), and Free Trade Area of the Asia-Pacific (FTAAP), there has been limited progress in the extension of turning bilateral RTAs into mega-multilateral RTAs (Park 2020).

Now that the RCEP has been signed in 2020 and entered into force in January 2022, there might be a significant improvement in transforming all of the bilateral East Asian RTAs into multilateral trade areas that can, later on, establish more trade deals with other trade areas and countries all over the world, following the global perspective that some of the countries would like to pursue. In the following paragraphs, the discussion will revolve around the three countries, their trade policy, agreements, and trade partners.

### 3.2.1 China's trade policy, agreements, and partners

The ASEAN Free Trade Area (AFTA), which was established in 1992, is the principal regional trade pact in East Asia. Since then, particularly following the 1997–1998 economic meltdown, East Asian nations have shown a strong interest in forming FTAs, with bilateral and plurilateral FTAs increasing (ADB 2014). Japan is a bilateral participant in over half of these FTAs, but the most notable and extensive one is the China-ASEAN Free Trade Area (CAFTA), which was approved in 2002. By 2010, China and the six original ASEAN member states—Singapore, Thailand, Malaysia, the Philippines, Indonesia, and Brunei—would construct a free trade zone. Later, Cambodia, Laos, Vietnam, and Myanmar, would be included in the zone by 2015 (De Grauwe and Zhang 2016). Following the China-ASEAN Free Trade Area's (CAFTA) introduction in 2010, the average rate of tariffs on Chinese exports to ASEAN decreased from 12.8% to 0.6%, while the average rate of tariffs on ASEAN exports to China decreased from 9.8% to 0.1%. The preexisting regional production linkages and economic interdependence in the region were also influenced by CAFTA, in addition to the commercial links between China and ASEAN. Additionally, against the historical backdrop of the ancient Silk Road, China's recent New Silk Road program seeks to promote stronger transcontinental development, cross-border investment, and trade and strengthen regional integration and cooperation among nations (De Grauwe and Zhang 2016). The adoption of this plan is anticipated to change trade relations, investment, and infrastructural facilities patterns and provide prospects for the new integration. However, the ascent of China as a regional and international economic force has sparked worries about the nature and ramifications of China's dominance. The dynamic effects of China's development both locally and worldwide, the stability of China's economic growth, and the future course of regional integration in East Asia have all aroused apprehensions. These worries also cover the issue of how to keep the East Asian region's economy stable and dynamic (De Grauwe and Zhang 2016). China has already finalized several trade deals, the CAFTA being only one of them. With Macao and Hong Kong, so-called Closer Economic Partnership Agreements were established in October and June of 2003, respectively. The most recent Chinese measures target partners outside the area, further clouding the picture. Particularly, in late 2003 and early 2004, China negotiated two comprehensive introductory framework agreements with Australia and New Zealand (Nicolas 2008). The variety of the agreements

involving China, both in terms of form and content, is a key aspect, which lessens the likelihood—or at the very least, makes it problematic—of the formation of an Asian trading block based on these agreements (Antkiewicz and Whalley 2004). The CAFTA supposedly caused a shock across Asia, and in especially Japan, because of its size. As a consequence, Japan began seriously evaluating other FTAs within the East Asian region, reversing its previous attitude to trade discussions (Nicolas 2008).

In the post-Cold War era, particularly during the crisis (the 1997–1998 economic crashes), China has actively participated in regional multilateral and bilateral agreements as a growing power, garnering interest both inside and outside of East Asia. Since the signing of the China-ASEAN Free Trade Agreement, various interpretations of China's regional goals have emerged. Launched by China in 2001, the China-ASEAN FTA sparked the creation of the "10+1" and raised worries among the neighboring nations. Since that time, China has expanded its FTA strategy by concluding bilateral FTAs with an increasing number of nations (Zhu 2009). During this time, China also actively participated in the Chiang Mai strategy on financial collaboration and expressed its preference for the "10+3", including Japan and South Korea, as the primary channel for East Asian coexistence (Wang 2011). The concept of regionalism in China is symbolized as economic regionalism. At first, the primary goal of China's diplomatic ties with foreign countries was typically economic cooperation. Furthermore, the major goal of China's international economic cooperation is always economic benefits, or more specifically, retaining high productivity growth. As the case study demonstrates, China aims to expand or nurture stability and change through the establishment of FTAs or other agreements in order to, on the one hand, rebalance its export routes and, on the other, utilize more resources available, both of which are essential to its economic growth in the post-crisis world. Thirdly, it is thought that economic cooperation, particularly by increasing economic interconnectedness, is an efficient approach to meeting geopolitical or security obstacles (Wang 2011). China decided to begin with bilateral agreements and has simultaneously fostered regional collaboration because regional agreements like the East Asian Free Trade Agreement (EAFTA) are still far from being negotiated. In fact, an FTA policy had been developing since 2007 to aid in achieving economic goals. The authorities of China were fully cognizant that ASEAN, a sizable economy with 500 million potential customers and a wealth of natural assets, might be vital to China's long-term success. In absolute terms, bilateral commerce between China and ASEAN increased by roughly 28% annually between 2001 and 2008, exceeding some predictions and increasing more rapidly than China's overall commerce (Wang 2011). With the start of the 2008 recession,

the significance of CAFTA has grown due to the fact that, despite its economic achievement in terms of fostering trade and fostering mutual understanding, China's biggest trade partners are still the EU, Japan, and the USA. Chinese policymakers started to see that improving bilateral economic ties would have a beneficial impact on Sino-ASEAN relations much beyond the direct economic benefits to both parties. They think that by promoting more ASEAN exports to China under the FTA, bilateral trade and the trade imbalance that advantages ASEAN would progress to the point where ASEAN's reliance on the Chinese market may give China greater negotiating power (Wang 2011). According to Wang (2011), Chinese leaders also expect that the successful collaboration would foster a cordial environment in which both sides may discuss some delicate subjects, such as the South China Sea and bilateral border claims.

According to Komori (2006), the idea that China progressively imports numerous intermediate products, primarily from other Asian nations, arranges them into finished products, and sells them to extra-regional marketplaces in Europe and North America can be partially attributed to the country's spectacular expansion in trade volume. A new triangle trade pattern and global division of labor between China, other Asian nations, and the US has developed as a result. However, by the early 1990s, Chinese policy experts had begun to realize the tremendous economic cost of China's exclusion from regional economic groups (Moore and Yang 1999). As a response, by the middle of the 1990s, China had participated in several regional organizations, such as Asia-Pacific Economic Cooperation (APEC), the ASEAN Regional Forum (ARF), and the Council for Security Cooperation in Asia Pacific (CSCAP), which in part changed Chinese perspectives on regional strategies (Komori 2006). Chinese leaders started to see the potential advantages of regional organizations for China's objectives in the second half of the 1990s. Beijing did not support the idea of making APT (ASEAN+3) an annual tradition in 1997, unlike Tokyo, but the next year, China began to show more active involvement in the APT initiative. China's change of perspective toward East Asian regionalism was prompted by a number of occasions and occurrences in the 1990s (Shambaugh 2005). As a result of the shifting surrounding environment, including the aftereffects of the post-Tianamen repression and the US-Japan coalition of 1996–1997, China initially moved toward APT and economic diplomacy in Asia. However, over the course of the decades, China grew increasingly directly engaged in influencing regional projects as a means of advancing its political goals (Komori 2006).



### 3.2.2 Japan's trade policy, agreements, and partners

Regardless of the common belief that East Asian economies were converging around Japan, this vision of an East Asian economy based on Japan was not materialized in the 1990s (McIntyre and Naughton 2004). A sequence of occurrences in the 1990s, including the burst of Japanese economic dominance in 1990–1991 and the accompanying economic recession, the Asian economic crisis, and the growth of China, significantly reduced Japan's leading position in the regional economy. As a result, Japan is no more a desirable economic system. The Japanese presence in the region decreased over the 1990s, as seen by a decrease in regional commerce, foreign direct investment, bank loans, and funding (Haggard 2004). As Inoguchi (2002) argues, Japan has interacted with Asia from the 1960s through the 1990s through official aid, the sale of Japanese-produced goods, and Japanese direct investment in the area. While China's external economic interactions take the shape of enticing international capital and companies into China, Japan's economic ties with the rest of Asia emerged in the form of spreading Japan's activities abroad (Inoguchi 2002). It is interesting to note that China's present economic progress is heavily reliant on foreign corporations for technology and investment. This stands in stark contrast to the instance of Japan, where international firms and technology were the primary drivers of that country's economic success (Komori 2006).

The Japanese reluctance to participate in the inaugural APT summit was lessened by the easing of U.S. antagonism toward East Asian regional integration. Nonetheless, Japan was inspired to take a keen interest in the APT for at least another two main reasons. Firstly, due to the large number of Japanese businesses operating in the region, the Asian economic crisis showed that Japan had a significant industrial commitment to the prosperity of the Southeast Asian nations (Komori 2006). In addition, as was already mentioned, the crisis diminished Japan's standing in the area. The Japanese government increased its efforts to integrate the region as a result of this situation in an attempt to prevent the loss of Japanese power in East Asia. Second, Japan's political worries over the expanding Chinese dominance in the East Asian area, are driving its participation in the APT process more and more. Japan clearly could not afford to enable China to dominate the regional structure in East Asia. Therefore, Japan and ASEAN have a shared desire to safeguard themselves against China's hegemonic position in the dynamics of East

Asian regional integration. In summary, both political and economic concerns drove Japan's increasing importance in the APT (Komori 2006).

The Japanese government started to focus less on multilateralism and more on regionalism and bilateralism when it comes to trade diplomacy in the late 1990s. Tokyo approved the Japan-Singapore Economic Partnership Agreement in January 2002 in accordance with this change. Then, in November 2002, December 2003, and January 2004, the administration formally began talks with Mexico, South Korea, and Malaysia on FTAs. Even while FTA talks were actively working, the Japanese government as a whole failed to establish a distinct vision for FTA policy. The government created the Basic Policy Towards Further Promotion of Economic Partnership Agreements (EPAs) in December 2004 to address this issue (Yoshimatsu 2012). The strategy presented EPAs as a vehicle to support the multilateral trade system focused on the WTO and recognized the importance of EPAs in the growth of Japan's global affairs, the achievement of its economic goals, and the advancement of economic changes. The fundamental policy was supported by guidelines for selecting which nations and areas to engage with.

The Japanese government progressively established a more defined FTA policy in 2004. It established a monetary goal for pushing FTAs and widened the list of potential FTA partners, such as the US and the EU. From 2007, though, the FTA's development stalled and fell behind the global average for the FTA creation rate (Yoshimatsu 2012). According to Yoshimatsu (2012), since 2007, there was a lack of governmental stability, which negatively affected Japan's FTA strategy. Beyond these issues with cooperation between leaders and bureaucrats, Japan's trading strategy has also been plagued by poor collaboration across the government agencies involved. The establishment of an executive agency with the power to independently supervise policy enforcement was met with indifference by the regulators. Additionally, the bureaucrats were very interested in maintaining control over the FTA policy. The FTA program was a successful way to boost the resources and staff of the ministers as it became more crucial to Japan's general economic foreign relations. The policy's stance on FTAs was unclear, simply explaining that the country would have boosted great investment cooperation and encouraged domestic institutional reforms in an inclusive approach by evaluating tariff and other trade measures as well as non-tariff assessments (Yoshimatsu 2012). This strategy also aimed to ensure coexistence with domestic industry. The main concerns of the Japanese people regarding external economic strategy are therefore focused on food and energy security. The lack of food self-sufficiency and the widespread public anxiety about food security have given anti-FTA

organizations the justification they need to maintain their stance. Executive leaders had to convince the public of the value of FTAs in the context of both global economic developments and Japan's overall foreign policy (Yoshimatsu 2012). Following Yoshimatsu's perspective (2012), since the majority of national leaders in the early 2000s held the position for only a year or less, they were unable to engage the people on controversial topics like free trade agreements. The only politician who was able to alter popular opinion on FTAs was Junichiro Koizumi. Unfortunately, Koizumi showed little interest in foreign economic plans and made no overt attempts to convince the public of the benefits of FTAs. The administration's public relations efforts were surprisingly lax due to the executive officials' lack of interest in FTAs. As a result, Japan has made the promotion of FTAs a priority in its foreign policy. Nonetheless, Japanese political figures haven't worked particularly hard to convince the populace of the value of FTAs in Japan's broader foreign policy.

Singapore and Japan concluded the Japan-Singapore Economic Agreement for a New Age Partnership (JSEPA) in January 2002. This accord signaled a change from Japan's conventional stance, which concentrated only on the GATT and its descendant, the WTO. The Japanese administration's initial response was extremely dubious, according to Munakata (2001), when the Singaporean government began to consider the idea of an FTA with Japan in late October 1999. Tokyo, nonetheless, started to worry more and more about the expansion of economic cooperation elsewhere in the world. Japanese policymakers eventually concluded that Japan should also investigate other policy alternatives that would enhance the WTO regardless of their initial reluctance. Munakata (2001) highlights how Singapore was thought to be a particularly suited partner for Japan's first FTA, one that may assist Japan to conquer its persistent reservations in negotiating FTAs and achieve a significant breakthrough in trade policy. Singapore was a sought-after partner for Japan in particular as a result of Singapore's lack of a sizeable agriculture or fishing sector (Munakata 2001).

On 17 September 2004, Japan and Mexico agreed to a free trade agreement (FTA), which became effective on 1 April 2005. This marks the second Free Trade Agreement that Japan has officially negotiated with another nation. Because Mexico is not a significant trading partner of Japan, particularly on the import side, this instance is challenging to understand from the typical perspective. Mexico's significance to Japan as a supplier of imported products increased marginally in 2004, the year the deal was signed; it was placed 32nd and contributed 0.48 percent of Japan's total imports. In reality, Mexico is more significant to Japan as a global

market for Japanese goods than any other country, coming in at number 21 in both 1998 and 2004 for what concerns Japanese exports (Wong 2005). Mexico purchased 1.09 percent of Japan's total exports in 1998 and 0.94 percent in 2004. The latter aspect is particularly crucial and can be used to illuminate Japan's motivation for negotiating an FTA with Mexico. Although the United States is Japan's major trading partner, many Japanese businesses are fiercely competing with American counterparts for businesses in third countries like Mexico because the United States and Mexico (as well as Canada) have an FTA (the North American Free Trade Agreement; NAFTA). As a result, these U.S. businesses have the benefit of selling their services to Mexico's industry tax-free, while goods from Japanese businesses must pay government taxes. Thus, Japan had a purpose to create a comparable FTA with Mexico in order to eliminate the economic losses brought on by the lack of an FTA (Wong 2005).

Japanese businesspeople encouraged the government to seek Trans-Pacific Partnership (TPP) to counteract the adverse effects of the South Korea-US Free Trade Agreement on the US economy (The Daily Yomiuri 2010).

Japan's involvement in the TPP is welcomed by Washington as it will increase the FTA's significance. With Japan's involvement, the TPP's percentage of global GDP would rise to 40%, boosting US export industries by \$60 billion (Gordon 2012). Excluding Japan, the TPP would be a much smaller trade agreement made up primarily of developing nations (Auslin 2012). Furthermore, Japan's economy and technology are more developed than those of other emerging economies in the TPP, and it is possible that this will make it more inclined to stress patent and copyright protection. Beyond the possible benefits of Japan joining the TPP, the US auto sector is deeply concerned about the potential effects on exports of American vehicles. Despite being the third-largest automobile market in the world, Japan continues to have the most restrictive auto markets among advanced countries. Despite the fact that Japan has no import taxes on US cars, there are still a variety of structural impediments in supply and standards that have led to a de facto ban on US imports for US car manufacturers (Inside the U.S. Trade 2013). Some US automakers are concerned that the recent monetary stimulus measures of Japan, notably the devaluation of its currency, may harm the exports of their vehicles on the global market (Inside the U.S. Trade 2013). Other industries, such as agriculture, regard the TPP as a chance to increase their exposure to the Japanese market, in contrast to the car industry (Cooper 2013).

### 3.2.3 South Korea's trade policy, agreements, and partners

Since the FTA Strategy was established in 2003, South Korea has actively participated in FTA negotiations with more than 50 nations. South Korea has pursued FTAs far more aggressively than other local economies like Taiwan, Hong Kong, and Japan. With respect to industrialized nations, South Korea has already established FTAs with Chile (2004), Singapore (2006), ASEAN (2007), the EU (2011), and the US (2012). The primary goal of negotiating FTAs, according to South Korea's Minister for Trade, are reaching into international markets and fostering technology and foreign investment. Other major concerns include dealing with the region's expanding FTA trend, the WTO's waning influence, and starting reform by widening its domestic economy (Chiang 2013). In contrast, South Korea has aspired to become the economic hub of Northeast Asia. The FTAs with China and Japan are viewed as a requirement for becoming a regional commercial hub because they are Korea's two most significant trading partners (Cheong 2008).

Even though there weren't many FTAs signed, South Korea did reach FTAs with significant trading partners, which contributed to the high participation of FTAs in its general commerce. Executive leaders in Korea had specific ideas for using FTA marketing to connect the expansion of the local industry to the foreign market. They also aimed to improve administrative organizations to advance the FTA plan and persuade the public that FTAs are essential for maintaining the export-oriented Korean economy. The South Korean manufacturing industries were inactive in their pursuit of preferential trade agreements since they were reliant on markets in many different countries around the world (Yoshimatsu 2012). In the late 1990s, South Korea shifted its focus on trade liberalization from multilateralism to regionalism and bilateralism, according to Yoshimatsu's studies (2012), and they chose a developing nation as the first FTA partner: Chile. Despite the policy change, they did not get involved in the FTA formation until the middle of the 2000s. This was mostly due to the authorities' concerns over the harmful effects of FTAs on delicate domestic industries that would be damaged by market liberalization.

In related industrial fields like technology and cars, Japan and South Korea are globally competitive. Disparities in tariff application would result in substantial disadvantages for Japanese companies because the EU and the US, South Korea's primary FTA partners, supply

essential markets for the Japanese industrial sectors. In reality, Japanese government leaders and company executives expressed serious worries in response to South Korea's vigorous FTA stance (Japan Business Federation 2011). Exports are especially important to Korea's competitive industry sectors like technology and cars. An aggressive FTA policy was pursued by the Korean government due to its high reliance on the global market and the need to increase exports (Fukawaga 2009). Various levels of market connectivity undoubtedly serve as the foundation for Korean politicians' motivation to support FTAs. This reality, unfortunately, cannot explain why South Korea started to participate actively in FTAs since 2005 because Korea's trade-to-GDP ratio exceeded 50% in 1997 and remained high thereafter. Producers and their groups in both nations have urged their administrations to increase efforts to create free trade agreements since they stand to gain from market liberalization (Katada and Solis 2010; Park and Koo 2008; Rhyu 2011; Yoshimatsu 2005). Although there are few distinctions in how corporate organizations promote market liberalization under FTAs, there are several disparities in how they fight against it. South Korea's agricultural concerns have had a far smaller role in the formulation of policies. Significant personal choices held by successive Korean leaders contributed to the development of political structures capable of formulating an aggressive FTA policy and influencing public perceptions in favor of such a program. A pro-FTA agenda would be both more necessary and simpler to adopt for Korea due to systemic factors like its significant reliance on trade and national factors like its federal structure and disorganized agriculture groups. Consequently, Korea's considerably more aggressive FTA policy was mostly driven by individual-level initiatives (Yoshimatsu 2012). The Korean government has consistently emphasized multilateralism as a strategy for advancing trade liberalization. With the election of the reformist Kim Dae-Jung Administration in February 1998, the position on economic relations was altered. The Office of the Minister for Trade (OMT) was formed inside the Ministry of Foreign Affairs and Trade as a result of institutional revisions in 1998. The Inter-Ministerial Trade Policy Coordination Committee officially declared in November 1998 that South Korea would begin free trade agreement negotiations with Chile while also undertaking proposals with other potential FTA partners such as Thailand, New Zealand, Japan, and the US (Lee and Moon 2009). The road map stressed the significance of FTAs in achieving Korea's objective of evolving into a free trading state (Yoshimatsu 2012). From Yoshimatsu's point of view (2012), the road map divided potential FTA partners into three categories: simple FTA partners like Chile, the European Free Trade Association (EFTA), Japan, and Singapore; intermediate FTA partners like ASEAN, Canada, China, and Mexico; and protracted FTA partners like the European Union, India, and, United States (Lee and Moon 2009). For South

Korea, the FTA with the EU was extremely important in two ways. Firstly, the FTA was anticipated to provide South Korea with significant economic gains. The second-biggest trading partner and main producer of foreign direct investment for Korea were the EU. Secondly, the FTA would assist Seoul in developing into an FTA hub in East Asia, linking North America, East Asia, and Europe.

South Korea was the first nation in East Asia to sign free trade agreements with the US and the EU. From the Kim Administration to the Roh and Lee Leadership, the Korean government advanced its FTA agenda. The government has made significant progress since the FTA talks with Japan were put on hold by increasing the number of FTA partners. The signing of FTAs with its two main commercial partners, the EU and the United States, was extremely meaningful. The Korean government can take immediate action in promoting FTA thanks to the presidential political system that is in place. The presidential system in Korea could not, by itself, clearly describe why Korea's FTA policy evolved independently from Japan's (Yoshimatsu 2012). The more comprehensive FTA policy of Korea is a direct result of the presidents of Korea having strong political inclinations. President Roh, especially, preferred pushing FTAs as the primary means of preserving the productivity of the Korean industry on the global market.

The deregulation of the agricultural market, which would have a detrimental effect on food self-sufficiency, is often more acceptable among Koreans than among Japanese people. Such an impression is based on the hard lessons learned from the Asian Financial Crisis of 1997–1998 that the standstill of exports would result in a dire economic situation. The Korean people undoubtedly understood that external connections pose a risk to their society and economy and that securing export markets is essential to attaining the steady growth of their economy (Yoshimatsu 2012). Despite the aforementioned overall trend, the public's opinion of FTAs was not always consistent and secure. This is due to the fact that the mindset was reliant on how FTAs affected the national economy and various industrial areas, as well as how partner states were perceived, which was frequently impacted by media. The policy governing resistance by organized social groups once again demonstrated the Korean politician's resolve in fostering an environment conducive to FTAs. In South Korea, there hasn't been much involvement for agricultural organizations in decision-making. Alternatively, there are strong, combative unions and civil society organizations that may organize rallies against governmental policy. In South Korea, stronger authorities in charge of FTAs served as an expression of executive officials'

inclinations for FTA development. Roh increased the office's power, particularly by supporting staff members involved in FTA negotiations. The OMT changed the established political structures, advancing FTAs to the point that other organizations objected to its expansive and independent function (Yoshimatsu 2012).

Following Park's research (2020), other causes that propelled the development of an FTA policy in South Korea include Korea's desire to leverage its strategic edge to develop into an East Asian corporate hub, its shift toward a more globalized economic system to rejuvenate its outward-focused economic growth plan through investment and trade liberalization.

After seeing how many free trade agreements these three countries were able to establish in the span of a couple of decades, it is truly astonishing to realize that a trilateral FTA lacks between the three countries. In the next paragraph, the analysis will focus on the economic integration and the commercial ties that specifically refer to China, Japan, and South Korea, highlighting once again how they are the core of East Asia and its most important pillars, allowing the region to be able to compete with other integrated economies such as the European Union and the NAFTA area. As will be shown in the following paragraph, these countries are already experiencing a strong economic interconnectedness that is truly beneficial to their economies and would only increase if these three nations were able to implement the infamous trilateral free trade agreement that has now been discussed for more than a decade.



### 3.3 China, Japan, and South Korea's commercial ties and economic integration

As already mentioned in the previous paragraphs, China and Japan became the leaders in economic growth and integration in the East Asian region. Japan's relevancy especially peaked in the 1970s and 1980s as the country was the first one to experience a significant catching-up process that allowed it to become a pillar of the Asian continent. In the last four decades, it was China that slowly assumed the role of a leader, with its outstanding economic expansion. Additionally, South Korea also began its economic growth, and it is now one of the most prominent economies in East Asia. This paragraph will focus on the deep integration and commercial ties that unite these three countries and it will also question why, despite the strong integration links that connect China, Japan, and South Korea, a Free Trade Agreement is still not a concrete option for these countries, despite the decades-long negotiations that have been surrounding the such topic.

The two countries that particularly characterized the lead of East Asian nations and contributed the most to the development of the interconnectedness among them are Japan and China, but their leading role happened at two different moments in the world's history. Japan's power and influence over the East Asian region's economy grew during the late 1980s. Several Japanese export-manufacturing firms relocated their manufacturing facilities first to South Korea and Taiwan and then to Southeast Asia to preserve their global competitiveness as a result of the significant strengthening of the Japanese yen after the Plaza Accord in 1985. As a result, Japanese FDI increased in the ASEAN nations, rising from \$855 million in 1986 to \$7.4 billion in 1989 (Gallant and Stubbs 2000). Intra-regional trade increased because of the sharp increase in FDI made by Japanese companies abroad, which also helped to build an interconnected regional economy with Japan as its main engine (Komori 2006). The triangle trade system, which involved Asian nations importing capital goods, materials, and elements from Japan, processing and assembling intermediate products, and exporting items to Western markets, particularly the United States, was made possible by Japan's rising economic integration of Asia and the establishment of manufacturing chains by Japanese businesses. Midway through the 1980s, Japanese innovation and money were crucial in aiding Asian economies in their recovery from the global recession (Komori 2006). But after the Asian financial crisis, Japan has begun losing power and influence over the East Asian region and it was at this moment that China took the lead and proposed itself as the main driver of the East Asian economy in the region.

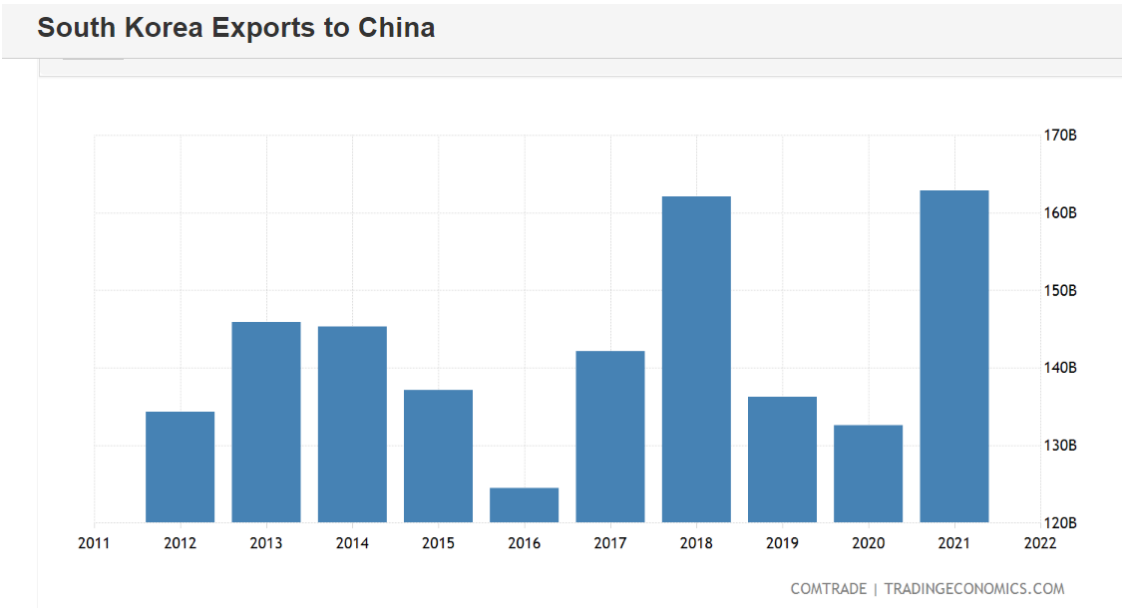
The region's trade arrangements have been profoundly changed by China's rise as a manufacturing center, which has important ramifications for Northeast Asia. China progressively acts as a strong stimulant for Northeast Asian economic cooperation as well as an engine for regional economic progress. China's position as a key participant in the regional production chains has led to a significant rise in the interconnectedness of China and the Northeast Asian nations of Japan and South Korea. China has been the major impetus for Northeast Asian economic interdependence in recent decades, giving Japan and South Korea the highest market share gains (Chan and Kuo 2005). The sudden increase in intra-regional commerce in Northeast Asia, which is mostly propelled by market forces, bodes well for future economic cooperation among the three countries in question. Relationships between China, Japan, and Korea have been gradually developing ever since the 1970s in the postwar period. Recent commercial relations between China and Japan and Korea have been primarily driven by the growth and development of the Chinese economy due to China's push toward economic modernization (Chan and Kuo 2005).

The economies of China, Japan, and South Korea have become very interdependent. Their industries are expanding, and following the Asian financial crisis in 1997, they are developing ever-closer economic ties. These three nations are geographically close neighbors, with South Korea in the center. The three countries are at various levels of growth and are following numerous development routes. The most advanced economy is that of Japan, but South Korea's economy, which began to flourish in the 1960s after some significant economic changes, is swiftly catching up. When China's economy started opening itself to the rest of the world at the end of the 1970s, it experienced phenomenal development (Wong 2005). These three nations have one thing in common: they all have an economy characterized by an international outlook and rely on trade with other nations to prosper. All of them are export-focused, with significant portions of their domestic production transferring to other economies. South Korea is moving in the same direction as Japan, which is a significant capital exporter. Being the greatest receiver of foreign direct investment among all emerging nations, China primarily benefits from foreign capital. Thus, it is not a surprise that these three markets are closely linked; they engage in extensive trade with one another, and Japan and South Korea are transferring funds to China, where many of their companies have established subsidiary companies or partnerships (Wong 2005).

It is therefore clear that these three economies have similar characteristics but how do they work and what do they produce? Japan first produces intermediate goods, some of which are exported. A sizable share of the exported intermediate goods is either imported as finished products or as intermediated items with better values back into Japan. Finally, Japan creates final commodities that are partially exported utilizing intermediate products that are partially made in Japan and partially imported. Japan is an example of an ordinary country with trade enhancement since many intermediary items are exchanged between Japan and other nations, especially in the East Asian region. South Korea and Japan have comparable trade structures, with the exception that Korea has larger trade percentages in industrial goods than Japan and lower trade portions in consumer items (Fujita 2007). A considerable amount of the imported intermediate goods is also exported again after being given greater value. China imports primarily intermediate products transforming them into final goods and then exports these items. A highly integrated production system has been established between Japan, China, and ASEAN members, with intermediate items traveling back and forth while the finished products, which are assembled in China and ASEAN countries, are shipped to the USA and the rest of the world. China especially has grown to be East Asia's most important export market, leading to the greatest bilateral trade deficit now present between China and the USA (Fujita 2007). Generally, overall, China receives larger capital- and technology-intensive commodities from both Japan and South Korea for the assembly process. China also sends to the other two nations industrial commodities that need a lot of labor. Their total trade has increased as a result of the well-established division of labor. Consequently, all three nations have been significant trading partners (Chiang 2013).

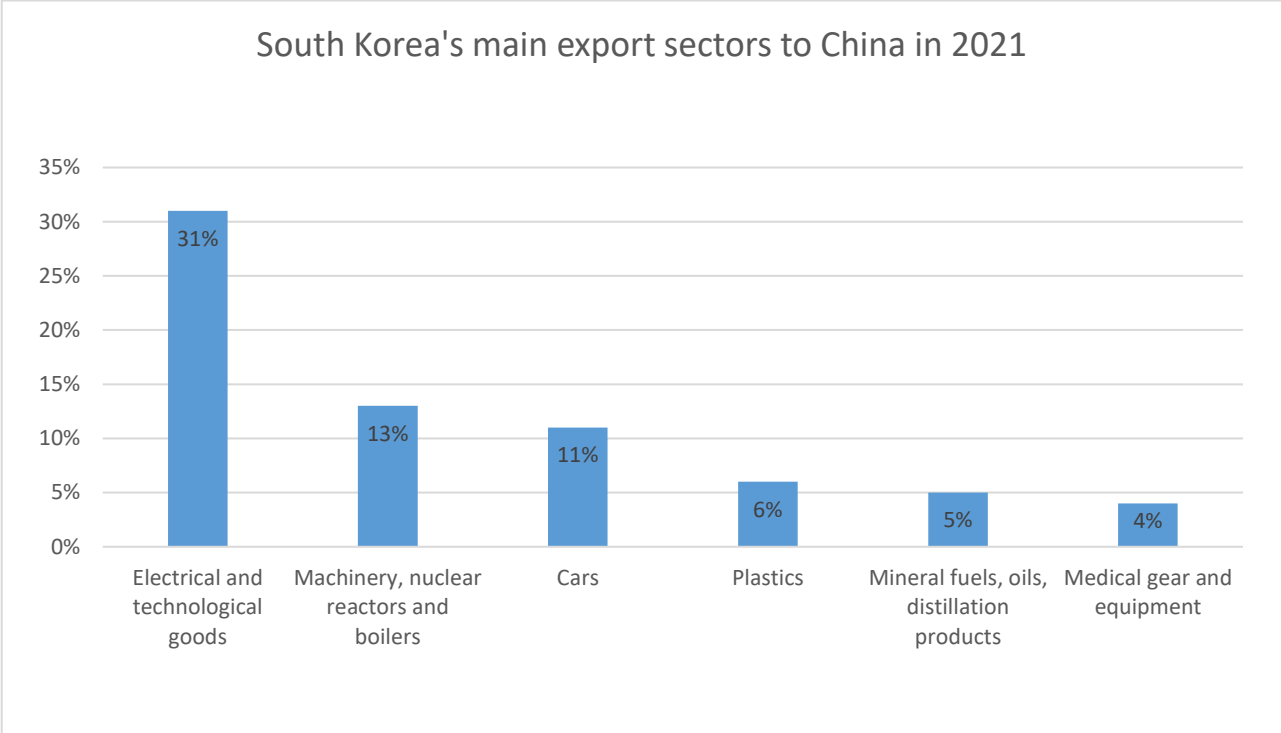
Thanks to its export-oriented policies, South Korea was able to achieve incredible economic growth. South Korea's most important export partner is China with 27% of total exports in 2021, followed by the United States (15%), Vietnam (9.8%), Hong Kong (6.2%), and Japan (5.1%). China is also South Korea's largest import source (24% of Korea's total imports), ahead of the USA (13%) and Japan (10%) in 2021 (United Nations Comtrade, 2021). The country exports mainly electrical and technological goods (31% of total exports in 2021), followed by machinery, nuclear reactors, boilers (13%), cars (11%), plastics (6.2%), mineral fuels, oils, distillation products (5%) and medical gear and equipment (3.9%) (United Nations Comtrade, 2021). These goods were South Korea's principal exports to China, but they were also Japan's and Taiwan's, particularly when it came to electrical machinery, which had export figures that were comparable to South Korea's. In particular, for vehicles, electronics, and electrical devices,

South Korea is concerned about losing more market share to Japanese products (Uechi and Kouuchi 2012). South Korea imports more from China than Japan does; the main items shipped from China are finished products like smartphones and computers whereas the main items coming from Japan are capital goods and essential components like technology, steel and iron, and electrical equipment (Chiang 2013). The disparity in their levels of industrialization is frequently cited as the reason for South Korea's heavy reliance on Japanese imports of commodities. In addition to selling intermediate goods to China, South Korea sees a large number of opportunities for other services and products to benefit from China's growing purchasing power. In contrast, South Korea's ability to increase exports is limited by Japan's elderly population. In fact, South Korea's younger demographic makes it more profitable for Japanese businesses to turn a profit here than in China (Yamazawa 2003). Similarly, to South Korea, China has been increasingly significant to Japan's overall commerce over the past ten years. From 4% in 1992 to 22% in 2021, China accounted for a significant portion of Japan's total exports, followed by the USA (18.5%) and South Korea (7%). Japan exported more machinery, electrical machinery, automobiles, optical, and medical equipment to China than any other country, making up 21%, 20%, 9%, and 8% of its overall exports, respectively. China is the largest source of completed items that Japan imports, including computers, cellphones, TVs, textiles, and other domestic appliances (Chiang 2013). Japan plays a crucial role as a technology provider to both South Korea and China in the triangular economic ties.



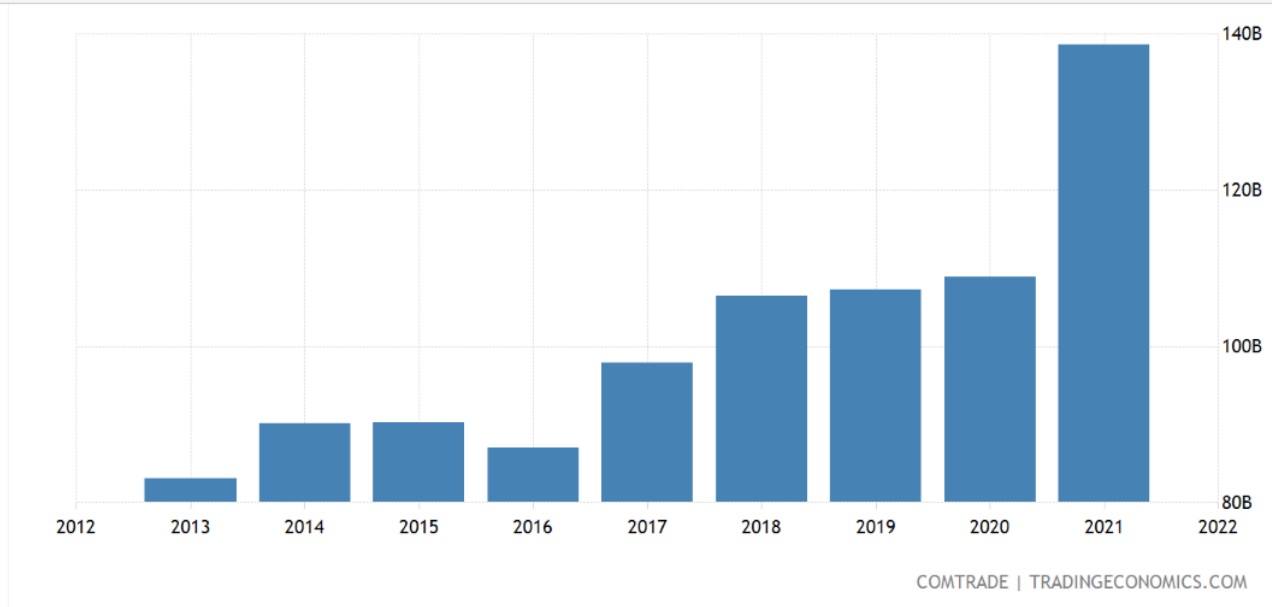
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As seen from the graph above, created through the United Nations Comtrade's data (2022), it is clear to see how in the span of ten years, South Korean exports to China significantly increased. In 2012, exports from South Korea to China were barely above 130 billion US\$ dollars, meanwhile, in 2021 they reached 162.92 billion US\$ dollars.



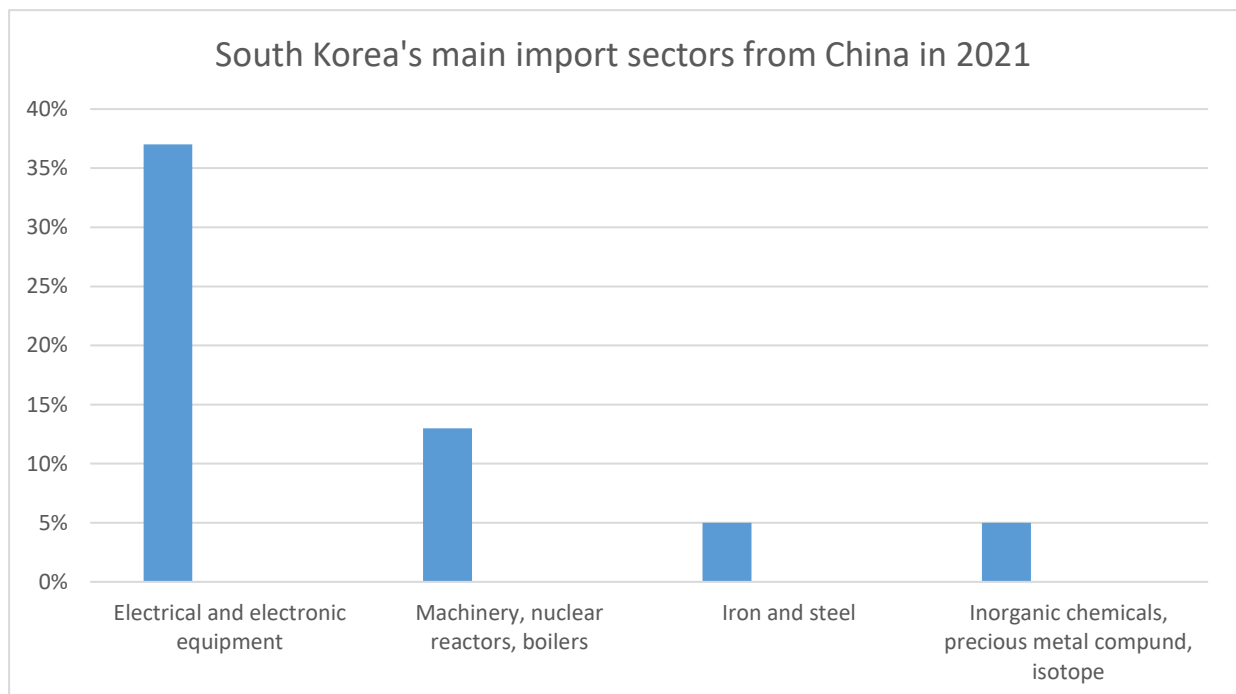
South Korea's main export sectors to China were: first, electrical and technological goods leading with 67.94 billion US\$ dollars accounting for 31% of the total export trade; secondly, the machinery, nuclear reactors, and boilers sectors with 17.52 billion of US dollars; in third position there is the car sectors with 15 billion US\$ dollars and lastly the plastics, mineral fuels, and medical gear sectors, with respectively 13.45 billion US\$ dollars, 11.07 billion US\$ dollars and 7.47 billion US\$ dollars (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

## South Korea Imports from China



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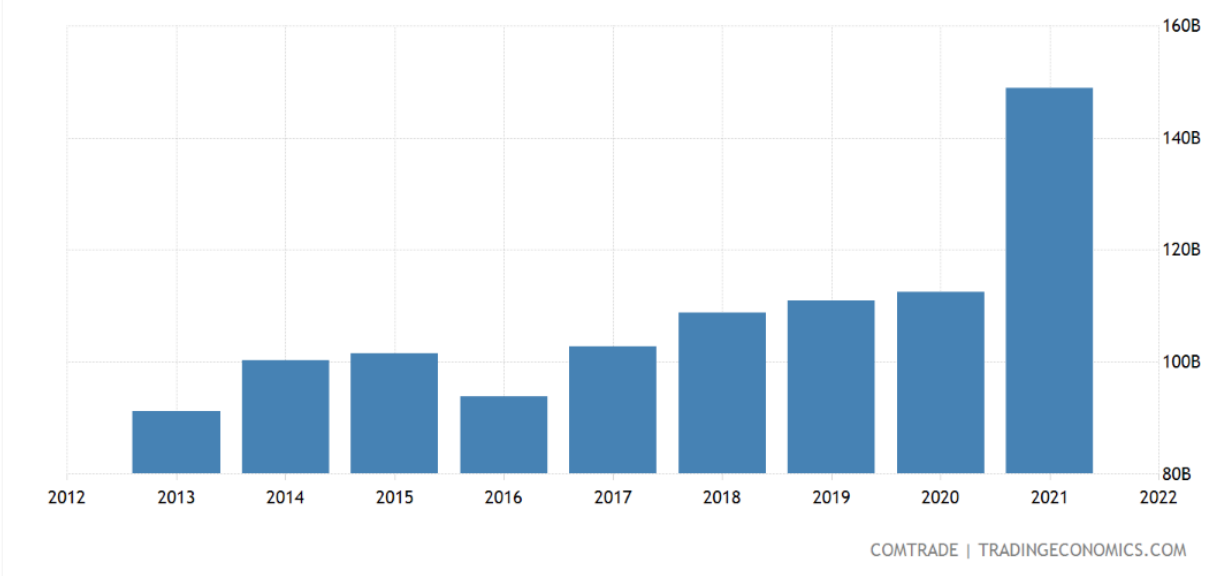
In 2021, South Korea registered its highest import quote from China with US\$ 138.2 billion. A significant data, especially if compared to its value in 2013, which was just a little over US\$ 80 billion (United Nations Comtrade 2022).



South Korea's main import sectors from China in 2021 were: electrical and electronic equipment with US\$ 51.04 billion; machinery, nuclear reactors, and boilers with US\$ 18.37 billion, iron and steel with US\$ 6.93 billion and

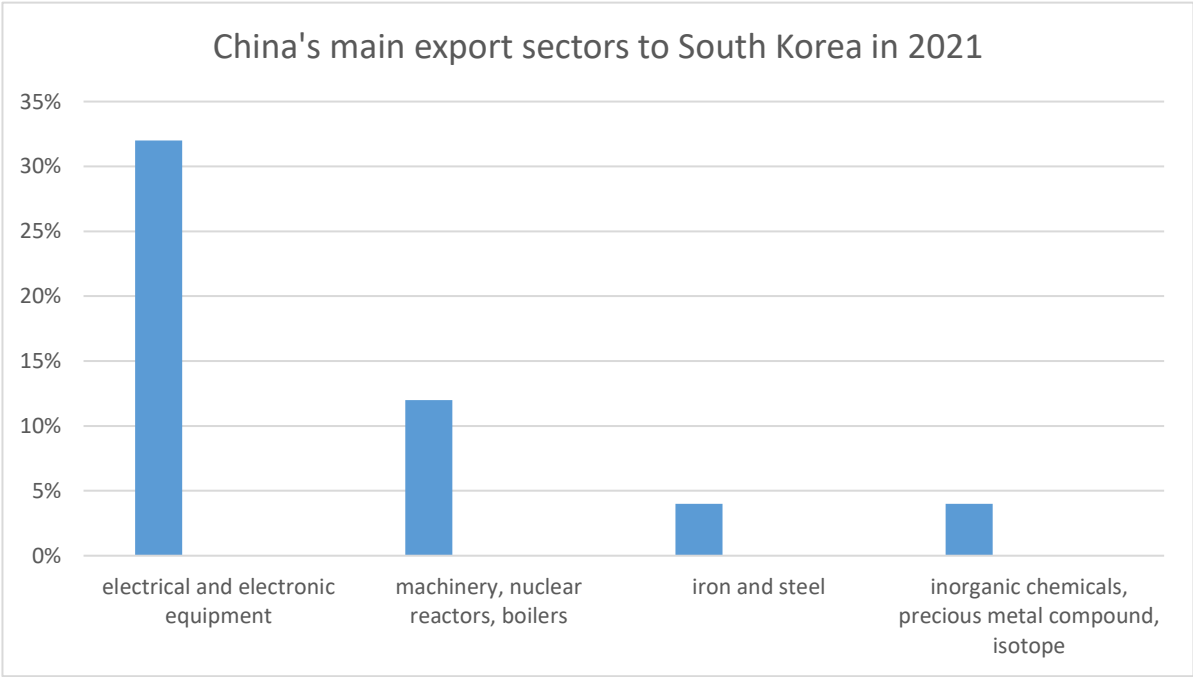
inorganic chemicals, precious metal compounds, and isotope with US\$ 6.25 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

### China Exports to South Korea

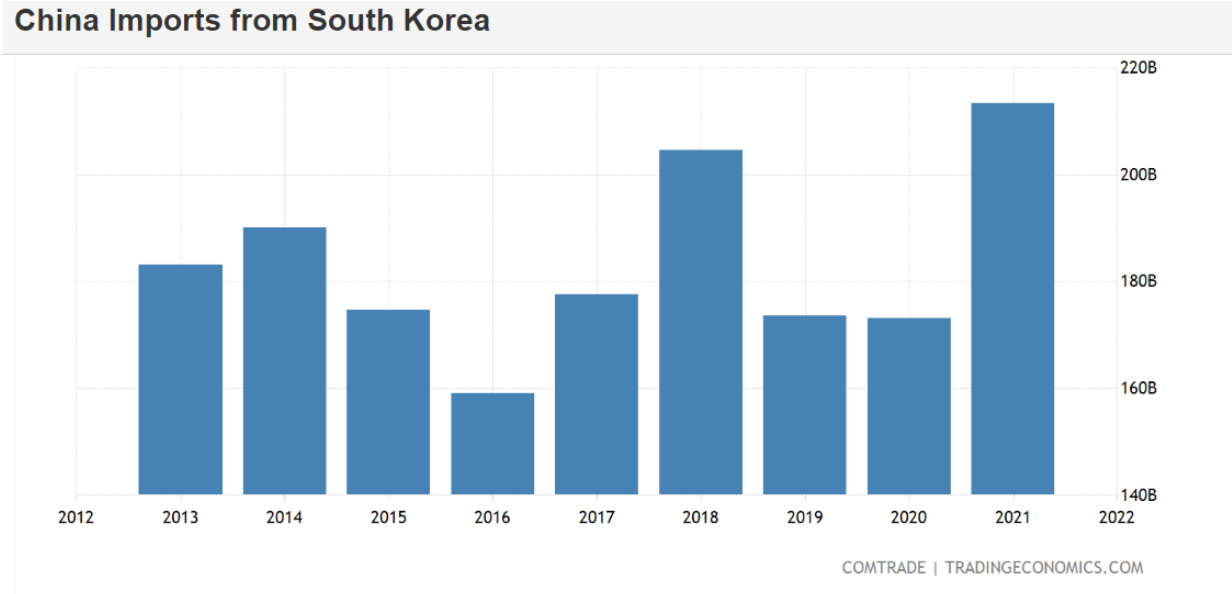


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In 2021, China’s exports to South Korea increased and reached US\$ 148.85 billion, a huge improvement considering that ten years ago these exports barely reached US\$ 80 billion (United Nations Comtrade 2022).



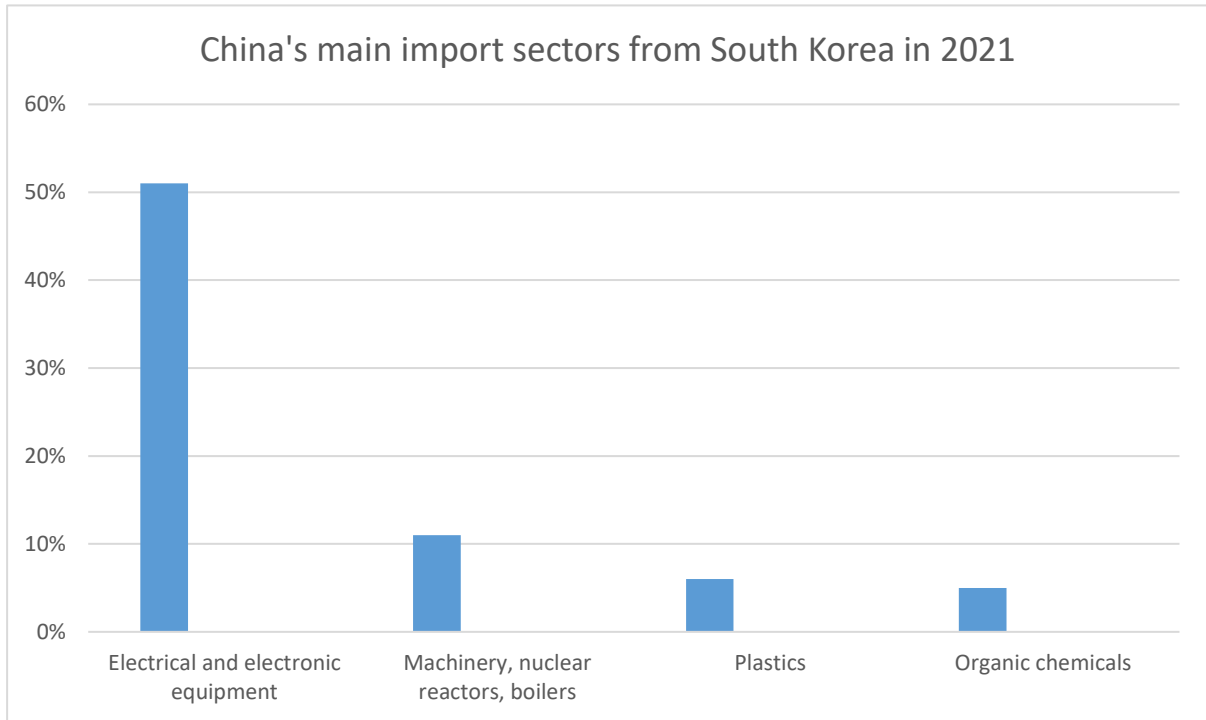
In 2021, China’s main export sectors to South Korea were: electrical and electronic equipment with US\$ 47.56 billion; machinery, nuclear reactors, and boilers with US\$ 17.19 billion; iron and steel with US\$ 6.82 billion and inorganic chemicals, precious metal compounds, and isotope with US\$ 6.21 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.



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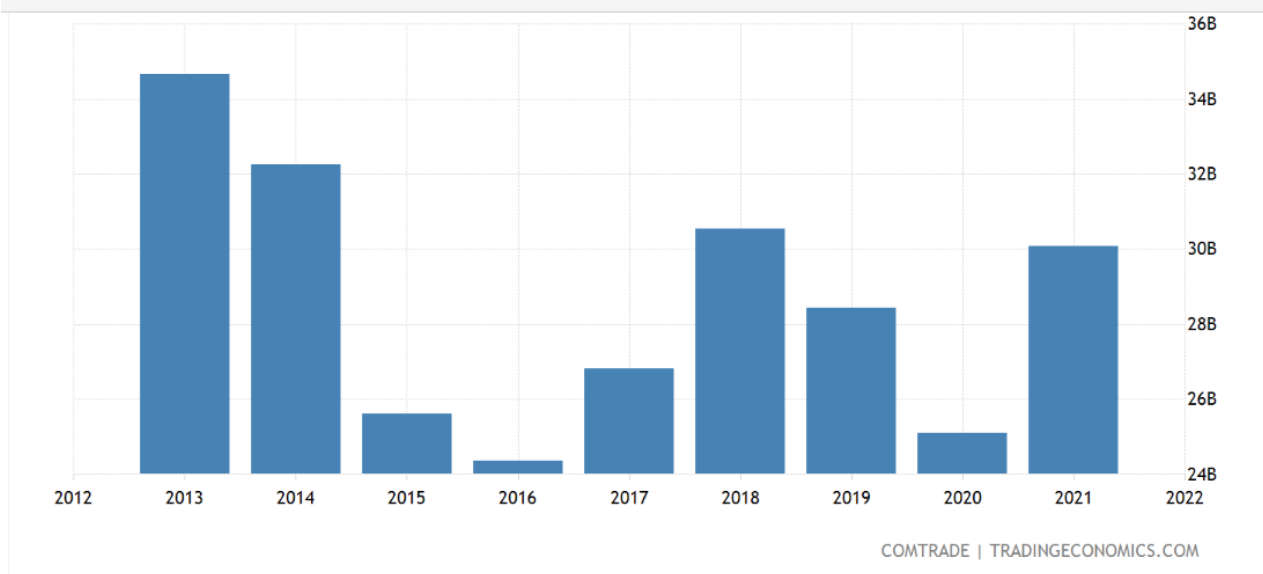
China’s imports from South Korea increased once again in 2021 after the stall in 2020 due to the pandemic, reaching US\$ 213.45 billion, compared to less than US\$ 180 billion from the previous year (United Nations Comtrade 2022).





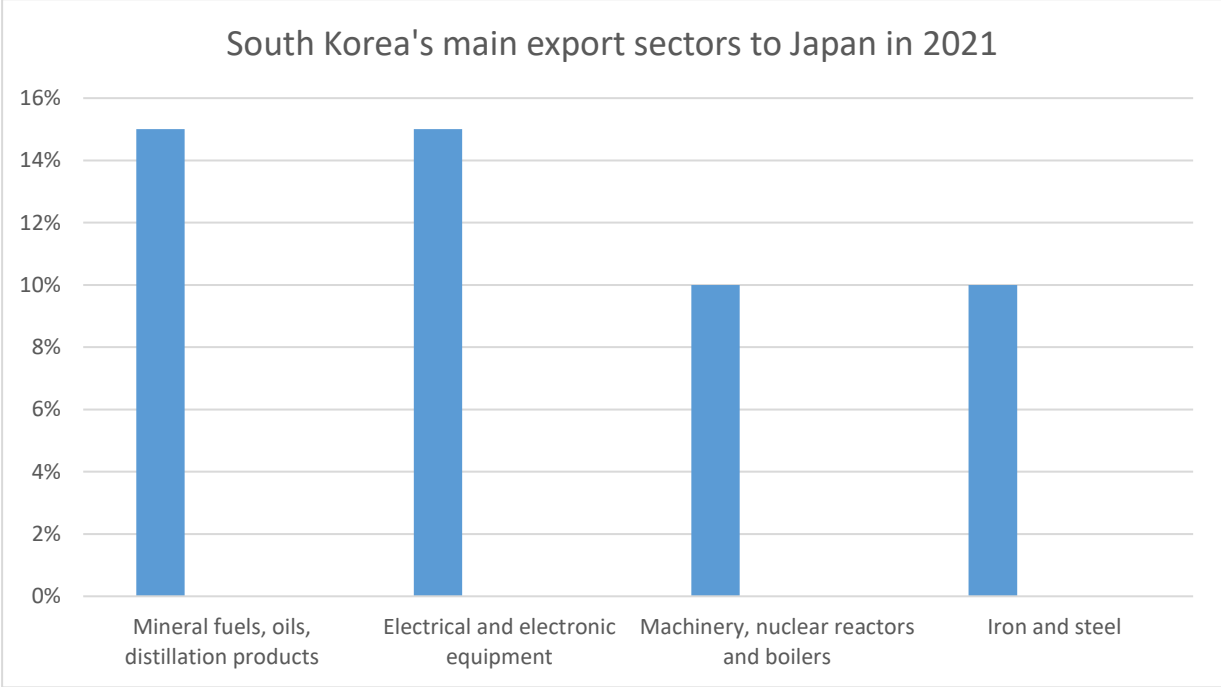
In 2021, China's main import sectors from South Korea were: electrical and electronic equipment with US\$ 109.49 billion; machinery, nuclear reactors, and boilers with US\$ 23.79 billion; plastics with US\$ 13.96 billion and organic chemicals with US\$ 11.66 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

### South Korea Exports to Japan

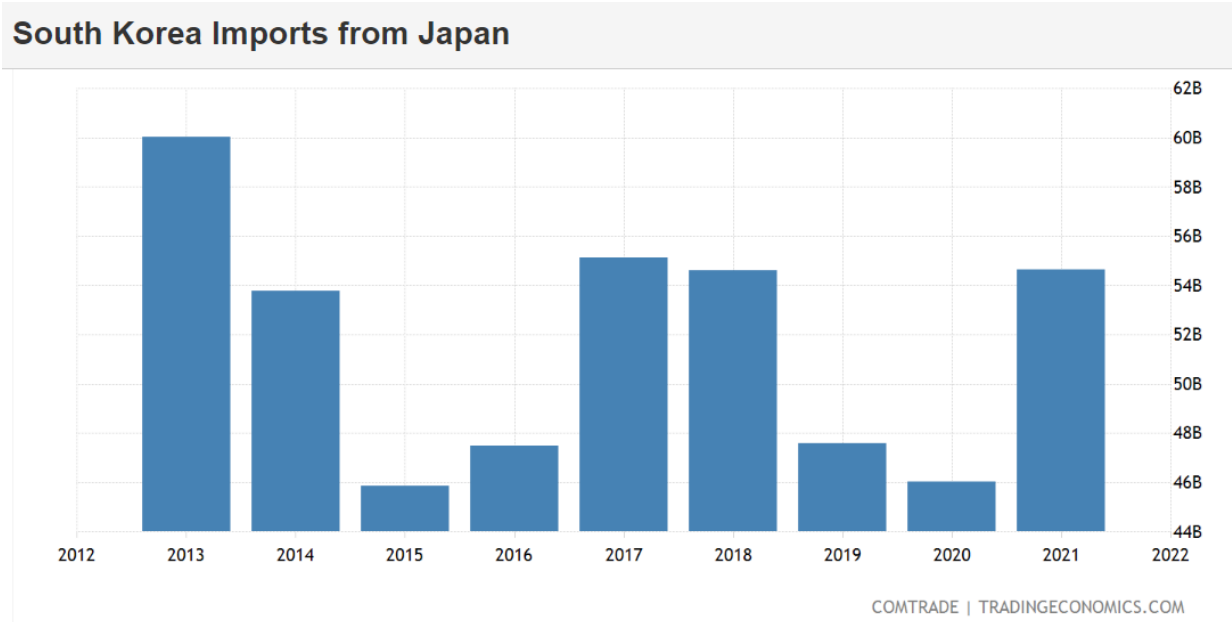


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South Korean exports to Japan increased in 2021 reaching US\$ 30 billion. A significant increase compared to 2020 when they did not even reach US\$ 26 billion (United Nations Comtrade 2022).

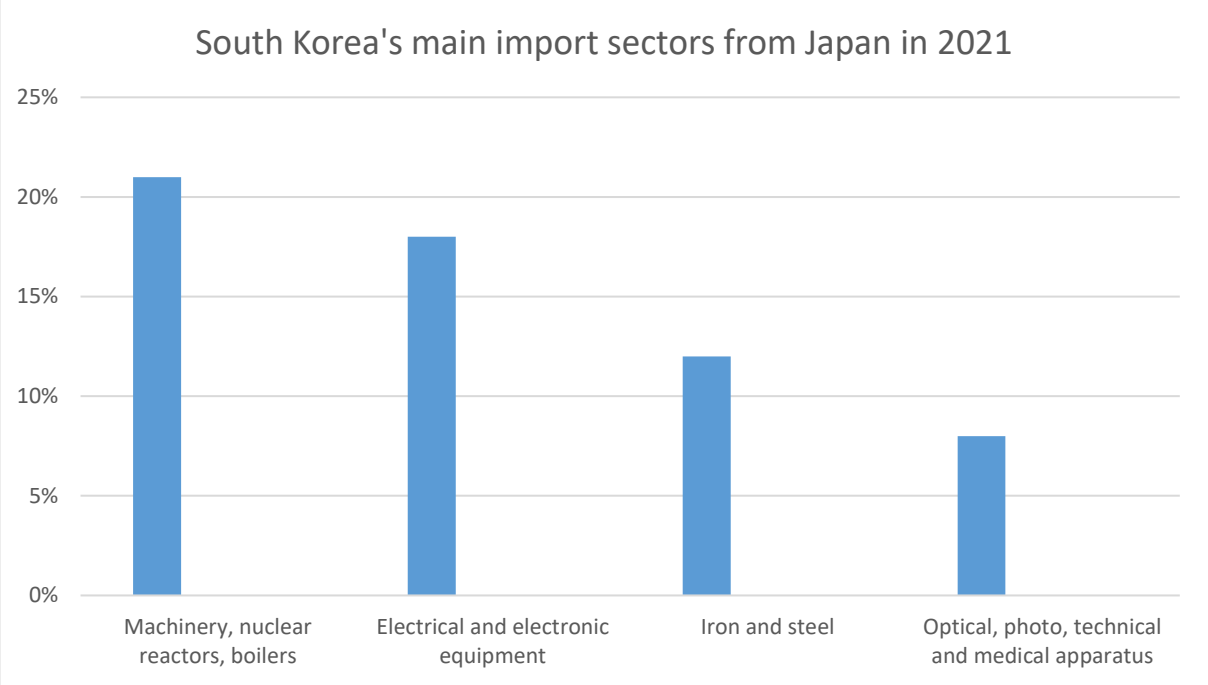


In 2021, South Korea’s main export sectors to Japan were: mineral fuels, oils, and distillation products with US\$ 4.81 billion; electrical and electronic equipment with US\$ 4.04 billion; machinery, nuclear reactors, and boilers with US\$ 3.15 billion; and iron and steel with US\$ 3.06 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

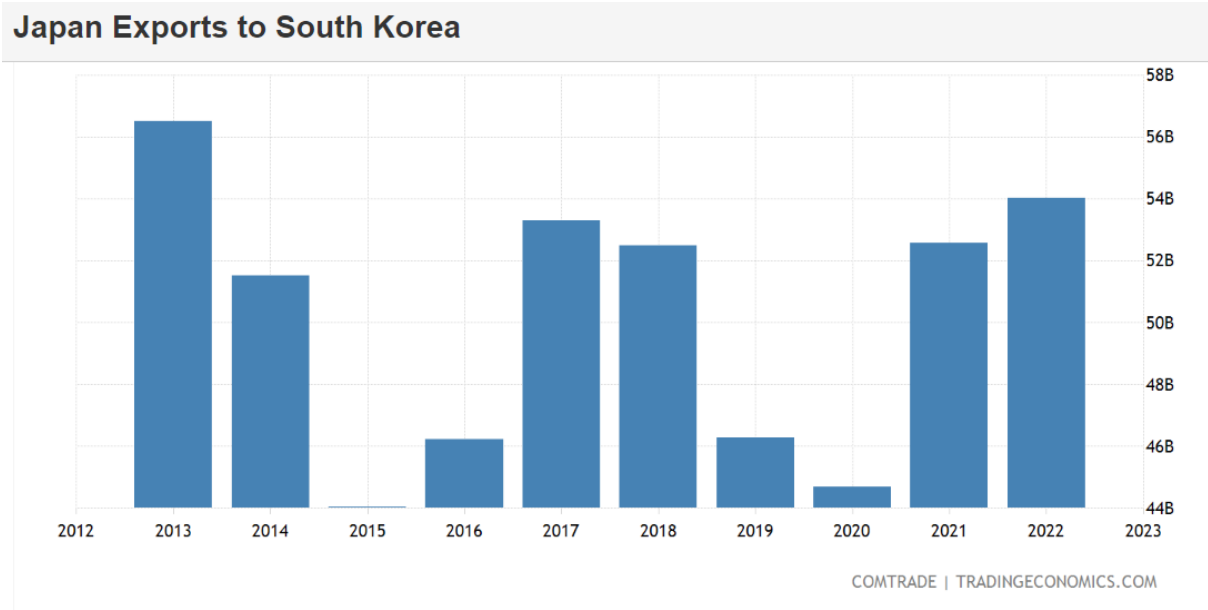


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In 2021 South Korea’s imports from Japan increased significantly compared to 2020. In 2021, South Korean imports from Japan reached US\$ 54.64 billion against the US\$ 46 billion from the previous year. However, this data still does not compare to the one from 2013 when imports from Japan reached US\$ 60 billion (United Nations Comtrade 2022).

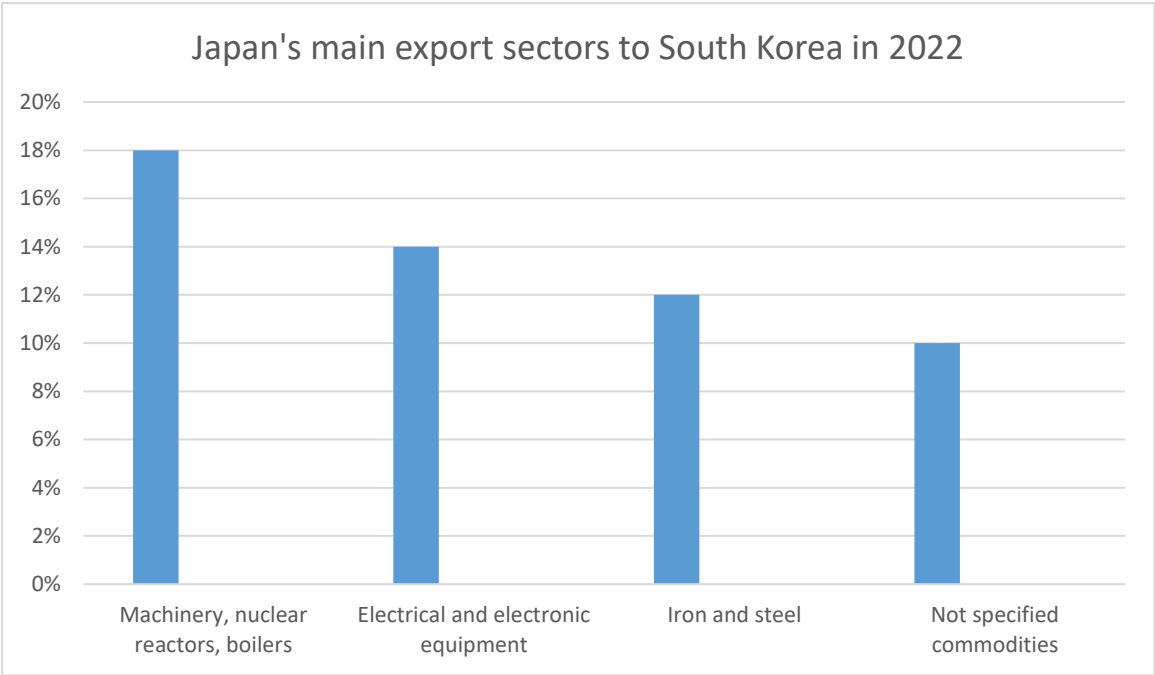


South Korea’s main import sectors from Japan, in 2021, were: machinery, nuclear reactors, and boilers with US\$ 11.06 billion; electrical and electronic equipment with US\$ 9.65 billion; iron and steel with US\$ 6.07 billion; and optical, photo, technical, and medical apparatus with US\$ 4.16 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

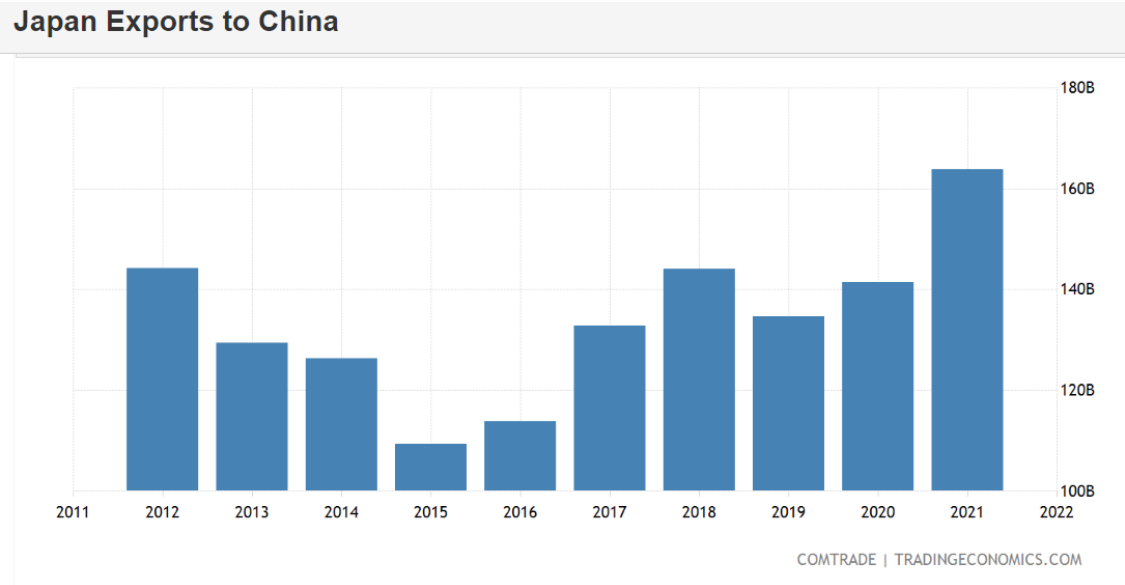


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Japan's exports to South Korea were US\$ 54.04 billion in 2022, according to the United Nations COMTRADE database on international trade (United Nations Comtrade 2022).

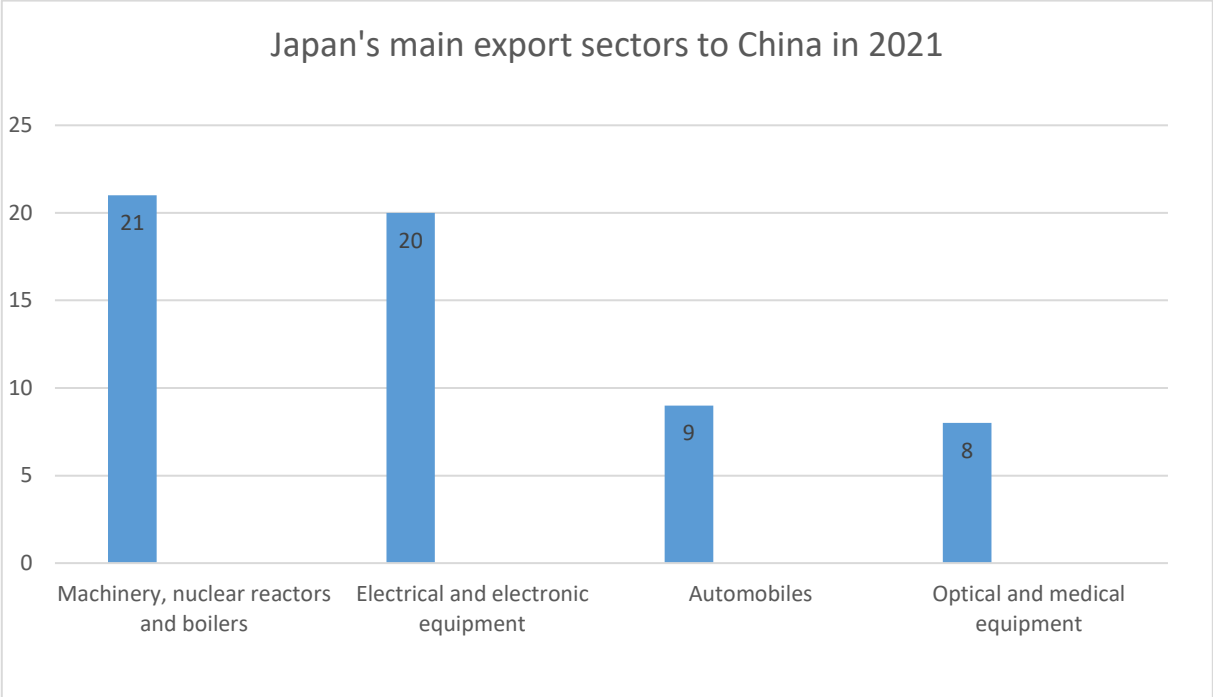


Japan's main export sectors to South Korea, in 2022, were: machinery, nuclear reactors, and boilers with US\$ 9.78 billion; electrical and electronic equipment with US\$ 7.83 billion; iron and steel with US\$ 6.31 billion; and not specified commodities with US\$ 5.18 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

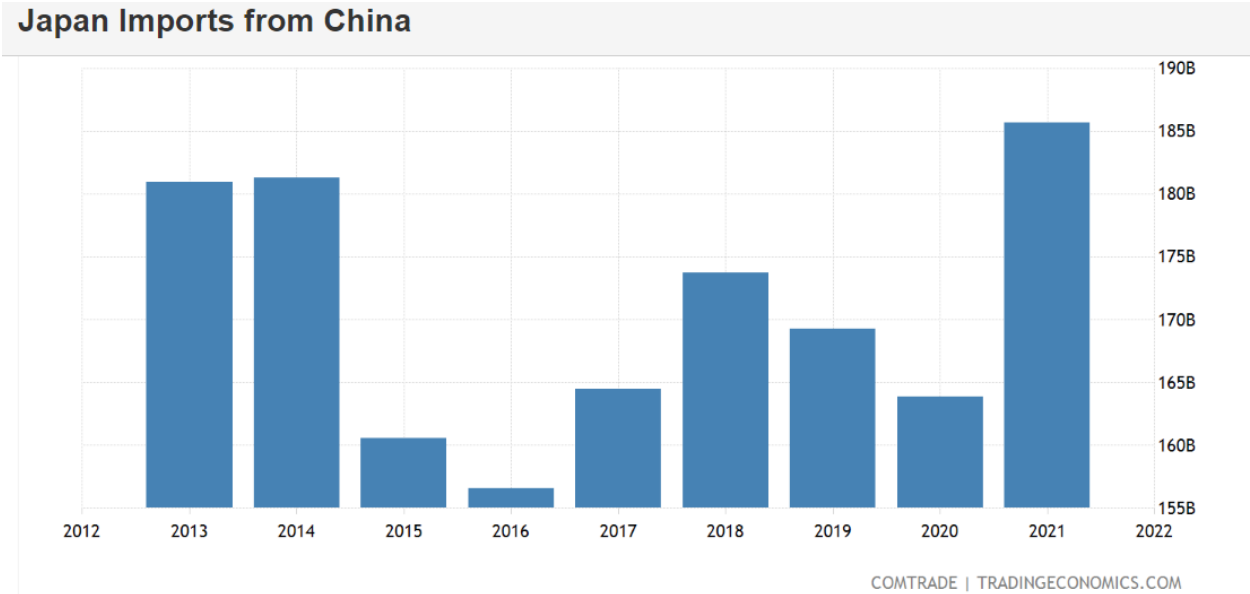


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Japan's exports to China were US\$ 144.54 billion in 2021, according to the United Nations COMTRADE database on international trade (United Nations Comtrade 2021).

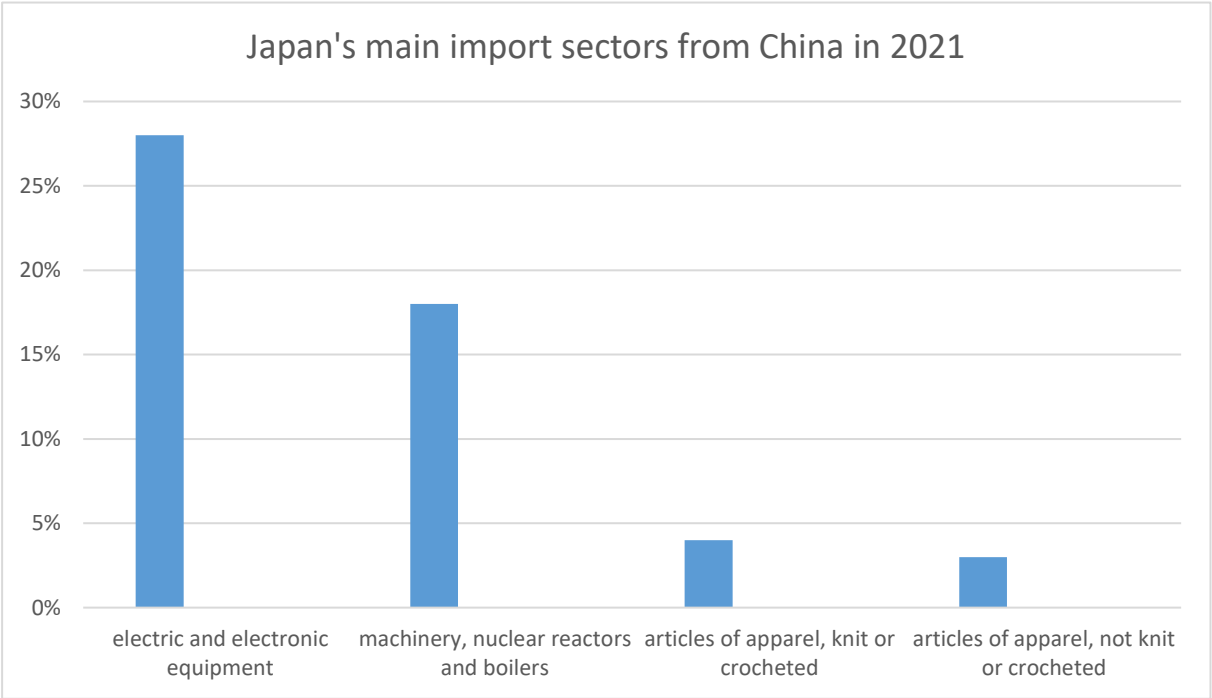


Japan's main export sectors to China, in 2021, were: machinery, nuclear reactors, and boilers with US\$ 30.94 billion; electrical and electronic equipment with US\$ 27.87 billion; automobiles with US\$ 12.37 billion; and not specified commodities with US\$ 9.59 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.



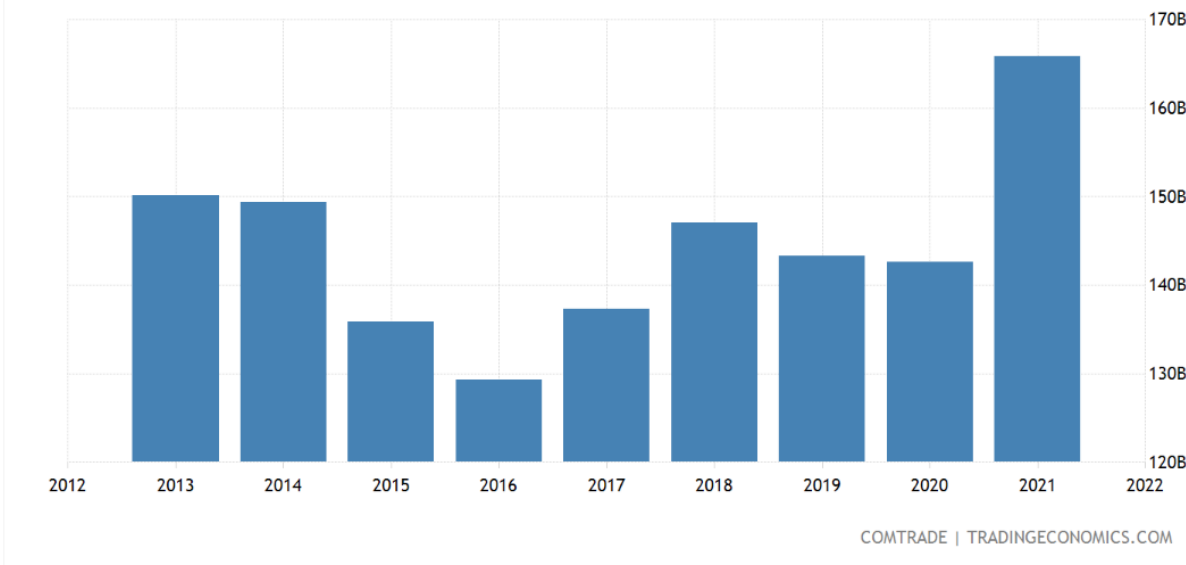
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Japan's imports from China were US\$ 185 billion in 2021, according to the United Nations COMTRADE database on international trade (United Nations Comtrade 2021)



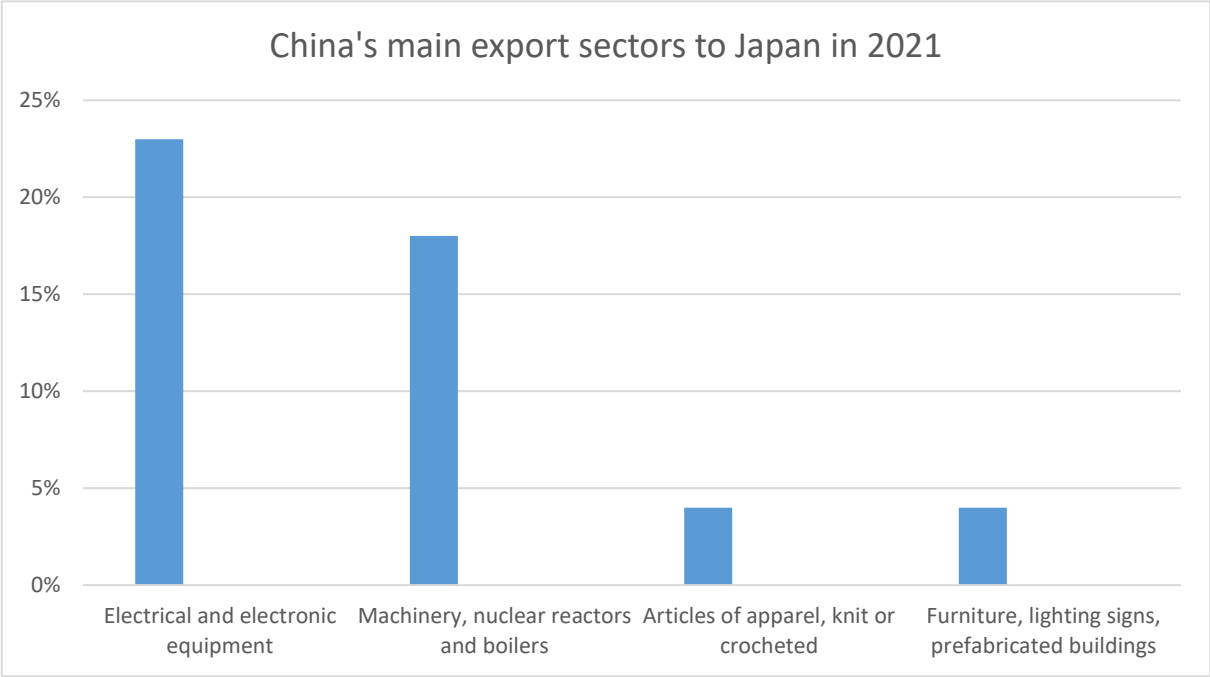
Japan's main import sectors from China, in 2021, were: electrical and electronic equipment with US\$ 53.47 billion; machinery, nuclear reactors, and boilers with US\$ 33.73 billion; articles of apparel, knit or crocheted with US\$ 7.55 billion; and articles of apparel, not knit or crocheted with US\$ 6.35 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

### China Exports to Japan

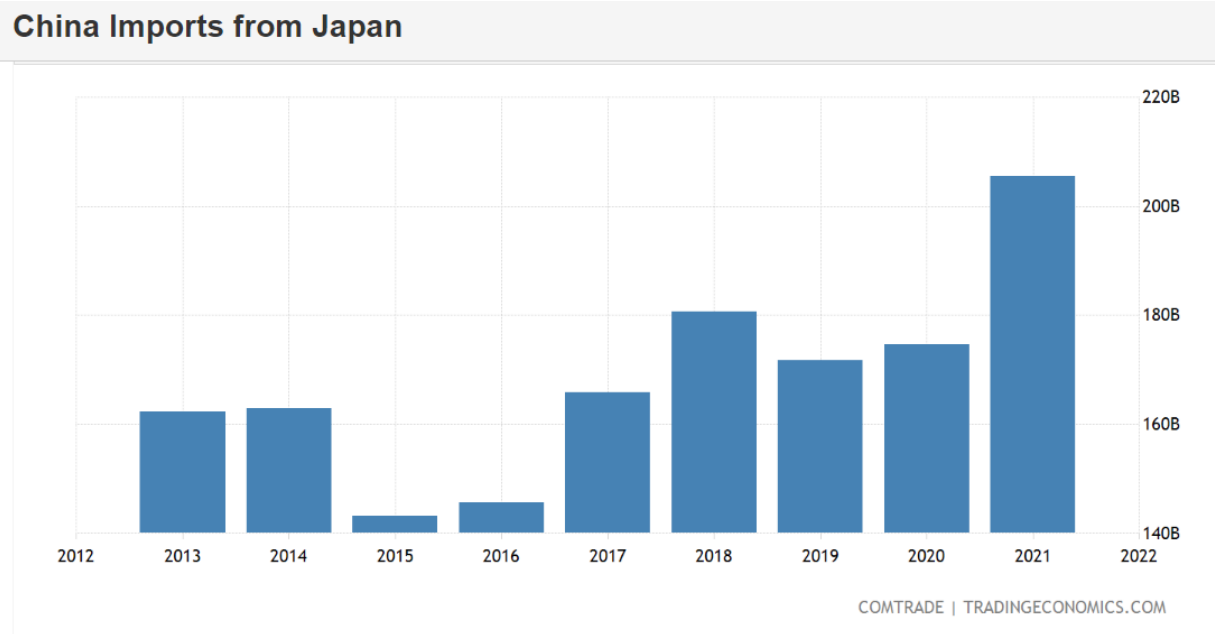


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China's exports to Japan were US\$ 165.82 billion in 2021, according to the United Nations COMTRADE database on international trade (United Nations Comtrade 2021).

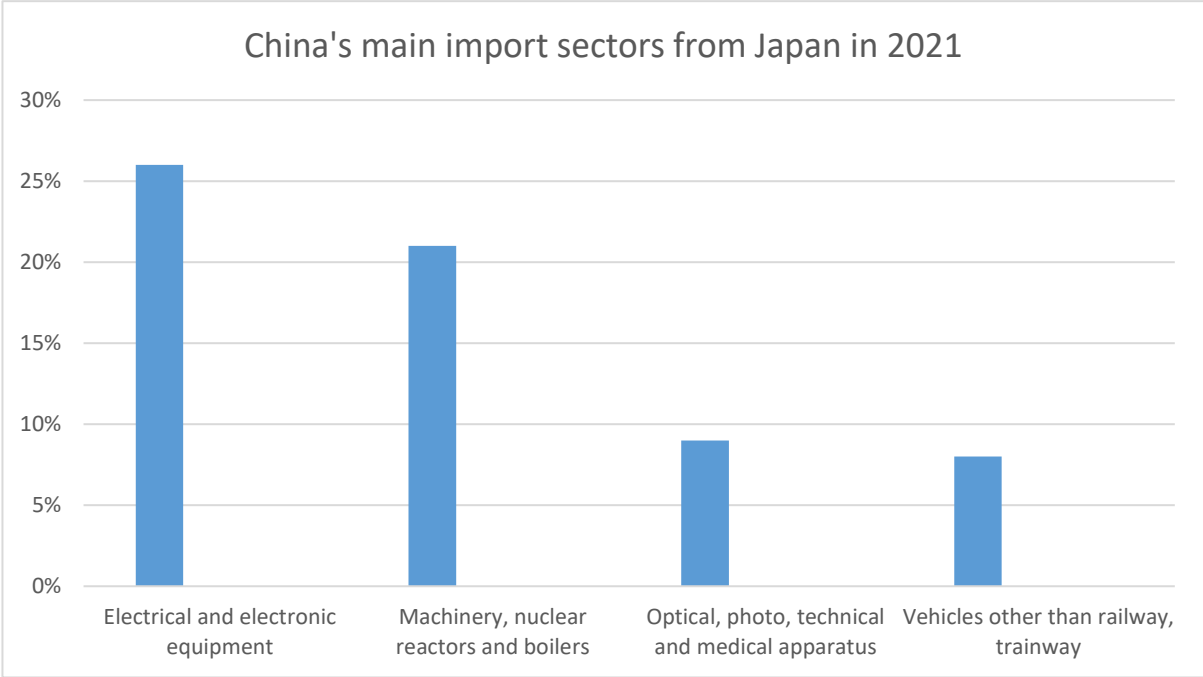


China's main export sectors to Japan, in 2021, were: electrical and electronic equipment with US\$ 38.17 billion; machinery, nuclear reactors, and boilers with US\$ 29.01 billion; articles of apparel, knit or crocheted with US\$ 7.72 billion; and furniture, lighting signs, prefabricated buildings with US\$ 6.50 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.



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China's imports from Japan in 2021 reached US\$ 210 billion according to the United Nations Comtrade data (2022).



China's main import sectors from Japan, in 2021, were: electrical and electronic equipment with US\$ 85.97 billion; machinery, nuclear reactors, and boilers with US\$ 63.66 billion; optical, photo, technical, and medical apparatus with US\$ 14.6 billion; and vehicles other than railway and trainway with US\$ 12.50 billion (United Nations Comtrade 2022). This graph has been created through the data collected from the United Nations Comtrade database.

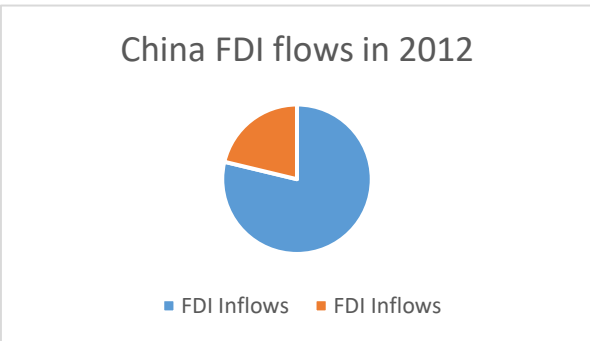
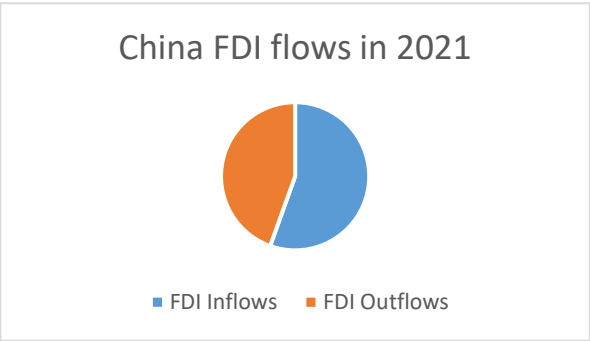
As described from the graphs above, we can see that China, Japan, and South Korea especially trade goods belonging to the electrical sector and the nuclear one. But the global value chains of the three countries developed in different ways and one main example is the global value chain related to the mobile phone industry. Following Lee, Kim, and Lim's report (2016), branded companies sponsored by sizable, broadly diversified firms such as Samsung and LG propelled globalization in Korea. Despite their strict grip over supply chains hindering the chance for expansion of local small and medium enterprises (SMEs) specializing in materials and manufacturing services, the producers were successful in exploiting their supremacy in an isolated domestic market to globalize revenue, manufacturing, and trademarks. Because of its disproportionate emphasis on the local market, Japan's history in mobile phone manufacture has been divergent from those of Korea and Taiwan. Even though they have well-known brands and a track record of excellence in manufacturing, Japanese phone companies in particular have struggled to achieve the same degree of success overseas as their Korean rivals. Compared to



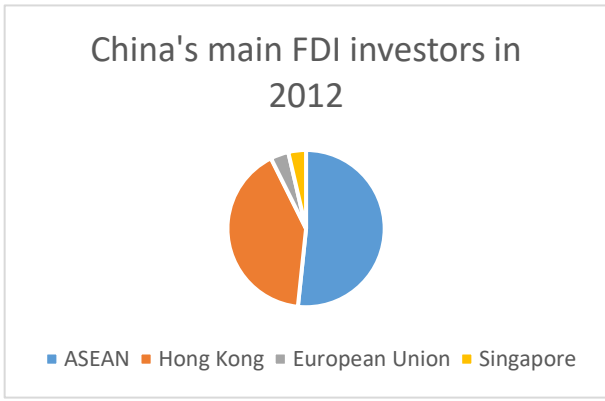
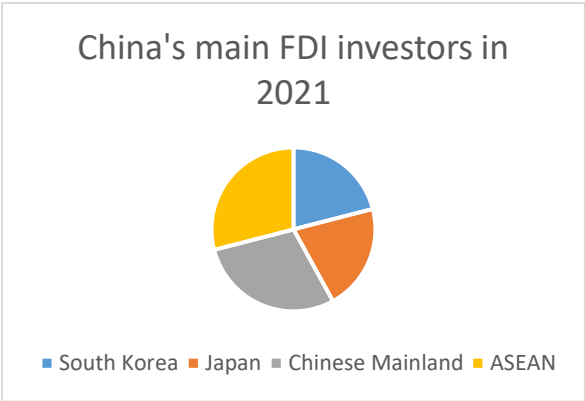
the modernization of its East Asian neighbors, China's manufacturing of mobile phones paints a considerably more complex picture, demonstrating the possibility of concurrent industrial growth along several diverse routes (Lee, Kim, and Lim 2016). China has an internal focus comparable to Japan due to its sizable domestic economy and exclusive standards. It also has manufacturing capabilities in component production and assembly that were built by international corporations. Similar to certain successful Korean businesses, Chinese companies have recently boosted their export capabilities on the strength of their trademarks. The Chinese mobile phone business also actively uses its distinctive local expertise to explore growth prospects in developing markets and relatively low sectors, unlike South Korea (Lee, Kim, and Lim 2016).

The heavy reliance of Asian nations on Japanese imports originated in the 1970s when Japan first started making outward investments throughout the area. Prior to the middle of the 1980s, the Japanese FDI-driven trade boom in the region mainly consisted of inter-industry expertise. Japan transferred the failing business to other Asian nations. Each nation in Asia produced commodities that required labor- or capital-intensive labor for export, depending on its economic development. Asian exports to other Asian nations have clearly increased since 1986, signaling the growth of intra-regional commerce. Japanese foreign direct investment (FDI) eventually became based on intra-regional trade as raw resources and semi-finished goods were transferred across countries to take advantage of cost benefits (Chiang 2013). Japanese manufacturers profited from a developing production alliance that connected Japan's huge multinational corporations with small component suppliers in host countries all around the region. Japanese subsidiaries in East Asia also had a strong reliance on their parent companies in Japan for the other parts and intermediate products (Hatch and Yamamura 1996). In the electrical and other high-technology sectors, this propensity for a localized manufacturing network is particularly pronounced. Japan was compelled to invest in cheaper locations in the ASEAN countries and China at the conclusion of the 1980s due to the growth in labor costs in Newly Industrialized Countries (NICs) and the opening of mainland China (Chiang 2013). Vertical production networks have been created as a result of the repeated transfers of Japanese FDI into Asia's developing nations, increasing commerce in intermediate goods between Japan and other Asian nations (Sohn 2002). Foreign direct investment is also a very important factor regarding the economic integration of China, Japan, and South Korea. According to data from UNCTAD (2022), in 2021 FDI from China to Japan reached its highest level since 2011 with 762 million U.S. dollars, meanwhile, according to the Ministry of Commerce of the People's

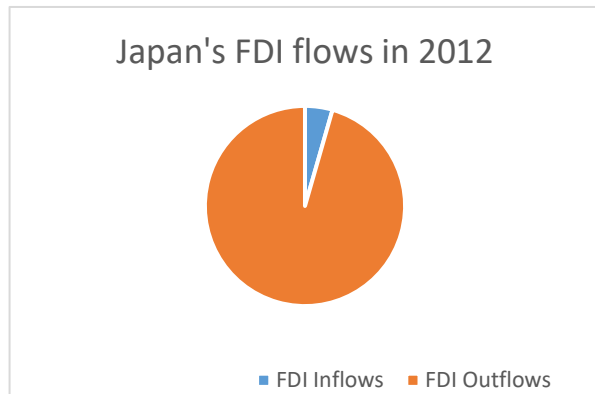
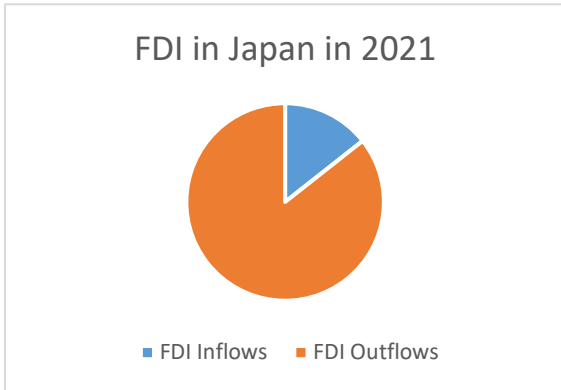
Republic of China (2022), South Korea was the biggest investor in China with a 64.2% overall. For what concerns Japanese FDI, nearly 10.2 billion dollars in foreign direct investment (FDI) from Japan went to China in 2021. In Asia last year, China got the second-highest percentage of Japanese FDI outflows (UNCTAD 2022). Despite the FDI rate declining in 2020 due to the pandemic in South Korea, in 2021, the country was able to register significant FDI inflow increases in some sectors (UNCTAD 2021). In 2019, Japan resulted in being the main investor in the country with an investment volume of 24.6% (OECD 2019).



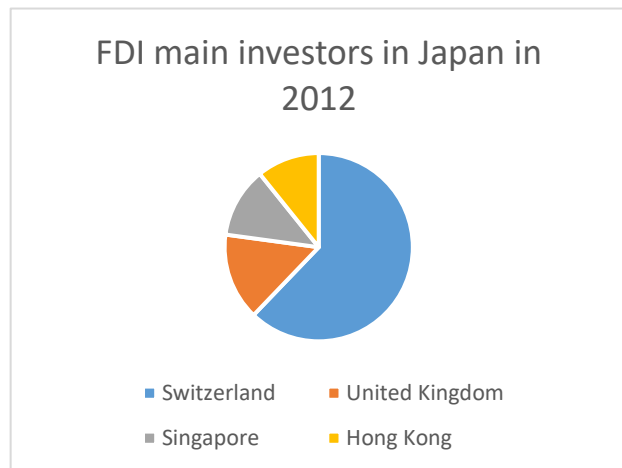
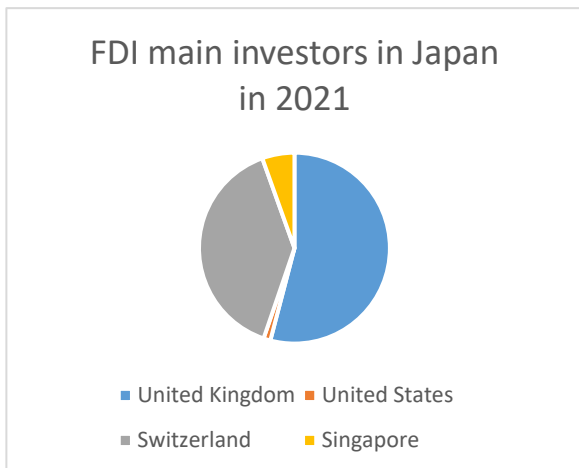
According to the data from the World Bank (2021), FDI inflows in China in 2021 were US\$ 180.95 billion while the FDI outflows were US\$ 145.19 billion. There is a significant difference in China’s FDI flows in 2012 with inflows and outflows respectively being US\$ 241 billion and US\$ 65 billion. This graph has been created through the data collected from the World Bank database.



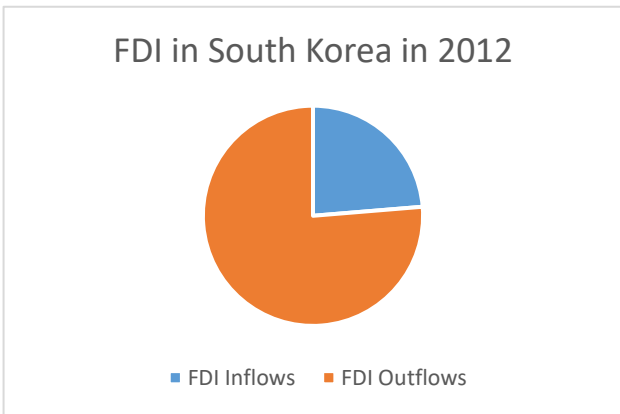
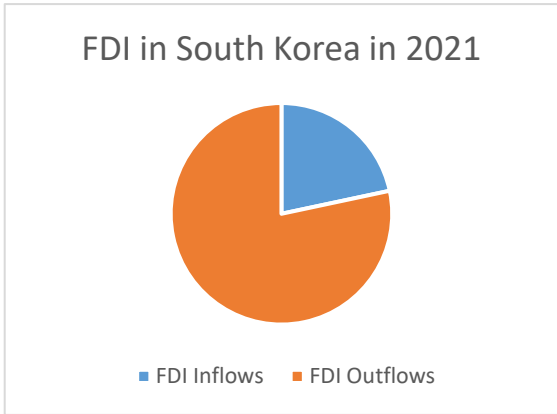
According to the World Bank database (2022), China’s main FDI investors in 2021 were South Korea, Japan, the Chinese Mainland, and ASEAN countries. In 2012, China’s main FDI investors were ASEAN countries, Hong Kong, the European Union and Singapore. This graph has been created through the data collected from the World Bank database.



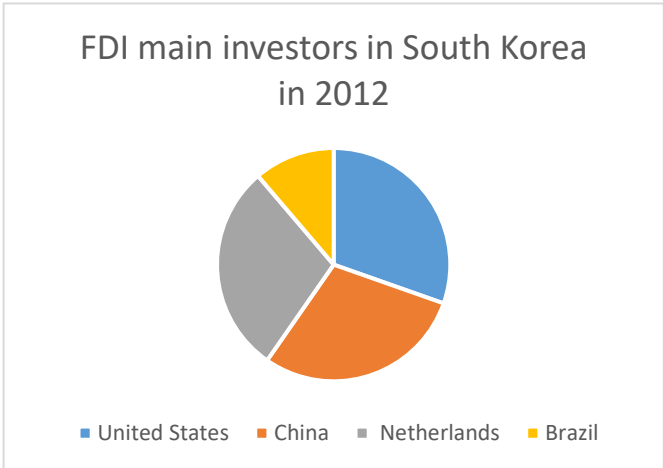
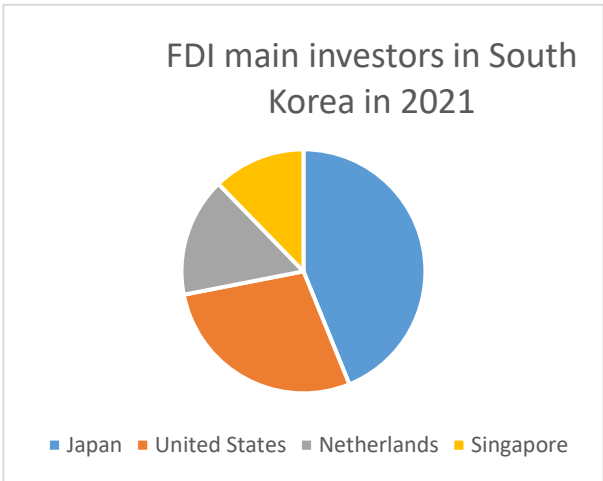
According to the data from the World Bank (2021), FDI inflows in Japan in 2021 were US\$ 24.65 billion while the FDI outflows were US\$ 146.78 billion. There is a significant difference in Japan's FDI flows in 2012 with inflows and outflows respectively being US\$ 11.76 billion and US\$ 546.96 billion. This graph has been created through the data collected from the World Bank database.



According to the World Bank database (2022), FDI's main investors in Japan in 2021 were the United Kingdom, the United States, Switzerland, and Singapore. While in 2012, FDI's main investors in Japan were Switzerland, the United Kingdom, Singapore, and Hong Kong. This graph has been created through the data collected from the World Bank database.



According to the data from the World Bank (2021), FDI inflows in South Korea in 2021 were US\$ 16.81 billion while the FDI outflows were US\$ 60.81 billion. There is a significant difference in South Korea’s FDI flows in 2012 with inflows and outflows respectively being US\$ 9.5 billion and US\$ 30.6 billion. This graph has been created through the data collected from the World Bank database.



According to the World Bank database (2022), FDI’s main investors in South Korea in 2021 were Japan, the United States, the Netherlands, and Singapore. Meanwhile, in 2012, the FDI’s main investors in South Korea were the United States, China, the Netherlands, and Brazil. This graph has been created through the data collected from the World Bank database.

It is undeniable to see how China, Japan, and South Korea have a strong interconnectedness with each other and that they are very important trade partners for each other. Not only these three countries are experiencing a significant level of interconnectedness in trade but also for what concerns foreign direct investment. Therefore, it is even more surprising to see that despite

the interdependence these three countries are already experiencing, they still lack a Trilateral Free Trade Agreement that would surely create more economic benefits for them and boost their power in the international arena, becoming one of the most economically important areas of the world. In the next chapter, the discussion will focus on the China-Japan-South Korea Trilateral Free Trade Agreement, specifically on its history, its decade-long negotiation process, and the multiple obstacles that have prevented the establishment of the agreement.

## CHAPTER FOUR

### **The China-Japan-South Korea Trilateral Free Trade Agreement: a decade-long ongoing process**

#### 4.1 Historical Context

As analyzed in the previous chapters of this work, despite East Asia experiencing a huge economic transformation and becoming one of the most dynamic and integrated areas in the world in the last decades, regional integration and cooperation have yet to be completely established (Grauwe and Zhang 2016). In contrast to Europe and North America, where regional economic integration happened thanks to powerful institutions and agreements namely the European Union and the North American Free Trade Agreement (NAFTA), in East Asia, market-oriented integration originated from economic entities and actors pursuing economic benefits from a wider regional economic interdependence (Capannelli 2009). While at first non-preferential trade agreements were not considered fundamental in the rise of regional integration, after the 1990s with the institution of the Association of Southeast Asian Nations (ASEAN), they gradually became a commonly followed patterns for all the countries belonging to the area (Grauwe and Zhang 2016). As of December 2020, 184 trade agreements are implemented, 19 are signed and awaiting ratification, and 95 are still under negotiation (United Nations ESCAP 2020).

Ever since 1997-1998, after the East Asian financial crisis, Free Trade Agreements (FTAs) started proliferating in the region, especially bilateral and plurilateral FTAs, such as the ASEAN+3 (China, Japan, and South Korea) in 1997, the 2002 China-ASEAN Free Trade Area (CAFTA) and recently even bigger regional FTAs such as the Regional Comprehensive Economic Partnership (RCEP) in 2020 (Grauwe and Zhang 2016). Free Trade Agreements are extremely important for countries because they usually generate positive consequences such as trade creation, and an increase in trade volume among the countries participating in the agreement, leading to the reduction or elimination of trade barriers (Hyun 2006).

It is obvious to state therefore that starting from the 1990s, noticing that market liberalization was not progressing, countries around the world discovered the importance of regional trade arrangements. After having discussed the many free trade agreements that have been implemented after the 1990s, the progressive catching-up process of China, Japan, and South Korea, and the regional integration that these three countries are already experiencing, the attention will now be shifted to the establishment of the Trilateral Free Trade Agreement between China, Japan, and South Korea, also known as the CJK FTA. From an economic perspective, the creation of a trilateral FTA within the three countries, which already had an impressive level of trade interdependence, is expected to increase even more the economic benefits for the three partners, such as removing tariff and non-tariff barriers and facilitating access to larger markets in contracting parties (Yoshimatsu 2015). Despite China, Japan, and South Korea being the three most prosperous countries in the East Asian region and being part of or having established many FTAs with both other Asian countries and the rest of the world, these nations have yet to establish a trilateral FTA among themselves. China became a manufacturing center for both Japan and South Korea. Japan is China's and South Korea's main source of capital, foreign aid, and technologies. South Korea is relying on exports from China and Japan markets due to the limited size of the domestic market and scarce natural resources (Yoshimatsu 2015).

Political ambitions and considerations have a big impact on the goal and progress of FTAs. Such political concerns are particularly significant in the development of FTAs for nations in Northeast Asia. Political mistrust between China, Japan, and South Korea as a result of historical hostilities and territorial disputes has a considerable detrimental impact on global diplomatic ties. The two East Asian superpowers, China and Japan, have battled with one another for political sway by attempting to assert themselves as the area's governors (Dent 2008; Park 2013). Additionally, as a result of different FTA attempts that have resulted in overlapping and layered political institutions, the FTA development involving the three nations has grown more controversial. In these circumstances, the trilateral FTA is a crucial political tool that allows the three nations to achieve specific diplomatic goals within the restrictions of changing political connections on a policy level (Yoshimatsu 2015).

Free Trade Agreements are often largely influenced by political perspectives and interests. Specifically, in the establishment of the CJK FTA, political factors had a significant relevance: it is, in fact, well known that China, Japan, and South Korea brood a strong political distrust towards each other, the result of historical divergences and territorial claims, which over the

course of the years have aggravated the diplomatic relations between the three countries. China and Japan, in particular, after settling as the most powerful countries in Asia, tried to impose their political influence in Southeast Asia by demonstrating regional leadership, trying to lure Asian countries into becoming economic partners with either of the two countries (Dent 2008). The turning point happened when China took the initiative to form a free trade agreement with the Association of Southeast Asian Nations (ASEAN) in November 2000 by proposing the ASEAN-China Free Trade Agreement (ACFTA). The Japanese, at first, saw this proposal as unrealistic and paid little attention to it. However, Beijing's pre-emptive actions towards the ACFTA surprised Japanese policymakers, who forcibly issued countermeasures (Taniguchi 2004). After Beijing and ASEAN progressed towards the ACFTA steadily, Japan followed the RPC's steps by promoting talks on the ASEAN-Japan Comprehensive Economic Partnership (AJCEP). After both agreements were signed under competitive conditions, Japan was not interested in promoting the FTA with China (Yoshimatsu 2015). Thus, the trilateral FTA is a critical political instrument, through which the three countries can pursue specific diplomatic objectives at a systemic stage. It is linked to the development of political relations; a tool able to ease the political tension that had been gradually rising in Northeast Asia at the beginning of the new millennium, finally bringing peace among China, Japan, and South Korea. The years between 2002 and 2009 represented, in many ways, a long warm-up preparatory phase for trilateral economic cooperation within the three different countries, preparing them for a process that is still in progress (Srinivasa 2013)

The idea of the creation of a China-Japan-South Korea Free Trade Agreement has been discussed ever since the early 2000s and its negotiation process began in 2012. As already analyzed in the previous chapters of this work, the three countries are already experiencing an outstanding level of economic interconnectedness therefore the establishment of a trilateral free trade agreement among them would only be the natural consequence. That step has yet to be achieved and in the following paragraph, the discussion will focus on how the three countries developed, why they are important to each other, and how the negotiation process started more than a decade ago.



#### 4.2 Actors and the beginning of the negotiation process of the CJK Free Trade Agreement

Free Trade Agreements are extremely important for countries because they usually generate positive consequences such as trade creation, and an increase in trade volume among the countries participating in the agreement, leading to the reduction or elimination of trade barriers (Hyun 2006). Especially in the last decades, the need for a regional trade agreement between China, Japan, and South Korea has been growing steadily. The three countries have all developed differently and are endowed with different resources as well. Japan is capital and technology abundant; China is a labor-abundant country and South Korea stands in the middle between the two in terms of development and economy, with a consistent endowment of high-skilled labor (Srinivasa, 2013). Aside from the many external factors that should be present to establish regional economic integration and cooperation, for instance, the division of labor or a strong connection to supply chains, another element that should be considered is the stabilization and revitalization of the region's economic dynamism, especially after the 1997-1998 East Asian financial crisis. Of particular importance was the shift that occurred in China, Japan, and South Korea, going from encouraging a multilateral approach to inclining towards a regional one (Park 2018).

Japan is a major regional power with the most advanced economy, capital, and technology abundant, whose political concern is maintaining its political and economic influence in East Asia (Srinivasa 2013). Since the late 1960s, the country has exercised its dominant economic influence in the region for the past 40 years. Japan engaged in trade deals, investments, and financial transactions with East Asian countries, being their main source of capital, foreign aid, and technologies. However, Tokyo's relative economic power has been declining since the 1990s as neighboring Asian countries have increased their economic capabilities through solid industrial growth. Japan's diplomatic objective is to enhance its political and security position by taking advantage of economic and trade policies (Yoshimatsu 2015). South Korea stands in the middle in terms of development and economy, with a consistent endowment of high-skilled labor. The country achieved significant industrial and economic advancements with the growth of chaebols and large conglomerated companies. Korean companies have a strong global focus in the commercial arena as they rely on exports to external markets due to the limited size of the domestic market and scarce natural resources. In the context of Northeast Asia, Seoul's

diplomatic objective resides in being a trade and business pole and thus, guaranteeing economic resources to support its continuous industrial growth (Corning 2014). The country is pursuing a first-come strategy of concluding trade agreements with key partners before its economic rivals. This strategy enables South Korea to secure privileged access to key markets and to gain solid economic advantages by building a favorable market position (Yoshimatsu 2015).

Despite always occupying a powerful position, at the end of the 1980s and the beginning of the 1990s, China was a labor-abundant country with the least developed economy (Kang 2003). In the early 2000s though, the country regained its long-standing position as a global player, and Chinese people started to recognize the PRC as a strong and prominent power in the international arena (Deng 2008). China's involvement in regional political-economic affairs is heavily influenced by its broad geopolitical perspective. Moreover, China's growth as a huge manufacturing center and a huge consumption market cemented its position as the economic and trade center of East Asia. The PRC's diplomatic objective consists in making East Asia a region with its sphere of influence. To achieve this diplomatic goal, Beijing implemented trade deals to maintain its relative political control in East Asia, attempting to reduce the political influence of another superpower, the United States (Yoshimatsu, 2015). With the three countries forming a free-trade bloc, they would hold one of the largest markets in the world for what concerns population and GDP, with their trade volume nearly as big as the EU. This would cause a huge impact on the world's economy with the US receiving the largest shock (Hyun, 2006).

In November 2002, at a trilateral summit, Chinese Premier Zhu Rongji proposed a feasibility study regarding the creation of a free trade area involving China, Japan, and South Korea. This proposal aimed to fortify tripartite economic and trade cooperation, which would result in a positive impact on said cooperation. In response to China's proposal, the three leaders decided to start a joint study on the trilateral FTA. In the following year, Beijing's State Council Development Research Center, Tokyo's National Institute for Research Advancement, and Seoul's Institute for International Economic Policy conducted joint research into the key macroeconomic benefits of the trilateral FTA and its impact on individual industrial sectors. The joint study lasted seven years until 2009. The study report, published in 2009, confirmed that the FTA would generate positive effects on the promotion of trade and investment between the three countries and on the economic growth of each country. At the trilateral summit in October 2009, the three leaders agreed to start the joint study of the trilateral FTA with

academic participants, companies, and, government officials (Yoshimatsu 2015). According to Yoshimatsu's report (2015), the first study meeting was held in Seoul in May 2010. The joint study of the trilateral FTA, which began in May 2010, was initially planned for two years, but the three leaders agreed, at the trilateral summit in May 2011, to complete the study by December 2011 and its report was published in March 2012, deciding to start the FTA negotiations in the same year. In November 2012, the three countries officially announced the start of negotiations on the 2011-2012 FTA. Despite China and Japan's renewed interest in concluding the FTA, South Korea was still skeptical about the whole ordeal. South Korea, in fact, instead of a trilateral FTA agreement, was inclined to join a bilateral FTA with China because they believed that aside from bilateral agreements being easier to be established, China's share in Korea was also quite consistent at the time, reaching 25% for exports in 2012 and 16% in imports, positioning itself ahead of Japan who only held the 12% (Chiang 2013). Later, South Korea formally made commitments to promoting the trilateral FTA. The new roadmap on trade policy, announced in June 2013, clearly states that it will support the trilateral FTA to strengthen existing economic cooperation among the three countries and build the institutional pillar to establish an East Asian community in the long term (Yoshimatsu 2015).

Following Yoshimatsu's perspective (2015), China was the driving force behind the trilateral FTA proposal. Japanese Prime Minister Koizumi declined to encourage the trilateral FTA feasibility analysis that Chinese Premier Zhu had proposed in 2002, saying that Japan would instead take a medium- and long-term approach while paying due consideration to how quickly China would remove trade restrictions in accordance with the World Trade Organization commitments (Nihon Keizai Shimbun, 2005). Japan had some desire to establish official trade ties with China or South Korea at the time. Business organizations were particularly interested in establishing FTAs with Korea and China. The Japan-Korea Industrial Cooperation Group was established by Japan's Business Federation as an internal committee in January 2001. Despite this, its representatives had a great interest in creating an FTA with China. During the trilateral meetings, Japan's main focus was on hastily concluding an investment agreement rather than an FTA. The establishment of an investment treaty was part of the Japanese Ministry of Economy, Trade, and Industry's (METI) effort to create more solid investment circumstances for the operation of Japanese businesses in China (Yoshimatsu 2015).

The China-Korea FTA played a significant role in South Korea's hesitation to join the trilateral FTA (CKFTA). As previously stated, Seoul had reservations regarding a free trade agreement

with Beijing but changed its mind when Taiwan and China signed the Economic Cooperation Framework Agreement (ECFA) in June 2010. Because the two countries fought in the Chinese industry's semiconductor market, the ECFA seemed to have the possibility of shifting trade away from South Korea and toward Taiwan. As a result, the Korean government modified its trade policy and pursued the swift completion of the CKFTA. The initial round of consultations on a bilateral FTA started in May 2012 after the heads of the two countries vowed to do so when Korean President Lee Myung-bak paid an official visit to Beijing in January 2012. A bilateral FTA with China was favored by South Korea instead of a trilateral agreement involving Japan as well (Yoshimatsu 2015). High-ranking government officials made their preference apparent. The South Korea-China free-trade area is considered a more organic phenomenon compared to a free-trade area between China, Japan, and South Korea, according to Korean Trade Minister Bark Taeho (Xinhua News Agency 2012). In light of expanding trade ties, South Korea's inclination for an FTA with China was reasonable. According to Yoshimatsu (2015), South Korea delayed signing the trilateral FTA due to strategic considerations regarding business interests. Establishing a competitive advantage for its manufacturing enterprises versus Japanese opponents in significant international markets is crucial to Seoul's economic interests. It was anticipated that gaining a dominant position in the enormous Chinese market by establishing a bilateral FTA before a trilateral one would significantly advance this business interest. Japan saw the trilateral FTA as a beneficial tool for promoting the trade balance policy and achieving a number of commercial goals. As a result, the trilateral FTA proved crucial for the Japanese economy in improving market access to Beijing. Secondly, Japan might include components of the trilateral FTA that adhere to high standards. The TPP was seen as a helpful framework for creating a new trading order in which several WTO-plus components, including intellectual property rights, the ecosystem, employment, and government contracting, would be implemented. Japan intended to incorporate high-standard TPP agreement provisions into the trilateral FTA. Finally, the trilateral FTA would strengthen the distribution networks and supply chains of Japanese firms in East Asia. The three nations might be capable of applying to all of East Asia the shared norms and laws negotiated at the trilateral FTA. It would undoubtedly help Japanese manufacturing enterprises establish manufacturing systems and supply chains more smoothly (Yoshimatsu 2015).

The sudden decision to intensify initiatives for a CJK FTA follows the establishment of the ASEAN+3 Macroeconomic Research Office (AMRO), the Credit Guarantee and Investment Facility (CGIF), and the prolific multi-lateralization of the Chiang Mai Initiative by the

ASEAN+3 Countries (the ten ASEAN countries plus China, Japan, and Korea). If the area could supplement these efforts in financial and monetary connection with successful investment and trade integration, the advantages would be increased. Following Srinivasa's point of view (2013), given that these three nations represent a major portion of the ASEAN+3 investment and trade movements, the CJK FTA may be the next step in that process. Therefore, now is a good moment for the three Northeast Asian nations to give the CJK FTA proposal more strong consideration than they previously had. A CJK FTA has the potential to promote a more multilateral, region-wide FTA originally in East Asia and then more broadly in Asia at the regional scale. Recent research on Asian economic integration has made several major recommendations, including the creation of a region-wide FTA in Asia (ADB 2008 and 2011). Such a regional FTA might also give Asian nations the chance to progressively voice shared viewpoints on investment and trade in multilateral conferences and organizations charged with overseeing global economic administration (Madhur 2012a and 2012b). A CJK FTA may thereby provide an opportunity for open regionalism in Asia alongside RCEP and TPP. The CJK countries represent about one-fifth of the worldwide Gross Domestic Product (GDP), only a few percentage points less than the North American Free Trade Area (NAFTA) countries' portion of the world (Srinivasa 2013). A CJK FTA may even surpass the decreases in investment and trade barriers experienced by NAFTA, the European Union, or the ASEAN because it may lead to tariff reductions for approximately 16% of world commerce in services and products as well as a sizeable part of foreign direct investment (Gill 2012). Srinivasa (2013) thinks that ultimately, a CJK FTA has the potential to benefit the most from the regional economic agreements that Asia has been negotiating for more than ten years. The numerous modeling studies suggest that according to these qualifications, a CJK FTA would increase GDP for all three of the concerned nations by a range of 0.95 to 5.1 percent growth for Korea, 0.03 to 1.54 percent growth for China, and 0.03 to 1.24 percent growth for Japan (Scott and Goodrich 2001; KIEP 2005; and Lee 2006). The straightforward inference to be made from these analytical models is that a CJK FTA would be advantageous to the three nations both jointly and individually. Nevertheless, these macroeconomic benefits conceal the regular sector-specific differences that an FTA produces (Srinivasa 2013). For instance, the majority of studies using scenarios of Computable General Equilibrium (CGE) models and sector-specific metrics of revealed comparative advantage reach the conclusive result that a CJK FTA would exert pressure on Japan's and Korea's fisheries and agriculture industries areas while bolstering their superior technology industries. Using the same reasoning, a CJK FTA would typically benefit China's agriculture and labor-intensive industries, but it would also strain some

of its more technologically advanced industries by increasing competition (Srinivasa 2013). One analysis (Cheong et al. 2003) found that a CJK FTA would have the following cumulative sectoral effects: China's agricultural production, processed food, apparel, and electronics areas would gain, while its fabrics, metals, and car sectors would lose; Japan's manufacturing, car, and greater electronics industries would gain; and Korea's petroleum products, fabrics, and processed food sectors would lose. It is now widely acknowledged, based on simulation model findings, that the advantages of three separate bilateral FTAs between China, Japan, and Korea would amount to less than those of a single trilateral FTA (KIEP 2005; Lee 2006). The three Northeast Asian nations would indeed profit most from a trilateral FTA. The next best option, nonetheless, might be to begin with bilateral FTAs while the trilateral talks are conducted gradually and steadily, and ultimately combine these bilaterals into a single CJK FTA. This is because it would be impossible to implement such an FTA quickly (Srinivasa 2013).

Over the years though, the three governments have taken a pragmatic stance and hold regular negotiating meetings. The first round of negotiations took place in Seoul in March 2013 where the negotiating mandate was accepted along with the discussion regarding the scope and method of the negotiations as well as the formation of working groups. The second round of negotiations happened in Shanghai in July 2013, where it was decided to open discussions in 15 sectors, including environmental protection, food, and public procurement. The third round of negotiations was held in Tokyo in November 2013. The next three rounds of talks took place in 2014. However, Japan's participation in the TPP talks undermined Seoul's willingness to promote the trilateral FTA. South Korea, at that point, had two options: on the one hand, they could form a free trade area with the PRC through the CKFTA; on the other hand, South Korea could promote the liberalization and facilitation of trade with Japan through the TPP. This meant that with either choice, there is less need for a political trilateral FTA among the three countries to be established (Yoshimatsu 2015).

Although several studies have highlighted the positive results of a free trade agreement with CJK, this agreement has yet to be signed. However, given the success of the Regional Comprehensive Economic Partnership (RCEP), a deal implemented in 2019 that facilitates trade among ASEAN countries, and noticing the similarities with the benefits of the China-Japan-Korea FTA, there is the perspective that the CJK FTA negotiations will receive a further push into sealing the agreement and concluding the ten-years negotiation process. Over the next five to ten years, the Asia-Pacific region will become the engine of global economic

development in terms of both production and consumption, especially if the CJK FTA finally manages to be settled (Global Times 2020).

As seen, the negotiation process among the three countries has been long and extremely difficult. Each actor has its own reasoning to strive from signing the agreement, despite the positive effects and results that a CJK free trade agreement will provide them. In the following paragraphs, first, there will be an analysis of the possible advantages that the CJK FTA will bring to the countries involved. Secondly, the discussion will vert on the obstacles that have strongly prevented the establishment of the CJK free trade agreement and that have prolonged the negotiation process for so long.

#### 4.3 Possible advantages of the CJK Free Trade Agreement and obstacles to its establishment

Another reason why FTAs started to become more popular, especially after East Asia witnessed the effects of the 1997-1998 crisis, is not only the economic benefits that such an agreement can bring but also other factors that help increase the cooperation of the countries involved in free trade agreements. Often countries see the FTAs as an instrument that, aside from pursuing economic objectives, would also help with non-economic goals. Small and medium-sized economies are adopting FTAs to increase their economic profits. They are also means of increasing economic benefits from a liberal perspective. They see greater trade interdependence as facilitating cooperation in bilateral relations (Lee 2015). At the same time, large economies see FTAs to halt possible rivals, except for economic gains. When reaching a free trade agreement, these economies pursue both economic and non-economic objectives. They are motivated to transform the asymmetry of interdependence into an instrument of economic advantage and a power base. Consequently, the high-cost economy must take a sustainable perspective with the low-cost economy in its FTA (Lee 2015). This type of dynamics is often seen in FTA with China or Japan, the large economies, and South Korea, depicted as the small-medium one. The PRC is the perfect candidate to enlace a possible FTA as China aided the growth of East Asian economies through trade, which compensated for the weak export demand of the major industrial economies (Estrada et al. 2012). Aside from the many benefits that the East Asian region could experience from establishing regional trade agreements, some reasons that make Asian countries hold back from establishing said agreements, particularly FTAs,

could be found. One of them is the constant dependency on Western countries. East Asian countries are reluctant to discriminate against important external trading partners such as the United States. The main objective is to remain competitive, avoid possible conflicts, or be excluded from the global FTA trend, and with the institution of several FTAs just among Asian countries, the risk of that becoming a possibility is quite high. Unfortunately, this does not contribute to creating a solid base for wider regional economic integration. Furthermore, these different agreements will not be able to build blocks of regional liberalization as they are not necessarily coherent with each other (Nicolas 2008).

#### 4.3.1 The possible advantages of the CJK Free Trade Agreement

As already stated in the introduction of this chapter and as deeply analyzed in the third chapter of this dissertation, China, Japan, and South Korea are linked to each other through important trade connections. Pre-existing business links between members of a possible FTA group are key elements in forming an FTA. Countries with strong trade ties before an FTA might receive more benefits from integration and therefore, they are more likely to support an FTA (Estrada et al. 2012). As studies have shown, trade is relatively high between these countries of East Asia, suggesting the possibility that an actual free trade agreement between the People's Republic of China, Japan, and the Republic of Korea will be beneficial to all parties involved (Estrada et al. 2012). China has specialized in the production of labor-intensive production and agricultural products and exported them to Japan and South Korea. Japan focused on the production of high-tech industrial products and exported them to China and South Korea. South Korea's trade with China and Japan relies on both domestic and intra-industrial trade, while the country concentrated on the production of medium and high technology products and exported them to Japan and China (Hyun 2006). As of now, aside from themselves, the main trading partners for these countries are the European Union and the United States. If a possible FTA was to be put into action, China will redirect its import sources of high-technology products from the Western bloc to Japan and South Korea (Hyun 2006). First, Chinese exports of food, agriculture, and natural resources to Japan and South Korea will increase significantly, while decreasing to the EU and the United States. Then, Japan will move the US and EU's sources of food and agricultural imports to China and South Korea.



Lastly, South Korea will increase its imports of food and agricultural goods from China and of high technology from Japan instead of the United States and the rest of the world will dramatically shrink (Hyun 2006). This trilateral CJK FTA would stimulate the economies of the member countries by increasing trade volumes and improving trade conditions in these countries, such as eliminating trade barriers. This FTA would also enhance the economic systems of the three countries and increase their economic integration and cooperation. The agreement would also encourage trade between the member countries through trade creation and trade diversion (Hyun 2006).

It is surprising that despite the strong integration these countries are already experiencing, a CJK FTA has still yet to be concluded. There are multiple reasons behind the lack of action regarding the said agreement. It is important to highlight though that the three countries did manage to start the negotiation process regarding the agreement in 2013 after the idea of a CJK had been in discussion ever since 2002. According to various studies (Zhang 2019), many factors halted the negotiations and the conclusion of the CJK FTA, the following paragraph will highlight these factors and their negative impact on the establishment of the agreement.

#### 4.3.2 The obstacles that prevented or halted the negotiation process of the CJK Free Trade Agreement

Ever since the negotiations started, more than a decade ago, the leaders of the three countries have met several times in order to discuss the terms regarding the key points of the CJK FTA. So far, they have encountered several obstacles coming from different areas such as the economic area or the political one. This section will highlight which obstacles played a fundamental role in the postponement of the conclusion of the agreements.

The negotiation process is still ongoing for several reasons. In the beginning, the PRC was not convinced that the outcome of a trilateral free trade agreement would benefit the country itself. During the 1990s, Beijing's primary goal was to join the WTO, which happened in 2001, sealing China's accession into the global trade panorama. With their focus on the GATT/WTO, the PRC completely ignored the possible creation of trade assessment in East Asia, especially with the two most developed countries, Japan, and South Korea. Not even the talks about a possible Japan-South Korea FTA agreement triggered a significant reaction in China, back then Chinese media did not show any interest in that topic and barely any reference to the possibility of said agreement appeared in Chinese academic research papers (Penhong 2002). The other

important issue that prolonged the negotiation even further was the skepticism that the PRC and South Korea had toward Japan. In fact, despite WWII ending decades before the FTA discussion even became a hot topic for the three countries, Japanese imperialism and its role and military invasion during those years still is a vivid and atrocious memory for the Chinese and the Koreans. During the Second World War, the Japanese invaded their territories and perpetrated atrocities toward the civil population, especially toward Chinese and Korean women who were victims of sex slavery and were denominated “comfort women” (Chiang 2013). A strong anti-Japanese movement was and still is very strong and heartfelt in the two countries, especially since Tokyo’s compensation for the damage caused to those women was misery compared to the condition they suffered. Along with this feeling, another action delayed the negotiations of the free trade agreement: Japan’s nationalization of the Diaoyu Islands sparked anti-Japanese protests in several cities all over China with Japanese businesses witnessing their sales drastically decreased in China, to the Chinese it seemed like another Japanese invasion was settling in their territory. (Chiang 2013).

Moreover, the economic interdependence among the three countries revealed to have experienced a downward trend in recent years and weakened the bottom-up economic base among the three countries. The inflow of foreign direct investment (FDI) from Japan to China reached its climax in 2011 and 2012, followed by an extreme downfall. Subsequently, the devastating crisis in Sino-Japanese relations due to the nationalization of the disputed Diaoyu Islands in 2012 sparked anti-Japanese protests in several cities all over China with Japanese businesses witnessing their sales drastically decreased in China (Chiang 2013). Japanese firms now see investing in China as less profitable than investing in other emerging markets such as India and Southeast Asia, mainly due to bilateral political tensions between China and Japan and rising human costs in China (Zhang 2019).

The bilateral Sino-Korean investments have also shown a volatile trend in recent years. Following the global financial crisis, mutual investment between China and Korea developed a steadily rising trend, thanks to also the reduction of Japanese investment in China, which created space for Korean businesses in the Chinese market, who started to invest more effectively in China than Japan (Zhang 2019). According to Zhang (2019), South Korea’s FDI in China has started to decline since 2015 due to the domestic rising of anti-Korean sentiment in China and the rapid increase of labor costs in China. Korean firms, for instance, Samsung, are either renouncing their market share and giving them to local Chinese rivals in China or relocating their manufacturing facilities to other developing countries (Martin 2018). Then,

there is still a strong conflict with the different sectoral interests included in the potential CJK FTA. The potential bilateral competition between Japan and South Korea risks blocking the negotiation process. As Japan and South Korea comparatively have similar industrial structures and comparative advantages, Seoul is concerned that its production capacity will remain weaker than Tokyo's and that its manufacturing sector may lose competitiveness with its Japanese equivalents in obtaining a large Chinese market share after signing the CJK FTA (Zhang 2019).

Another key factors opposing this FTA agreement are the strong rejection of the agreement by the Japanese agricultural producers, who would be the losers from the establishment of the agreement (Zhang 2019). Despite agriculture not being a fundamental sector in Japan anymore, agricultural protection is still resisting. Japan's reluctance to enter into negotiations on various agricultural products was also one of the motives for blocking first and disregarding afterward the free trade agreement between Japan and South Korea (Chiang 2013). Additionally, Tokyo's participation in the Trans-Pacific Partnership (TPP) discussion surely added to the obstacles in the completion of the CJK FTA. The TPP not only is seen as a measure to oppose China's further growth but also made South Korea reconsider its policies. The country feared that Japan and the United States were going to lead the Asia-Pacific territory with their trade rules through the TPP and that South Korea would remain behind Japan in reaching free trade agreements with four countries, including Canada and Mexico. Tokyo's participation in the TPP negotiations made the FTA policies concluded by the three parties more difficult and strategic. Thus, Beijing and Seoul were forced to adopt new trade strategies in response to Japan's new initiatives, making it difficult to harmonize the political position on the trilateral FTA, with the result that the prospect of a swift conclusion of the agreement remained unclear (Yoshimatsu 2015).

South Korea was more prone to a bilateral CK FTA with China rather than a trilateral agreement with Japan as well, as the South Korean government believed that a free trade agreement with China only would be more beneficial to South Korea's economy. Aside from the rivalry with Japan due to their similar productions and comparative advantages, South Korea being extremely worried about losing to Japan is another reason why South Korea prefers a free trade agreement with China over Japan is its growing trade deficit with Japan. Although South Korea's imports from China are greater, they only consist of final goods, while the imports from Japan consist of capital and capital equipment, creating for South Korea a strong dependency on Japanese industrial goods. Thus, South Korea is worried that a potential CJK FTA will

enforce this intra-industrial specialization, with Japan always being many steps ahead of South Korea in terms of the production of higher value-added products and technology (Chiang 2013).

Some studies (Zeng 2016) have emphasized how these countries prefer to engage in preferential trade agreements with countries that are politically on good terms with these countries governments. China, for example, instituted a free trade agreement with Pakistan, a long-term ally in 2007. The main motive behind this policy is establishing first and maintaining later China's leading role in the Asian Continent. By securing agreements with countries that could be considered allies instead of rivals, China can be able to counter-balance the influence of the two main rivals that could threaten its hegemony in the region: the United States and Japan. It was shown how the same policy was also implemented by Japan to block China's rising power (Zeng 2016). However, while many studies did highlight how at first political leaders in China, Japan, and South Korea prefer partners with a favorable political-military relationship for the establishment of FTAs, in the following phases, it is an issue that can easily be overcome (Choi 2020). Therefore, even if it is an obstacle in the initial phases of the negotiations, it is not as severe as some of the above-mentioned hurdles. Lastly, these three parties are in no rush to conclude the negotiation process as they do not consider the said agreement a primary issue (Zhang 2019).

Another extremely important factor that nowadays is heavily influenced by the diplomatic talks and economic ties between the three countries is the geopolitical context they are in. Especially with the invasion of Ukraine by Russia, China's biggest ally, and the threats from North Korea along with the continuous tensions between Tokyo and Seoul, the situation is far from being a cooperative one. The next paragraph will focus on the geopolitical context surrounding these three countries and how they have been moving within it, particularly since February 2022.

#### 4.4 Geopolitical context and nowadays tension among China, Japan, and South Korea

As already mentioned, there has been a tense situation in the East Asian region, especially because the three pillars of the region, China, Japan, and South Korea have been living in a tense environment due to recent events.

Although the commitment to have a yearly session where their leaders meet for negotiations each year, Japan, China, and South Korea have been unable to do so for the third year in a row. According to government reports, strained relations between Tokyo and Seoul over a long-standing potential labor conflict and Beijing's escalating military maneuvers in the East China Sea are among the reasons the trilateral communication arrangement effectively collapsed. The three East Asian presidents' most recent gathering took place in Chengdu, southwest China, in December 2019. The three nations committed to further increase collaboration in a variety of areas, including global finance, the economy, and emergency management, at their first trilateral conference in 2008. The three nations also decided to conduct official discussions once a year and alternate hosting the event (Japan Times 2022).

The following summit is scheduled to be hosted by South Korea, but it was postponed between 2020 and 2021 due to the coronavirus outbreak and tense circumstances between South Korea and Japan. Bilateral cooperation started to improve after Yoon Suk-yeol, by winning the presidential elections in May 2022, replaced President Moon Jae-in, and pledged to strengthen ties with Japan. Nonetheless, the two nations continue to be at odds because of the South Korean court decisions made during the Moon administration to dispose of regional assets confiscated from two Japanese corporations that declined to pay damages for allegedly using forced labor during Japan's colonial occupation of the Korean Peninsula from 1910 to 1945 (Japan Times 2022). Japan Times' sources (2022) report that Yoon and Prime Minister Fumio Kishida met in Cambodia in the middle of November, and they agreed to work for an initial settlement of the issue of wartime labor. It was the two countries' first official face-to-face encounter in nearly three years. However, a representative of the Japanese Foreign Ministry stated that it is challenging right now for the two leaders to travel to each other's countries because it is dubious that the labor dispute will be resolved. According to the experts, Tokyo and Seoul have been considering ideas for a fund to be arranged by South Korean businesses that would be utilized to compensate litigants in wartime labor cases on behalf of Japanese corporate accused. China

and Japan are also in conflict over several issues, such as their quarrel over the Senkaku Islands, a cluster of Japan-controlled territories in the East China Sea that the PRC claims as part of their territory and renamed Diaoyu. In an effort to destabilize Tokyo's sovereignty over the disputed islets, Chinese coast guard warships have frequently crossed the areas surrounding Japan. The United States, a military ally of Japan, has also endured hostilities with China over Taiwan escalation, particularly since the Speaker of the White House of Representatives Nancy Pelosi's visit to Taipei in August. Massive military exercises were conducted by Beijing in response to Taiwan, along with the launching of long-range missiles, a portion of which landed into Japan's territorial economic zone towards the east of the island, which China views as a renegade territory. Using force to annex the island is something that Chinese President Xi Jinping has not completely excluded. In November of 2022, Kishida and Xi met in Bangkok, marking the first in-person encounter between the representatives of both Asian superpowers since 2019. They also decided that Foreign Minister Yoshimasa Hayashi will travel to China to further deepen their institutional connections (Japan Times 2022). Nonetheless, Hayashi's travel to China, which was planned for the end of December 2022, has been delayed because of a scheduling issue on China's side. Tokyo and Beijing had originally planned to execute the mentioned visit in 2022, the year in which the two nations celebrated the 50th anniversary of the restoration of diplomatic ties, but they have now decided to postpone it to next year, taking into consideration the political calendars of both nations (Japan Times 2022).

With new presidents in charge in both nations and impending dangers from China and North Korea taunting their borders, Seoul and Tokyo could soon be willing to have a fresh start, or at least, a push in a positive direction regarding their diplomatic cooperation and ties. The relationship between South Korea and Japan is a key national security concern for Washington. The United States largely relies on both allies to combat concurrent challenges from China, which has been a long-term hegemon rival for Washington; Russia, in the wake of Moscow's military intervention in Ukraine; and North Korea, which has obstinately pushed its missile system and nuclear weapons projects in spite of devastating international sanctions (Robbie Gramer 2022). Therefore, it is essential to encourage South Korea and Japan to strengthen their diplomatic relations. Washington's politicians nevertheless believe that the Yoon and Kishida administrations will inaugurate a new phase in the South Korea-Japan ties, one in which, even if the two nations are unable to indefinitely resolve their differences, they will at least be capable of putting them aside long enough to achieve stability together. According to discussions with numerous South Korean executives and analysts, as Robbie Gramer reports (2022), Yoon and

his new conservative government have asserted that strengthening ties with Japan is a primary foreign-policy objective. Yoon has filled top roles in his cabinet with professionals who have been outspoken supporters of strengthening bilateral cooperation. The Yoon administration has already made it clear that it intends to strengthen connections with Japan by reinvigorating the General Security of Military Information Agreement (GSOMIA), an agreement for collaborative intelligence sharing and potentially resuming trilateral military drills as a precaution against threats from North Korea. Despite the fact that the Kishida administration in Tokyo has adopted a more aggressive stance toward China than that of the government in Seoul, South Koreans are becoming increasingly worried about the long-term effects of China's totalitarian tendencies and aggressive foreign policy on the Korean Peninsula's stability.

In all scenarios, Seoul's authorities generally agree that strengthening relationships with the Washington and Tokyo is their best option to safeguard against rising tensions with the PRC and North Korea (Gramer 2022). In the meantime, American President Joe Biden is urging both nations to strengthen their security and political cooperation through a series of meticulously planned trilateral summits. It was Biden who organized the first encounter with the leaders of all three nations since 2017 when he met with Kishida and Yoon on the fringes of a NATO summit on June 29th, 2022, in Madrid. According to authorities with knowledge of the situation, the trilateral conference was a diplomatic triumph but also some sort of a consolation prize since Japan and South Korea were unable to hold their own independent bilateral summits on the sidelines of the NATO summit, which put the United States in the unique circumstance of being able to bring them together in a three-way gathering (Gramer 2022).

Over the last few months, Chinese aircraft and ships have repeatedly tested the maritime and air boundaries of South Korea and Japan. Researchers theorize that China is evaluating the readiness and determination of America's two key regional security allies. Observers believe that there will be more invasions and conflicts as Beijing intensifies its assertions in Taiwan. In October 2022, the South Korean government officially acknowledged that in 2021, Chinese military aircraft entered its air defense radar zone more than 70 times without permission. Worry was also expressed when, in the previous year, a fleet of Chinese warships traveled through the congested Tsushima Strait, the body of water dividing Japan from the Korean Peninsula, to conduct maneuvers with Russian warships (Julian Ryall 2022). Socotra Rock also referred to as Jeodo, is a sunken sea hill that is 149 kilometers (92 miles) from the Korean island of Marado. China has repetitively asserted its claim to the environment surrounding the

platform, which is 287 kilometers from the closest Chinese territory. Seoul also runs an ocean research center near the platform.

As already mentioned, in the previous paragraphs, a territorial conflict between Japan and Beijing is also ongoing. The Senkaku islands, also known as the Diaoyu Islands in China, are a group of five deserted islands in the East China Sea that China claims are legitimately its land. Following Ryall's report (2022), Chinese maritime ships have regularly trespassed into the Japanese maritime borders encircling the Senkaku islands. Tokyo's navy forces have also previously discovered Chinese surveying submarines and monitoring equipment and military ships in its seas off the southern province of Okinawa. Nancy Pelosi, the speaker of the American House of Representatives, traveled to Taiwan at the beginning of August, and when China launched long-range missiles into Japan's internal economic zone encompassing Okinawa, as a retaliation against that visit, Japan was also frightened. Experts estimate the missiles that crashed in Japanese waters were meant as a warning, notwithstanding China's assurances that Taiwan is a territory of China that will someday be absorbed back into the mainland, even with the use of force and violence if needed.

According to economic analysts (Ryall 2022), South Korea and Japan both have relatively restricted natural resources and strongly rely on China for commerce, so they must be continuously careful with opposing China without inciting it to respond in the trade zone. In order to prevent North Korean nuclear missile threats, South Korea built the cutting-edge Terminal High Altitude Area Defense (THAAD) nuclear deterrent. The PRC expressed its objection to this measure by forbidding citizens of China from traveling to South Korea, striking a fatal blow to the country's tourism industry. Experts like the economist and professor James Brown, in an interview conducted by Julian Ryall (2022) remarked on how this strategy works. In fact, President Yoon essentially hid and said he was not able to see Pelosi in person when the speaker traveled to Seoul after being in Taiwan because he was so fearful of the response from China. Yoon has been a strong opponent to the economic power and cooperation South Korea has had with the PRC for the past decades. Nonetheless, he still has to recognize that the power the PRC has on South Korea's economy is incredibly strong and he cannot allow himself to commit mistakes that could potentially harm and damage his country and make his administration unpopular.

In a yearly security report released on Friday, July 15th, 2022, Tokyo, which is trying to increase its military budget and capacity, warned of growing national security risks resulting



from China's conflicts with Taiwan and Russia's conflict in Ukraine. The Indo-Pacific area is at the core of a global strategic struggle, according to defense minister Nobuo Kishi's remark in the paper. The report expresses fears that the impact of such unilateral reforms to the status quo by war may spread throughout the Indo-Pacific zone and labels Russia's war on Ukraine a severe breach of international law. A shifting global balance of power has heightened strategic competition between nations, which is particularly exacerbated by variables like China's broad and fast military growth, according to the research (Yamaguchi 2022). It sparked worries about Russia's incursion in Ukraine and its effects on Asia, thus laying the foundation for any future hostilities between Taiwan and China. According to the source, there is rising hostility between Beijing and Washington about Taiwan since Chinese airplanes have been invading Taiwanese airspace more frequently while the United States continues to deploy warships through the Taiwan Strait and provide weaponry to Taipei. The research noted that Kremlin's political and military partnership with China may become more significant as a result of Russia's international isolation and weariness from the war in a new phase focused on Moscow's conflict with Ukraine. According to the paper, bilateral military collaboration should be strictly monitored since it might have a serious impact on Japan's safety (Yamaguchi 2022). As Yamaguchi reports (2022), though China threatens to use coercion over Taiwan and raises regional instability, Beijing and Moscow are speeding up joint activities and maneuvers deploying their warships and military planes surrounding Japan, according to Defense Minister Kishi. Beijing reaffirmed its sovereignty to the contested East China Sea islands and slammed the Japanese security study for exaggerating China's military menace and interfering with its domestic Taiwan affairs. Wang Wenbin, a spokesman for the Chinese Foreign Ministry, warned, Japan to cease exaggerating the security concerns in its communities to excuse its own military expansion. These recent events have not only put the countries in a worse political situation than before, rising more tensions and threats, especially military ones, but with the countries being unable to have a diplomatic meeting in order to discuss their policies and strategies, it is unlikely that there will be any substantial progress for the conclusion of the CJK FTA.

Perhaps in the most recent years, aside from all the factors mentioned above that contributed to disrupting the negotiation process of the CJK FTA, the last point, the lack of priority in concluding the negotiations has taken a huge toll on the agreement developments. Especially after the Regional Comprehensive Economic Partnership (RCEP) was signed in 2020 and will

enter into force starting from January 2022. There are different views concerning the connection between the RCEP and the CJK FTA. Some say that noticing the similarities of the RCEP with the benefits of the China-Japan-Korea FTA, there is the perspective that the CJK FTA negotiations will receive a further push into sealing the agreement and concluding the ten-year negotiation process (Global Times, 2020). Others believe that if the RCEP will be proven to be successful and simultaneously the CJK negotiations will deteriorate once again, failing to achieve some concrete action regarding trade capabilities, the CJK will be once and for all dismissed as the RCEP will be able to fully balance the CJK area on its own (Zhang 2019).

These three countries always had different objectives and goals that made them push aside a possible FTA among them. For example, China until the late 2000s had never been particularly interested in the creation of a CJK FTA. After it acceded to the global panorama through the World Trade Organization (WTO), the PRC completely ignored the possible creation of trade assessment in East Asia, especially with the two most developed countries, Japan and South Korea (Penhong 2002). Later on, as Beijing wanted to expand its export markets, it started working on an FTA with ASEAN, which resulted in being the successful China-ASEAN FTA (CAFTA). This pact not only helped the PRC overcome its dependence on the already developed nations' economies but also was a crucial key element to counter back the 2008 global financial crisis (Wang 2011). In the most recent years, China focused on evolving from a developing country's economy to a superpower one, establishing its dominance in Asia first and gradually in the rest of the world. Moreover, the country's focus on the Belt and Road Initiative ever since 2013, shortly after the CJK FTA negotiations had started, proceeded to further push the completion of the agreement even further (Zhang 2019).

For what concerns Japan, as already mentioned by joining the TPP, the country posed as clear threat in wanting to block the rising of China using soft power. It is no novelty that although the two countries possess similar interests in certain areas, they are hesitant to cooperate. Both of them want to assume a dominant role in East Asia and therefore over the course of the years instead of building strong cooperation, they focus on blocking each other from reaching the mentioned leadership position (Park 2013). Meanwhile, South Korea has already managed to sign an FTA with China in 2014, which was implemented the following year. With how dependent South Korea was and still is on the Chinese economy and how difficult the negotiations for a trilateral FTA with Japan have been, united under the same anti-Japanese feeling, it is not surprising to see how China and South Korea managed to conclude an FTA agreement among themselves. This agreement lead to propitious conditions for trade and

investment growth along with the promotion of wealth for both countries, just as expected from the pre-conditions (Li 2021).

Given all the reasons listed above in the critical review and conclusion, it is not surprising to see that despite the deep integration, cooperation, and economic interdependence among the three countries a free trade agreement has yet to be achieved. Perhaps seeing how the China-South Korea FTA has successfully worked, Japan would be willing to restart the CJK FTA negotiations. As already stated, the implementation of the RCEP could also have positive effects on the conclusion of this almost 10-year-long process. However due to the rising tensions that have been testing the stability of the three countries and enabling the three leaders from actually meeting and discussing new economic strategies, the CJK FTA project seems to be momentarily put aside, that is until China, Japan, and South Korea will be able to go back to yearly trilateral summits like they used to.

## CONCLUSION

As discussed in the first chapter of this dissertation, free trade agreements have changed the way countries interact with each other's for what concerns economic relationships. Thanks to the many free trade agreements that have been implemented over the course of the years, many small and underdeveloped countries were able to not only increase their economic growth and development but also improve their prestige at their international level. FTAs are also able to link countries from different areas of the planet who perhaps without this tool, would have not been able to do so. In particular, countries from South America and Asia were able to develop and construct new economic partnerships with developed countries from the rest of the world. Developing countries aside from experiencing the benefits of free trade agreements, such as the reduction or elimination of tariffs and trade barriers, these countries also gained knowledge and skills from developed countries that helped them develop their economy even further. While FTAs, have been widely criticized for the possible stagnation of the economy deriving from them (Bhagwati 1994), it has also been proved how their implementation has positively increased the quality of the trade between countries and also their diplomatic ties in certain cases such as the ASEAN Free Trade Agreement introduced in 1992.

As already mentioned, Asian countries were the countries that perhaps benefitted the most from the implementation of free trade agreements. In particular, China, Japan, and South Korea, thanks to a smart trading strategy, were able to implement many FTAs and emerge as the pillars of the East Asian region. As analyzed in the second chapter of this dissertation, what also supported these countries' economic growth was the catching-up process that they experienced. As explained by Perez and Soete (1988), the catching-up process represents the procedure by which technological and knowledge gaps between countries are reduced. Japan was the first of the three to industrialize, and it is also regarded as the first Asian nation to have gone through the catching-up process. After suffering a severe economic setback during World War II, Japan was able to reconstruct its economy with a focus on technology and the development of domestic technological expertise, which enabled it to become one of the economic pillars of Asia and a significant global player (Ehrlich 1984). Regarding South Korea, the GDP of the nation was at its lowest point following the end of Japanese colonial rule and the Korean War. Nonetheless, South Korea was capable of establishing itself as a new economic power, that could compete with nations with similar comparative advantages such as Japan, and it is

deemed by many researchers to be the most prominent example of the catching-up process. This was made possible thanks to the assistance and knowledge provided and obtained by the United States and then a class of rulers that concentrated on promoting economic development (Bresser-Pereira et al. 2020). It is commonly known that China, particularly between the 1980s and 2017, has had the most substantial economic expansion worldwide. The Chinese government launched a number of initiatives, such as the reforms of the financial system, to boost its economic growth and development in order to start the process of catching up that enabled the People's Republic of China (PRC) to become one of the world's most significant economies (Bresser-Pereira et al. 2020). China, Japan, and South Korea, all experienced a different type of catching-up process that sustained their growth and development and shaped them into the now leaders of the Asian continent and pillars of the world economy.

Since China, Japan, and South Korea are considered to be the main players in the East Asian region, it would be expected for them to also have signed a free trade agreement with each other. Unfortunately, despite the high level of economic integration that these three countries are already experiencing, a trilateral free trade agreement has yet to be implemented. As seen in chapter three of this dissertation, China, Japan, and South Korea, through their trading policies, were able to sign different free trade agreements with countries all over the world, going from South America with its developing economies to the superpowers of the Western world. The three nations are already linked to each other by an outstanding degree of economic integration, both for what concerns their goods and services and also their foreign direct investment. They also result in being each other's top trade partners and investors. This is why it is surprising to see that they still lack a trilateral free trade agreement, because such an agreement would surely benefit their economies and also increase their economic power at the international level, with the possibility of such a bloc being able to compare to the one of the United States.

Lastly, in chapter four, the analysis focused on how the idea for a China-Japan-South Korea (CJK) FTA originated, how the negotiation process started and how it evolved over the course of the years, the advantages and disadvantages of the proposed trilateral agreement, and lastly the geopolitical context that plays a fundamental role in the diplomatic and economic ties of the three countries. The negotiation process started in 2012 and as of now, there is not a clear indication regarding when it could be resumed and especially if the three countries are still

willing to cooperate. Many economic reasons stalled the negotiation of the agreements such as Japan joining the TPP partnership; South Korea's insecurities regarding a trade agreement with Japan due to their similarities regarding their resources and capabilities; and China's focus on becoming a superpower. Additionally, the international tensions rising in the East Asian region have also played a significant role in the stalling of the conclusion of the agreement. The PRC's foreign policy has received bad feedback from Japan and South Korea, who fear that the country might replicate what Russia did with Ukraine with Taiwan and put in danger the entire East Asian area. Although both of them would like to counter back China's threats, they are heavily dependent on China's economy, and they fear that the PRC would deliberately try to damage the Japanese and Korean economies if met with hostility. Moreover, diplomatic relations between Japan and South Korea are also strained, despite the promise of the South Korean President Yoon to improve them during his government. These three countries have promised to meet at least once a year ever since the negotiating process started but they have failed to do after 2019 due to the COVID pandemic and rising international tensions. Many officials hope that these three countries will see the benefits of the Regional Comprehensive Economic Partnership (RCEP), signed in 2020 and which was implemented in 2022, and later decide to finish the CJK FTA negotiation process and, finally, implement the trilateral free trade agreement. However, that also depends on how the geopolitical context will evolve and whether all the tensions surrounding these three countries will be reduced. Therefore, despite the high level of economic integration and the strong trade relations that are already connecting these countries and the importance that these countries have in economic terms for each other, a free trade agreement has still to be signed and established. These countries not only face multiple obstacles for what concerned the economic terms of the agreements and also geopolitical tension both in the East Asian area and in the international arena.

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