



The optimal path of regional economic integration between asymmetric countries in the North East Asia

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Abstract

This paper examines the optimal path of regional integration in the East Asian region from the perspective of Korea, as a country with an intermediate level of technology in the Asian region. Based on the welfare analysis of three types of FTA regimes between technologically asymmetric countries, this paper demonstrate that the optimal path of regional integration for the country with an intermediate technology level would be to form multiple bilateral FTAs, i.e., Hub and Spoke type FTA between technically asymmetric countries from the very initial stage. The second best regime is the multilateral Asia wide FTA. The worst case for a country with an intermediate technology would be to form a FTA with a country with advanced technologies, and extends the FTA with the less developed countries in the later stage. These results imply that the optimal strategy of regional integration for a country with an intermediate technology level, such as Korea, is to form a Hub and Spoke type FTA rather than a bilateral FTA with Japan followed by the participation of other Asian countries. The pre-requirement for the multiple bilateral FTAs is the fundamental industrial restructuring of the Korean industries, such as reallocating the human and economic resources from the sectors of comparative disadvantage to the sectors with comparative advantage. The successful FTAs assumes the nation-wide efforts involving the massive restructuring cost including the establishment of the social-safety net during the transition period. Moreover, the Asian type fiscal federalism is required for a genuine economic integration in the region.

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1. Introduction

With the launch of official negotiation on the Korea–Japan Free Trade Agreement, a deluge of discussions and policy suggestions are provided over the future direction of FTA formation in the Asian region from the perspective of Korea, as a country with an intermediate technology and an intermediate market size. The current Korean government gives the first priority on the formation of the bilateral FTA with Japan followed by the FTA with Singapore, ASEAN and other Asian countries while China remains as a partner in the future, not in a near future. Regarding the above Korean government approach, many criticisms are raised especially from the long-term industrial restructuring aspects.

One argument goes that when Korea forms a FTA with Japan excluding all the other Asian countries, Korean industrial structure, which is vertically integrated to Japanese industries in terms of technology, might specialize in less valued-added sectors, where she has comparative advantage compared to Japan. Other counter-argument goes that with the larger market access chances and the increased competition with Japan, the efficiency of the Korean economy will be enhanced. Without theoretical consensus on the long-term industrial effects of Korea–Japan exclusive bilateral FTA, the Korean targets to launch the agreement as soon as possible focusing on the political effects of the agreement.¹ The arguments on the long-term industrial effects of Korea–Japan FTA can be generalized as the issue of the preferential trade agreement's long-term effects between the technologically asymmetric countries. This paper targets to examine this controversial issue focusing on the impacts of technical asymmetry on the PTA's welfare effects and the optimal dynamic path of regional integration in the Asian region considering the technological asymmetry.

Dynamic path to reach the Asian economic integration can be categorized into three groups: (i) Sequential bilateral trade agreement initiated by the Korea–Japan FTA followed by Korea's FTA with other Asian countries, (ii) Hub and Spoke type FTA, i.e., simultaneous multiple bilateral FTAs, and (iii) a multilateral FTA such as a Pan-Asia wide FTA. This paper will examine the welfare effects and the producer surplus effects of each case, and determine the optimal path for a country with intermediate technology such as Korea.

There have been several approaches to examine the economic impacts of forming preferential trade agreement, and prior studies can be categorized into three groups. The first group, based on simulations about the impacts of FTA formation through CGE model, tried to provide a projection on the static effects on trade balance and other macroeconomic variables.² The second group of studies focuses on the coalition formation issue based on the incentive mechanism to abide by the FTA arrangement. Through this analytical model based approach, they tried to examine whether FTA is a stumbling bloc or a stepping-stone towards multilateral trade liberalization. The third approach is led by economic geographic approaches with special emphasis on the spatial economy.³ This approach has its strong points in examining industrial agglomeration and relocation effect of FTA.

¹ Refer James and Movshuk (2003), Brown, Deardorff, and Stern (2003) and Yamazawa (2001) for the details of the economic and the political backgrounds of Korea–Japan FTA negotiation.

² The representative studies of CGE approaches include Hinojosa-Ojeda, Robinson, and De Paolis (1999), Scollay and Gilbert (2000), and Brown, Deardorff, and Stern (1996).

³ The basic methodology and the major findings from economic geographic approaches are concisely summarized in Fujita, Krugman, and Venables (1999).

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