

2003 to 2008, joint research on a CJK FTA in the first phase covered almost all the important issues on FTAs, other than trade facilitation (see Appendix). Trade facilitation in regional trade agreements is a comparatively new issue, and has increasingly drawn the attention of policy makers in trade and investment. Naturally, a prospective CJK FTA will have the characteristics of a regional agreement, which will place a focus on both cooperation and liberalization aspects. The review and study on trade facilitation measures in an FTA will address the issues.

### *Structure of the Report*

The second and third sections cover the global economic crisis and the road to recovery in Northeast Asia, and trade facilitation and a CJK FTA, respectively. Some remarks follow on the progress in other East Asian region-wide liberalization initiatives. Four specific policy recommendations to the leaders and governments conclude the report.

## **2. Global Economic Crisis and the Road to Recovery in Northeast Asia**

After a brief review of the impacts of the global financial crisis on world economy and trade, this section examines its impacts on trade in China, Japan and Korea by comparing the recent trade data with the trends prior to the crisis. Then comes an analysis on the changes in the trade patterns of China, Japan and Korea with major trading partners before and in the wake of the crisis, seeking to find out the structure of their exports in terms of broad economic categories. Lastly, some implications conclude the section.

### *Impacts of the Global Financial Crisis on Trade in China, Japan and Korea*

The world's trade in goods had a tendency to increase more rapidly, even though it used to fluctuate more widely than the world's industrial production, before the global financial crisis. However, in the wake of the global financial crisis, the fall in world exports was much more severe than that of the world's industrial production. In February 2009, world exports declined by 30.0 percent on a year-on-year basis, while the world's industrial production decreased by 13.6 percent.

Most forecasting institutions predict that the impact of the global financial crisis on the world economy and trade will become severe and generally more devastating for advanced economies. According to the World Bank, global GDP is expected to contract by 1.7 percent in 2009, which would be the first decline in world output on record, and volumes of world trade in goods and services are expected to drop 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of

manufactured products.<sup>1</sup> Then, in June this year, the World Bank announced a gloomier outlook. It predicted that the global economy would decline this year by about 2.9 percent and that the economies in high-income nations would contract by a total of 4.2 percent this year. According to the International Monetary Fund (IMF),<sup>2</sup> world output is expected to contract by 1.4 percent in 2009, and that of developed countries by 3.8 percent, while the OECD Economic Outlook predicted that the world real GDP would decline by 2.2 percent in 2009 and grow 2.3 percent in 2010.<sup>3</sup>

**Table 1. Forecasts of World GDP and Trade for 2009**

(Percent)

	WTO (March 2009)	IMF (July 2009)	World Bank (June 2009)	OECD (June 2009)
World GDP <sup>1)</sup>	-	-1.4	-2.9	-2.2
Developed countries	-	-3.8	-4.2	-
Emerging and developing countries	-	1.5	1.2	-
World Trade	-9.0	-12.2	-9.7	-16.0
Developed countries <sup>2)</sup>	-10.0	-15.0	-	-15.6
Emerging and developing countries <sup>3)</sup>	-3.0 to -2.0	-6.5	-	-17.0 to -16.4

Notes: 1) Annual percent change at constant prices.

2) and 3) represent export growth rates.

Sources: International Monetary Fund (July 8, 2009); OECD (June 2009); World Bank (June 2009); World Trade Organization (March 23, 2009).

With regard to world trade, the forecasting institutions predicted an even sharper decline than global GDP. As shown in Table 1, the WTO predicted that it would shrink by 9.0 percent in 2009, while according to the World Bank and the IMF, it is expected to contract by 9.7 percent and 12.2 percent, respectively. The OECD Economic Outlook forecasted that world real trade would shrink by 16.0 percent in 2009 and grow 2.1 percent in 2010.

### *Trends in Trade of China, Japan and Korea*

#### (1) Exports

Annual trade data show that both the exports and imports of China, Japan and Korea have increased rapidly from 2001 to 2008. China showed the fastest growth, while Japan's trade growth rate was relatively slow among the three countries. The exports of China, Japan and Korea together also

<sup>1</sup> World Bank. *Global Economic Prospects 2009*. Forecast Update, March 30, 2009.

<sup>2</sup> IMF. 2009. *World Economic Outlook*, April.

<sup>3</sup> *OECD Economic Outlook*. Volume 2009/1 No.85, June. The economies of the United States, Euro area and Japan are expected to shrink by 2.8 percent, 4.8 percent, and 6.8 percent, respectively, in 2009, and grow by 0.9 percent, 0.0 percent, and 0.7 percent, respectively, in 2010.

continued to increase until the third quarter of 2008. Exports from all three countries began to decline in the fourth quarter of 2008 and contracted markedly in the first quarter of 2009 before rising in the second quarter of 2009. However, in the second quarter of 2009, the levels of exports from China, Japan and Korea were still much lower than those of the same period last year. The year-on-year export growth rates of China, Japan and Korea amounted to -23.5 percent, -34.0 percent and -20.4 percent, respectively, in the second quarter of 2009.

Among the three countries, Japan seemed to have suffered the most in terms of export contraction. Japan's export level shrank by 40.3 percent, and 34.0 percent, respectively, in the first and second quarter of 2009 compared to the same period last year. Additionally, China's export level in the fourth quarter of 2008 remained still higher than the previous year by 4.3 percent, while that of Japan and Korea contracted by 9.4 percent and 9.9 percent, respectively.

## (2) Imports

The imports of China, Japan and Korea showed a similar trend as their exports. They continued to grow until the third quarter of 2008 before going down sharply in the fourth quarter of 2008 and the first quarter of 2009. However, there were several differences. First, Japan's imports began to decline later than those of China and Korea. Second, in the second quarter of 2009, Japan's imports continued to decrease, whereas both Korea and China's imports began to recover. Third, Korea's imports, unlike its exports, seemed to recover slowly. As of the second quarter of 2009, Korea's import level was still lower than that of the same period last year by 36.2 percent, while China's imports were only 20.4 percent below the level of the previous year.

### *Intra-regional Trade Has Become Important in Northeast Asia: Long-term Trends in Trade Shares*

The intra-regional share in the exports of China, Japan and Korea increased from 11.1 percent in 1990 to 20.6 percent in 2004, except during the Asian financial crisis periods, before diminishing to 18.8 percent in 2007. It went up slightly to 19.5 percent in 2008. Meanwhile, the shares of the United States and the EU decreased from 27.9 percent and 18.1 percent, respectively, in 1990 to 17.3 percent and 15.6 percent, respectively, in 2008. ASEAN's share fluctuated, but represented 10.2 percent in 2008, which was almost at the same level as 10.3 percent in 1990.

The intra-regional share in the imports of China, Japan and Korea rose from 14.0 percent in 1990 to 28.1 percent in 2004 before diminishing to 25.4 percent in 2008. ASEAN's share went up from 10.7 percent in 1990 to 12.8 percent in 2003 before slightly diminishing to 11.9 percent in 2008. Meanwhile, the shares of the United States and the EU shrank from 21.3 percent and 15.6 percent,

respectively, in 1990 to 8.5 percent and 10.0 percent, respectively, in 2008.

Overall, the intra-regional trade between China, Japan and Korea has become truly important for the trade of China, Japan and Korea. In particular, in terms of imports, the intra-regional share has become the predominant factor for all three countries, while the relative importance of the United States and the EU as importing sources has significantly weakened. Even in terms of exports, the intra-regional market is by far the most important for Korea, and has become the most important for Japan, surpassing the United States. However, China is an exception. For China, the United States and the EU have become the most important export destinations, ahead of the intra-regional market.

### *Effects of the Crisis on the Decline in Trade of China, Japan and Korea with Major Trading Partners*

#### (1) Exports

As shown in the previous section, **China's** exports started to recover in the second quarter of 2009. The intra-regional share (that of Japan and Korea) in China's exports continued to shrink in the first three quarters of 2008. The trends were reversed in the fourth quarter of 2008 and the first quarter of 2009 before contracting again to 12.5 percent. The share of the United States remained the same in the wake of the global financial crisis in late 2008, but increased in the first quarter of 2009, while the share of the EU, that has seen a rising trend, decreased in the first two quarters of 2009. The imports of the United States and the EU from China reduced after the latter half of 2008. However, the intra-regional exports from China, particularly to Japan, were hit harder than her exports to the US and the EU in the second quarter of 2009. This showed that Japan suffered from a shrinkage of import demands that was larger than the United States and the EU.

The intra-regional share (that of China and Korea) in **Japan's** exports shrank in the fourth quarter of 2008 before getting larger in the first two quarters of 2009 to reach 28.0 percent in the second quarter of 2009. On the other hand, the share of the United States rather decreased in the first two quarters of 2009, while the share of the EU diminished in the second quarter of 2009. This indicates that the imports of China and Korea from Japan were hit less severely than those of the US and the EU and started to recover in the first half of 2009.

The intra-regional share (that of China and Japan) in **Korea's** exports contracted in the fourth quarter of 2008 before recovering in the first two quarters of 2009 to record 28.6 percent in the second quarter of 2009. This is due to the recovery of China's imports from Korea. The shares of the United States and the EU rose in the fourth quarter of 2008, but they contracted in the first two quarters of 2009.

## (2) Imports

The intra-regional share of **China's** imports increased in the fourth quarter of 2008 and the first quarter of 2009 before coming down to the previous level in the second quarter of 2009. The shares of the United States and the EU also showed a similar pattern. The intra-regional share of **Japan's** imports got bigger in the wake of the global financial crisis, reversing the diminishing trends that have existed since 2006. In addition, the shares of both the US and the EU increased since the fourth quarter of 2008. The intra-regional share of **Korea's** imports also showed a growing pattern. They increased since the fourth quarter of 2008, confirming the continuation of the rising trends that existed prior to the crisis. Imports of Japan and Korea from China, despite the crisis, declined to a lesser degree during the crisis period.

As for the intra-regional share in the imports of China, Japan and Korea, this increased in the wake of the global financial crisis, amounting to 25.8 percent in the second quarter of 2009, reversing the diminishing trends since 2005. The shares of the United States and the EU also became more important in the second quarter of 2009 than before the crisis, also reversing the previous trends.

Overall, we can observe the macroeconomic multiplier effects in the trade of the region. First, due to the crisis, exports from all three countries to the United States and the EU declined sharply. This led to a reduction in macroeconomic production in the three countries, bringing about a contraction of their import demands. A decline in intra-regional trade emerged. The shares of intra-regional trade reflected the differences in the received damage and timing of the recovery of each country. In addition, international input-output relations, analyzed below, may have also affected the outcome.

### *Commodity-based Analysis: Longer-term Trends*

We highlight some characteristics of the exports of China, Japan and Korea, as a region and as individual countries, that could be useful in drawing policy implications for the future of intra-regional trade by analyzing yearly data on structures of their exports to major trading partners in terms of broad economic categories.

As shown in Table 2, the shares of consumption goods in **China's** exports to major trading partners all shrank for the period between 1995 and 2007, while the shares of intermediate goods and capital goods in its exports to them all increased during the same period. However, in terms of levels, the shares of intermediate goods in China's exports to the CJK region and ASEAN remained higher than those to other regions. For the same period, the structure changes in **Japan's** exports differed significantly depending on trading partners. For Japan's intra-regional export to the CJK region and

ASEAN, the share of intermediate goods increased and its level remained high, while the share of capital goods decreased. The main characteristics of the structure of **Korea's** exports seem to be as follows: first, the rising importance of capital goods in Korea's exports to all major trading partners, second, the share of consumption goods exports decreased, and third, the share of intermediate goods exports has been higher to the CJK region and ASEAN than those to other regions.

**Table 2. Share of Exports of China, Japan and Korea by Production Process with Major Trading Partners**

(Percent)

Region	Goods		China		Japan		Korea		CJK	
			1995	2007	1995	2007	1995	2007	1995	2007
Intra (CJK)	Intermediate Goods	Parts	5.9	19.8	26.5	31.3	18.4	36.5	18.3	28.2
		Semi-finished	26.5	28	36.9	39.9	46.5	36.8	35.9	34.6
	Capital Goods		7	17.6	30.7	19.9	9.2	20.3	18.4	19.1
	Consumption Goods		50	30.8	4.1	3.7	24.2	4.4	22.9	14.2
	Dual Use Goods		0	0	1.1	2	0.4	0.8	0.6	0.9
ASEAN	Intermediate Goods	Parts	10.7	23.6	41.8	39.4	34.3	32.5	37.5	31.3
		Semi-finished	41.3	32.6	23.4	33.4	43.2	37	28.6	33.7
	Capital Goods		16.8	26.4	28	20.6	15.2	25.1	24.7	23.9
	Consumption Goods		25.2	15.8	3.8	3.8	5.6	3.1	6.2	9
	Dual Use Goods*		0.1	0	2.8	2.2	1.4	1.8	2.3	1.2
EU	Intermediate Goods	Parts	5.5	14.2	31.8	30.7	33	17.8	27.2	18.9
		Semi-finished	26.3	20.5	14	15.5	14.7	13.9	16.3	18.4
	Capital Goods		13.9	34.5	33.4	24	25.9	44.2	28.7	32.8
	Consumption Goods		49.7	30	8.2	11.3	13.8	6.2	16.6	22.3
	Dual Use Goods*		0	0.2	12.6	18.2	12.5	17.7	10.3	7
USA	Intermediate Goods	Parts	6.4	13.7	37.4	27.7	41.9	25.6	33.5	19.6
		Semi-finished	13.7	15	11.4	12.2	11.1	17.3	11.7	14.3
	Capital Goods		16.1	32.2	27.1	19.1	20.2	28.8	24.4	27.5
	Consumption Goods		61.4	38.7	6.3	8.2	19.9	8.7	16.4	25.5
	Dual Use Goods*		0	0	17.8	32.6	6.7	19.5	13.5	12.9

Note: We identified each product by stage of production based on the Broad Economic Categories (BEC) Classification released by the United Nations. \*"Dual use goods" in the table means "automobiles," which cannot be classified into either industrial or consumer goods.

Source: Calculated by the Authors using the COMTRADE Database [online].

In sum, Table 2 indicates that intermediate goods occupied a dominant portion in the intra-regional trade of the three Northeast Asian countries as well as in their exports to ASEAN, while their shares were relatively less important for the United States and the EU in 2007. Among the trade with the three Northeast Asian countries, the shares of intermediate goods exports were notably higher from

Japan and Korea to China. On the other hand, the shares of dual use goods (i.e. automobiles) for intra-regional trade and ASEAN were only 0.9 percent and 1.2 percent, respectively, in 2007, whereas they represented 12.9 percent for the United States and 7.0 percent for the EU in 2007. In other words, until recently, the three countries exported mainly intermediate trade goods among themselves and to ASEAN, while they exported mainly final goods to the United States and the EU.

#### *Commodity-based Analysis: Impacts of the Global Financial Crisis on Exports*

When it comes to the effects of the global financial crisis in terms of broad economic categories in the exports of China, Japan and Korea, China suffered only moderately from the decline in the exports of consumption goods to Japan and Korea, whose share actually increased in the first two quarters of 2009. The major damage in her intra-regional exports came from the reduction in the exports of semi-finished goods to Japan and Korea. Japan and Korea maintained high shares of intermediate goods exports in intra-regional trade. This means that the exports of intermediate goods by Japan and Korea to China declined by almost the same proportion to other commodities. We may observe the input-output effects, by which the reduction in the exports of final goods from the region led to a shrinkage in production, bringing about a reduction in the intra-regional trade of intermediate goods.

#### *Implications*

China, Japan and Korea have suffered from the global financial crisis. Although most recently their economies and trade have begun to show some signs of recovery, their production and trade volumes still remain markedly below the pre-crisis levels. Moreover, since it is expected that the recovery will be slower in the economies of the United States and the EU, the difficulties that the three countries are facing in their trade are likely to last for a while.

Thus, in the short-term, to compensate for the slowing demand in the United States and the EU, a larger regional market will be needed. In the long-term, since the United States is not expected to continue to absorb rising imports from the Northeast Asian countries, it will be necessary to create an enlarged regional market in Northeast Asia or East Asia.

Furthermore, given the fact that the three countries export mainly intermediate goods among themselves and to ASEAN (albeit with some exceptions), while they export mainly final goods to the United States and the EU, in particular, a larger regional market for final goods should be sought after.

Therefore, China, Japan and Korea should turn this global financial crisis into an opportunity to form a China-Japan-Korea FTA (CJK FTA). It is well-known that Europe started its regional economic

integration process after World War II, and more recently, the Asian financial crisis prompted the East Asian countries to consider more seriously economic regionalism, and gave birth to the ASEAN+3 framework.

### **3. Trade Facilitation and the CJK FTA**

There is no common definition of trade facilitation in the existing international agreements. The definitions depend on the purpose, scope and direction of the agreements, and can naturally vary with each other. For instance, according to the Asia Pacific Economic Cooperation (APEC) in 2002, trade facilitation generally refers to the simplification, harmonization, use of new technologies, and other measures to address procedural and administrative impediments to trade. While the APEC's agreements are non-binding, the coverage of trade facilitation was wide and challenging. Compared to this definition, the WTO for instance narrowly defines trade facilitation as the simplification and harmonization of international trade procedures.

This section reviews and surveys the significant roles of trade facilitation both theoretically and empirically, and seeks possible application to a CJK FTA. The review looks first at the scope, coverage and economic rationale of trade facilitation in the regional trade/cooperation agreements. This also includes a brief review of the trade facilitation initiatives in the WTO and APEC. The second part of the section reviews the economic effects of various trade facilitation measures. The third part concludes the section with some consideration of trade facilitation in FTAs.

#### *Trade Facilitation: Its Revisited Roles*

Bilateral or regional cooperation has been the standard modality to facilitate international trade in the history of trade liberalization after the War. The multilateral approach in trade facilitation emerged as an active initiative only recently, since the new round of trade negotiation in the World Trade Organization (WTO). Until then, bilateral or regional initiatives had been the major arena of trade facilitation. However, such bilateral/regional cooperation in trade paid attention only to the natural bi-products of the regional trade agreements (RTAs), namely those which closely relate to the tariff enforcement, such as customs procedures and the cooperation between customs administrations.

For these two decades, a new trend in the strategy to liberalize international trade has appeared among the policy-makers as an emerging consensus: that is, to revisit the roles of trade facilitation and to use it more actively as one of the major vehicles to promote trade. The trade facilitation in the new context covers much wider areas of trade policies than ever, not limited to customs procedures. One of the notable examples in East Asia is the APEC, which regards trade facilitation as one of the two pillars to