

ASEAN-CHINA FREE TRADE AREA

**CHALLENGES , OPPORTUNITIES
AND THE ROAD AHEAD**

RSIS Monograph No. 22

Edited by
Keith E. Flick & Kalyan M. Kemburi

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S. Rajaratnam School of International Studies

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INTRODUCTION

Keith E. Flick

The full implementation of the ASEAN-China Free Trade Area (ACFTA, or sometimes referred to as CAFTA) from January 2010 marked a major milestone in relations between China and Southeast Asian states. The path to the creation of the world's largest free trade area by population can be traced back just over a decade, and bears examination if we are to fully understand the complexities, challenges, opportunities and ultimately the future of this initiative.

This introduction aims to serve as a background for the subsequent chapters, which explore the FTA in further depth, and to help the reader better understand these underlying issues that have affected—and will continue to affect—the efficacy of the FTA. While seeking to provide the reader a brief history of the efforts that led to the formation of ACFTA, this chapter also makes the argument that from the outset the impetus of an FTA between China and ASEAN grew as much, if not more, from geopolitical goals, as economic ones. Further, an awareness of these motivations is key to understanding the challenges that the parties in this FTA face.

THE ROOTS OF THE ASEAN-CHINA FREE TRADE AREA

The proposal for the formation of a FTA between China and ASEAN by former Chinese Premier Zhu Rongji in 2000, followed in the wake of

several years of what has come to be known as the “China threat thesis”¹ After the 1989 Tiananmen Square incident and a steady increase in its economic growth, many observers—particularly, but not exclusively, from the United States—began sounding the alarm of the dangers of a rising China. As a result, fear of a Washington-led attempt at containment developed in Beijing.

Then, in 1997 an opportunity for China to convince its neighbours of its peaceful and cooperative intentions presented itself in the form of the Asian Financial Crisis. Beijing’s commitment during the crisis not to devalue its currency was seen as a strong gesture of support in Southeast Asian capitals, and subsequent Chinese economic assistance further eroded the trepidation felt by some within ASEAN. In this context, Premier Zhu’s proposal for an FTA can be viewed as another salvo in Beijing’s “charm offensive”²

The proposal for an FTA, however, was initially met with some amount of surprise and caution by ASEAN delegates.³ Singapore’s then-prime minister was quoted as saying the proposal was “a challenge, not a threat”⁴ This could hardly be taken as an eager response to the idea. At the time, the growth of China’s economy had begun to worry some in the 10-member association, and China’s pursuit towards WTO membership further caused anxiety in Southeast Asia. In 2000 China was already receiving two-thirds of foreign direct investment going to Asia’s emerging economies.⁵ But China’s proposal of deeper economic cooperation was an adroit move aimed at showing Southeast Asian states that China wished to share the opportunities of its expanding economic power, rather than compete with its southern neighbours.

Despite the geopolitical motivations involved, there can be no doubt that the Chinese idea of an FTA with ASEAN was also borne from eco-

- 1 Some of the most prominent early examples of the China threat thesis include: Charles Krauthammer, “Why We Must Contain China”, *Time* (31 July 1995), p. 72; Richard Bernstein & Ross Munro, “The Coming Conflict With America”, *Foreign Affairs*, Vol. 76, No. 2 (March–April, 1997), p. 19.
- 2 A term popularised by Joshua Kurlantzick’s book of the same name, *Charm Offensive: How China’s Soft Power is Transforming the World* (Yale University Press, 2007).
- 3 *Bangkok Post*, “China seeks ASEAN free trade link-up”, 24 August 2001.
- 4 *The Economist*, “The best things in life”, 30 November 2000.
- 5 *The Economist*, “China Charms South-East Asia”, 25 November 2000.

conomic motivations. Free trade with Southeast Asian states promised China access to cheaper raw materials and agricultural products. There were only a few downsides to such an economic tie-up from China's perspective. China's manufacturers would face little threat from their ASEAN counterparts, who could hardly compete with China's abundant and cheap labour force.

Though there were initially some concerns about the proposal in ASEAN,⁶ there was also recognition of the opportunities to profit from increased exports to the huge and ever-growing Chinese domestic market. And at least some Southeast Asian leaders likely had their own geopolitical motivations, in what Evelyn Goh has called ASEAN's "omni-meshment" strategy towards China and the other major powers.⁷ As this line of reasoning goes, ASEAN cannot hope to influence China's behaviour through direct power politics, so it takes a Lilliputian approach to tying down the giant through myriad multilateral agreements and cooperative projects—all with the hope that a China more involved in the region will be obliged to be a more responsible actor.

Following Zhu's proposal, the China-ASEAN Experts Group on Economic Cooperation was formed in 2001 to explore the possible establishment of an FTA between the parties. Later that year, the Experts Group recommended that the FTA concept go forward, citing the potential for such an agreement to create an economic region of 1.7 billion consumers and a regional GDP of about US\$1.23 trillion.⁸

A year later, in 2002, China and the ASEAN states formally adopted what became known as the Framework Agreement on Comprehensive Economic Cooperation, which set out to establish the FTA within 10 years. Though the agreement included China and all 10 ASEAN countries, there was from the beginning an explicit understanding that "special and differential treatment and flexibility for the newer ASEAN Member

6 For example, see comments from former ASEAN Secretary-General Rodolfo Severino and others in Barry Wain, "Some in ASEAN have issues with China FTA", *The Asian Wall Street Journal*, 7 October 2002.

7 Evelyn Goh, "Great powers and hierarchical order in Southeast Asia: Analyzing regional security strategies", *International Security*, Vol. 32, No. 3 (Winter 2007/2008), pp. 113–157.

8 "Forging closer ASEAN-China Experts Group on economic relations in the 21st century", a report submitted by the ASEAN-China Experts Group on Economic Cooperation, October 2001, p. 36, www.aseansec.org.

States of Cambodia, Lao PDR, Myanmar and Viet Nam”⁹ The older members (known as the ASEAN 6) would reduce, and in some cases eliminate, tariffs on all normal-track products by 2010 and the newer members (abbreviated as CLMV) by 2015.

The agreement covered not only trade in goods and services but also investment and other forms of economic cooperation. It also outlined the creation of an Early Harvest Programme, discussed further below. Later agreements at ASEAN-China meetings fleshed out the broad outline of the 2002 framework. The first of which was the Protocol to Amend the Framework Agreement, signed in Bali in 2003. This amendment further clarified the terms and timeline under which member countries reduced or eliminated their tariffs, as well as making it possible for individual ASEAN members to sign separate bilateral agreements with China.

The signing of the 2003 Protocol also implemented the Early Harvest Agreement (EHP). The EHP was primarily aimed at offering an immediate reduction of tariffs on certain products prior to the full enactment of ACFTA, the majority of such action to be undertaken by China. The programme meant that over 600 agricultural products and more than 100 types of manufactured goods from ASEAN exported to China from 2004 to 2010 saw a reduction and eventual elimination in tariffs. ASEAN members, in turn, granted some tariff concessions on specific agricultural products from China. However, the uneven agricultural sector capabilities of the different ASEAN member states caused some to worry that others would reap benefits without contributing their fair share. This resulted in an amendment as part of the 2003 protocol that allowed ASEAN members to unilaterally reduce tariffs with China, rather than doing so on a multilateral basis with each other. The most forward-leaning approach under the EHP came from China and Thailand, which agreed to eliminate tariffs on all fruits and vegetables by 1 October 2003.¹⁰

Further negotiations on the trade in goods (outside of EHP) and services as well as investments began in earnest in 2003, but not without some difficulty. As Chen Huiping from Xiamen University asserts,

9 *Framework Agreement on Comprehensive Economic Co-Operation Between ASEAN and the People's Republic of China*, Phnom Penh, 4 November 2002, The ASEAN Secretariat, available at www.asean.org/13196.htm

10 This agreement can be found at China's Ministry of Commerce website, mofcom.gov.cn.

China's rush to enter into an FTA with ASEAN was borne from broad political goals and without a complete analysis of the implications of such an agreement.¹¹ This resulted in some hesitation on the part of the Chinese central government once negotiations came into full swing, causing delays. Other issues on the Chinese side, such as the mixed representation of various agencies and ministries within the Chinese delegation, further complicated negotiations. Likewise, the varying national interests and levels of economic developmental among the different ASEAN member states also contributed to the complexity of the talks.

The Agreement on Trade in Goods (TIG) outlined the two tracks of goods laid out in the Framework Agreement: a Normal Track and a Sensitive Track. In the normal track, the ASEAN 6 could maintain 150 tariff lines for two years beyond the full implementation of ACFTA (until 2012). The CLMV countries, on the other hand, could retain approximately 50 per cent of their tariffs on normal-track products until 2010. Beyond 2010, CLMV tariffs are to be reduced and eventually eliminated within several years. For the sensitive track, each of the ASEAN states held negotiations with China to come to agreement on the reduction and elimination of tariffs on those products considered sensitive to individual economies. As with the normal track, the CLMV countries had more leeway with both the number of tariff lines and the ultimate date of tariff elimination on the sensitive track.

Once the agreement on TIG was inked, negotiations on trade in services (TIS) and investment were tackled, and continued into 2007. Again, as noted above, talks leading up to these agreements were complicated by the differing concerns of the individual ASEAN members. Whereas Singapore was more concerned about its service sector, the less-developed ASEAN states put more attention on goods and investment. In the end, a series of bilateral agreements between China and individual ASEAN members resulted to address the discordant concerns of the different parties.

As negotiations between the respective governments wound down and implementation drew near, concerns from various industry groups

11 Chen Huiping, "China-ASEAN FTA: An investment perspective", in John Wong et al. (Eds.), *China-ASEAN Relations: Economic and Legal Dimensions* (Singapore: World Scientific Publishing, 2006).

(primarily in Southeast Asia) were on the rise.¹² Would local industries in Southeast Asia remain competitive or would they suffer from a massive influx of less expensive Chinese goods? Would workers' wages be affected? Questions were raised from within regional governments themselves. How would governments encourage businesses to utilise the FTA? Would businesses opt to pay more rather than deal with the red tape involved to take advantage of the lowered tariff rates? How would non-tariff trade barriers be addressed? How might the growth of new industries in particular areas affect the environment?

Even shortly after the implementation deadline, some Indonesian lawmakers were feeling uneasy with the potential impacts of the agreement. Members of Indonesia's lower house, apparently reacting to industry and public concern, argued for a delay of tariff reductions on some 228 items. In the end, Jakarta's executive leadership rejected any delays. Yet the fact that many questions and concerns remained suggests that the motivation "from the top down" to conclude the negotiations and implement the FTA took precedence over ironing out the details, despite how significant those details might be. In the end, the geopolitical aims of the agreement were moved forward, but many questions and concerns emanating from the businesses, economists and academics remained.

ABOUT THIS MONOGRAPH

In February 2011, just over one year into the official start of ACFTA, the China Programme at the S. Rajaratnam School of International Studies at Nanyang Technological University in Singapore hosted a workshop aimed at addressing the above questions and, more generally, to examine the FTA's progress, successes and remaining challenges. This volume is the result of the hard work that the contributors and organisers put into that workshop. It is hoped that this work will provide the reader with a solid background and understanding of the FTA and the attendant issues it faces in the years to come.

12 For examples, see: Liz Gooch, "In Southeast Asia, Unease Over Free Trade Zone", *The New York Times*, 28 December 2009; "Indonesian manufacturers urge govt to delay China-ASEAN FTA", Reuters News Service, 29 July 2009; Mustaqim Adamrah, "ASEAN and China FTA to ignite 'tug of war in trade'", *The Jakarta Post*, 27 July 2009.

The volume, like the workshop upon which it is based, is organised into three thematic parts, and calls upon scholars and practitioners from across Southeast Asia and China to address various aspects of the FTA. The first part addresses the region-wide impact of ACFTA—its successes and challenges—by calling on two experts from China and ASEAN, respectively.

Chapter 1, by Liu Jianren, offers a broad Chinese perspective and looks at the achievements and challenges of the FTA in its first year of full implementation. Liu argues that the FTA has thus far promoted greater economic ties between China and ASEAN while also relieving some of ASEAN's concerns over China's rise. From the ASEAN perspective, the author of Chapter 2, Rony Soerakoesoemah, is similarly optimistic for ACFTA's future as a vehicle to not only improve trade relations but also to promote a greater sense of community among its signatories.

The second part of the monograph explores perspectives from individual FTA member states. This part grants the reader a window into the thoughts and perceptions of scholars and practitioners who are best positioned to offer their analysis, as they have their "boots on the ground", as it were. This allows the reader the opportunity to compare and contrast the various experiences of each country, which is often neglected by works that focus on macro-level analysis.

In Chapter 3, Paisan Rupanichkij offers an overview of Thailand's experience with the FTA. Mahani Zainal Abidin explores ACFTA from Malaysia's perspective in Chapter 4. In Chapter 5, Amado M. Mendoza Jr. reviews the first year of ACFTA from the Philippines' point of view, and places it in the context of what he calls the "roller coaster" pattern of relations between Manila and Beijing.

The Vietnamese perspective on the FTA, by Chu Minh Thao, is featured in Chapter 6. In Chapter 7, Indonesia's experience with the first year of ACFTA's implementation is analysed by Tirta N. Mursitama. A perspective from Cambodia is presented in Chapter 8 by Suon Sophal. Last but not least of the ASEAN countries featured is Singapore in Chapter 9 by Yang Mu. Rounding out this section is Chapter 10 by Liao Shaolian, which outlines the progress and problems of ACFTA seen thus far from China's vantage point.

The third and final part explores ACFTA's impact on, and its relationship with, broader Asia-Pacific regional trade and relations. In

this section we hear first from Noboru Hatakeyama in Chapter 11 on how ACFTA fits into the network of other FTAs that have proliferated throughout the Asia-Pacific region. Chapter 12, by Fan Ying, looks at the Free Trade Area of the Asia-Pacific (FTAAP), which has been proposed to include all the members of the Asia-Pacific Economic Forum (APEC). Lastly, the Trans-Pacific Partnership (TPP) is featured in Chapter 13, by Henry Gao.

This monograph ends with concluding remarks from Kalyan M. Kemburi, in Chapter 14. The chapter provides an overview of the achievements made by ACFTA as well as the challenges that the countries within the free trade area will face in coming years. Additionally, the chapter provides an alternative explanation for some of the challenges noted, highlights the additional opportunities that ACFTA brings to the region, and finally provides selected policy options to lessen the impact from the challenges and strengthen the opportunities.

ASEAN-CHINA FREE TRADE AREA
CHALLENGES, OPPORTUNITIES AND THE ROAD AHEAD

PART 1

**An Overview
of ACFTA's Implementation**

EARLY REVIEW OF ACFTA

ACHIEVEMENTS, PROBLEMS AND ITS IMPACT ON SINO-ASEAN RELATIONS

Liu Jianren

ACFTA came into force from 1 January 2010 with zero tariff for 93 per cent of the products traded between China and ASEAN-6. The average tariff imposed on products from ASEAN by China was reduced from 9.8 per cent to 0.1 per cent, and ASEAN reciprocated by reducing the tariffs from 12.8 per cent to 0.6 per cent for products from China. In the cases of Vietnam, Laos, Cambodia and Myanmar zero tariff on 90 per cent of Chinese commodities is expected by 2015.

Currently, ACFTA encompasses a population of over 1.9 billion over an area of 14 million square kilometres with a US\$6 trillion GDP and a trade volume of US\$4.5 trillion. This free trade area is the largest in the world in terms of population and territory. The establishment of ACFTA signals the transition of Sino-ASEAN economic cooperation from area/sector cooperation to that of economic integration.

ACHIEVEMENTS MADE BY ACFTA IN THE FIRST YEAR OF IMPLEMENTATION

The first year of ACFTA's implementation registered several achievements including expansion of bilateral trade, expansion of bilateral foreign direct investment, additional progress in ACFTA related agreements, enhanced regional integration and strengthening the understanding of ASEAN markets.

In spite of the global financial crisis, the bilateral trade between China and ASEAN, aided by ACFTA's "Zero Tariff" regime, witnessed a rapid growth during 2010. According to China's General Administration

of Customs, bilateral trade from January to December in 2010 reached US\$292.78 billion, achieving a year-on-year (y.o.y.) increase of 37.5 per cent; this is the highest growth rate in the history of China-ASEAN bilateral trade. During this period, China's imports from ASEAN increased by 44.8 per cent to US\$154.56 billion and exports to ASEAN increased by 30.1 per cent to US\$138.22 billion.

In 2010, the total trade amount between China and ASEAN-6 reached US\$255.75 billion with an increase of 36.5 per cent y.o.y. Among these six ASEAN countries, trade with Malaysia, Singapore and Thailand increased by 42.8, 19.2 and 38.6 per cent respectively, whereas with Brunei Darussalam trade expanded by 2.4 times. The trade volume between China and the four new members (Vietnam, Laos, Cambodia and Myanmar) increased by 44.4 per cent reaching US\$37.03 billion. At present, China has become the largest trading partner of ASEAN while the latter remains the fourth largest partner of China.

The expansion of trade in goods was also complemented by an increase in bilateral foreign direct investment. The mutual direct investment increased rapidly ever since the Investment Agreement came into effect under ACFTA in 2009. According to the preliminary statistics, China's investment in ASEAN reached US\$1.96 billion for January to November in 2010 and the total cumulative FDI amount to US\$10.8 billion. In 2010, the investment by ASEAN in China reached US\$5 billion, an increase of 35 per cent y.o.y. According to the statistics by China's Ministry of Commerce, the investment by Singapore in China reached US\$5.657 billion, ranking third among the top investing economies in China for 2010.¹ Moreover, the Philippines, Thailand, Malaysia and Indonesia have become important sources of China's FDI.²

The implementation of ACFTA also aided progress in related treaties and agreements. The Second Agreement of Trade in Goods within China-ASEAN Framework Agreement on Comprehensive Economic

1 "Sun yuanjiang: Zhongguo – dongmeng zi mao qū jiakuaille dongya yitihua jincheng", Asean-China Centre, 30 December 2010, http://www.asean-china-center.org/2010-12/30/c_13670394.htm

2 "2010 Nian 1-12 yue quanguo xishou waishang zhijie touzi kuaixun", *Invest in China*, 17 January 2011, http://www.fdi.gov.cn/pub/FDI/wztj/wstztj/lywzqx/t20110117_130179.htm

Cooperation was signed on 29 October 2010, providing additional benefits to ACFTA enterprises from the preferential policies including the rules of origin.

ACFTA achievements were not just limited to trade and treaties but also percolated and aided regional integration initiatives. The first meeting of China-ASEAN Industry Cooperation was held in Kunming on 17 September 2010, aiding the progress for industrial connectivity between China and ASEAN. This meeting along with the improvement in connectivity among industries symbolises the transition from government to government cooperation to connection between industries and enterprises. These industries and enterprises, as the implementing bodies, will determine success or failure of ACFTA.

Additionally, progress has been made in building trans-border economic cooperation zones. By the end of 2010, the Tax-Protected Zone in Pingxiang city of Guangxi Zhuang Autonomous Region (China) had been completed and will begin operations from 2011. The zone with 8.5 square kilometres is close to the China-Vietnam border with its counterpart in Vietnam being the Dong Dang-Liangshan Port Economy Zone in Liangshan Province. With the connection of the two zones, transportation, industries and services between the two countries will be connected seamlessly, resulting in a common industrial zone.

Another accomplishment of ACFTA was strengthening the understanding of ASEAN markets. In 2010, the initiation of ACFTA was marked by more than 40 meetings in various Chinese provinces and cities, especially in the western region to explain the numerous policies and opportunities associated with ACFTA. To illustrate, there was much confusion over differences between ACFTA and AFTA (ASEAN Free Trade Agreement), an uncertainty that was mitigated through these meetings thereby aiding in better understanding of ASEAN and its markets. Meanwhile, promotion of the trade and investment with ASEAN has been brought into the strategies at the provincial level in China by Guangdong, Guangxi Zhuang Autonomous Region and Yunnan, which already have close relationships with ASEAN. Even the provinces located in the central and north-eastern part of China are also exploring the opportunities associated with ASEAN markets. In one word, "ASEAN fever" gripped the country in 2010.

PROBLEMS ASSOCIATED WITH THE IMPLEMENTATION OF ACFTA

In spite of several achievements to its credit, the first year of ACFTA's implementation has also highlighted some problems including disproportionate emphasis over ACFTA in China and ASEAN, unbalanced trade, lingering concerns about China and lack of understanding of ACFTA by enterprises.

First, disproportionate emphasis over ACFTA in China and ASEAN: In January 2010, the establishment of ACFTA was celebrated on a large scale in Nanning (capital of Guangxi Zhuang Autonomous Region) with important political delegations from ASEAN gathered. In the past 10 years, the establishment of ACFTA at times tended to be a one-sided affair with ASEAN being a passive participant. To illustrate, the annual China-ASEAN Expo has been organised annually only at Nanning without an alternative venue in an ASEAN country. Also, the ASEAN-China Centre is located in Beijing, China. Although these activities greatly promoted the understanding of ASEAN by Chinese industries, lack of concomitant effort within the ASEAN region has limited the understanding of opportunities in China by ASEAN countries. The enthusiasm for ACFTA from two sides seems unbalanced. ACFTA is the first FTA for China. China's enthusiasm for ACFTA, as the initial proponent, is natural because the government and enterprises are eager to seek better business opportunities in Southeast Asia. ASEAN, with its longer experience with FTAs, envisages not just opportunities but also potential challenges. Perhaps this is the reason for the disproportionate passion. With activities over-centralised in China, the understanding of Chinese markets and investment opportunities by ASEAN is weakened.

Second, unbalanced trade: Historically, the bilateral trade between ASEAN and China favoured the former. However, recent years witnessed a steady decline of this surplus; resulting in concerns among various ASEAN members, especially given that trade surplus is connected with employment generation. By the end of 2009, ASEAN's trade surplus was only US\$0.417 billion. However, with concerted efforts by China to increase imports from ASEAN, the surplus reached US\$1.634 billion by the end of 2010. Nevertheless, it should be noted that electronic products, the main trade item between China and ASEAN, are controlled by the transnational corporations instead of Chinese firms. Therefore, China cannot control the surplus unilaterally and consistently.

Third, lingering concerns about China: There are also concerns from various industries among ASEAN members of the possibility of Chinese products flooding their markets due to the zero tariff regime under ACFTA. These concerns resulted in calls for the suspension of the Zero Tariff Agreement. For example, 14 national industrial chambers of commerce in Indonesia, including the steel and garment industries, asked the government and ASEAN Secretariat for the postponement of ACFTA implementation. Similar concerns were also echoed in Thailand, Philippines and Vietnam. These concerns did not disappear in spite of efforts by the Chinese government and related industry chambers.

Besides, the negotiations on the second batch of market access for trade in services under ACFTA failed due to disagreement of an ASEAN member, a disagreement associated with the concerns pertaining to goods and services from China.

Fourth, lack of understanding of ACFTA by enterprises: Even after one year of ACFTA, many Chinese enterprises still lack concrete understanding of the contents of the ROOs and the schedule of tariff reduction of sensitive products. There is also a lack of comprehension of the related markets as well as laws and rules in ASEAN countries, which impede outward investments in these countries. A similar situation prevails within the enterprises from ASEAN. For example, a study discovered that only 20 per cent of the Philippines companies had taken advantage of ACFTA's zero tariff benefits; lower than the average 28 per cent in East Asia.³

IMPACT ON SINO-ASEAN BILATERAL RELATIONS

The establishment and operation of ACFTA lay a firm foundation for economic integration between China and ASEAN and strengthen the bilateral economic relations. The close economic relationship will be beneficial to the development of bilateral political relations; for the fulfilment of the "cooperation and win-win" objective; and to the peace and stability of South East Asia.

The China-ASEAN dialogue mechanism has been going on for the last 20 years with constant efforts to establish a relationship of mutual

3 "China-ASEAN FTA adds new vitality into Sino-Philippines economic and trade cooperation", *People's Daily Online*, 17 January 2011, english.peopledaily.com.cn/90001/90776/90883/7262500.html

trust. In the development of relations with ASEAN, China has given preponderance for “enhancing mutual trust and clearing doubts” and has proposed and implemented a set of new-thinking foreign policies. These policies involved “treating neighbours with goodwill and coexist with neighbours as partners”, “bringing harmony, security and prosperity to neighbours” and “new security concept”. As part of these policies, China took the initiative for involvement in the region’s multilateral cooperation institutions created by ASEAN and consistently supported the leading role played by ASEAN. However, the so-called “China threat” still waxes and wanes among some ASEAN countries because of China’s rapid economic development and rise. China originally meant to dispel the concerns for the competitiveness of Chinese products with a proposal for establishing ACFTA. This initiative did not completely relieve the concerns and in fact was augmented within some ASEAN countries; this situation entails attention and focus from both sides.

The South China Sea territorial disputes exist between China and some ASEAN countries. China has consistently stressed the role of peaceful negotiations in resolving the dispute, albeit giving preference for bilateral negotiations rather than dealing with ASEAN at the institutional level. Although ACFTA by promoting economic development is beneficial to the improvement of Sino-ASEAN’s political relations, the quintessential question is whether ACFTA would be beneficial to the settlement of South China Sea disputes? Recent events do not provide a positive assessment. To illustrate, in spite of growing economic engagement between Vietnam and China, especially aided by ACFTA, the former tried to take advantage of its position as the chair of 17th ARF Foreign Ministers’ Meeting (held in July 2010) to list South China Sea issue in the agenda, creating opportunities for the United States to interfere in the issue. This deteriorated the atmosphere of the meeting and proved fruitless in resolving the dispute. This shows that territorial disputes, due to their complexity left over by history, must be resolved through other channels, though economic integration mechanisms like ACFTA helps to better political and economic relations among its members.

As China proposed, the year 2011 is China-ASEAN Amity and Exchange Year with the theme as “China-ASEAN: Mutually Beneficial and Win-Win Partners”. ACFTA is particularly helpful for both sides to realise this theme.

ASEAN-CHINA FREE TRADE AREA

A REVIEW

Rony Soerakoesoemah

Since the formal establishment of relations between ASEAN and China in 1991, trade and economic ties between ASEAN and China have been growing rapidly over the past years. Economic cooperation between ASEAN and China was elevated to a higher level with the signing of the Framework Agreement on Comprehensive Economic Cooperation by the ASEAN and China Leaders on 4 November 2002 in Phnom Penh, Cambodia.

The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China provides the legal instrument for enhancing the ASEAN-China economic, trade and investment relations. It is also the basis for establishing the free trade area (FTA) by 2010 for ASEAN-6: Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, and 2015 for Cambodia, Lao PDR, Myanmar and Vietnam.

The Framework Agreement which came into force on 1 July 2003 is an umbrella agreement which provides general provision on the establishment of an ASEAN-China FTA (ACFTA) within 10 years by pursuing:

- progressive elimination of tariffs and non-tariff barriers;
- progressive liberalisation of trade in services and investment;
- strengthen trade facilitation measures;
- and economic cooperation in areas of common interest.

The Framework Agreement paved the way for the conclusion of the Trade in Goods Agreement in November 2004; Trade in Services Agree-

ment in January 2007; and the Investment Agreement in August 2009 completing the comprehensive ACFTA.

The ASEAN-China Agreement on Trade in Goods laid down the modality for tariff reduction and elimination for tariff lines categorised in either the NT or the Sensitive Track. In the NT, tariffs on almost all tariff lines in this category have been eliminated by ASEAN-6 and China as of 1 January 2010. The remaining few products in this category (i.e. not exceeding 150 tariff lines) will have tariffs eliminated not later than 1 January 2012, as part of the flexibility provided in the modality. For Cambodia, Laos, Myanmar and Vietnam, tariff elimination will have to be completed by 1 January 2015, with flexibility to eliminate tariffs on products not exceeding 250 tariff lines by 1 January 2018.

The ASEAN-China Investment Agreement aims to create a favourable environment for investors and their investments from ASEAN and China, and therefore stipulates key protection elements that will provide fair and equitable treatment to investors, non-discriminatory treatment on nationalisation or expropriation and compensation for losses. It has provisions that allow transfers and repatriation of profits to be made freely and in freely usable currency, as well as a provision on investor-state dispute settlement that provides investors recourse to arbitration.

The ASEAN-China Trade in Services Agreement aims to liberalise and substantially eliminate discriminatory measures with respect to trade in services among the Parties in various services sectors e.g. tourism, telecoms, energy and computers. By applying the GATS Plus principle, the level of liberalisation commitments under this agreement would be considerably higher than the commitments made by participating countries under the General Agreement on Trade in Services (GATS) in the WTO.

ASEAN and China already have the foundation for engaging in mutual collaboration through several directives that support implementation of ACFTA:

- MOU on Agricultural Cooperation for the period 2007–2011 (January 2007)
- MOU on Strengthening Sanitary and Phytosanitary (SPS) Cooperation (November 2007)
- MOU between ASEAN and China on Technical Barriers to Trade (TBT) (October 2009)

- MOU on the establishment of the ASEAN-China Centre (October 2009) to expand trade and investment as well as the increase of SME business, tourism, and people and cultural exchanges between ASEAN and China.

Cooperation was further strengthened by China setting up a US\$15 billion credit facility and a US\$10 billion China-ASEAN Investment Cooperation Fund with a focus on infrastructure and connectivity, thereby helping realise the ASEAN Community by 2015, narrow down the development gap in the region, and enhance connectivity between ASEAN and China. China's support of the Master Plan on ASEAN Connectivity also paves the way for a more active role and enhanced cooperation with ASEAN in infrastructure development, transport, energy and resources, information and communication technology, trade and investment facilitation.

COOPERATION WITH THE PROVINCIAL GOVERNMENTS OF CHINA

The most obvious economic benefits out of ACFTA include increased bilateral trade, expanded GDP, greater economic efficiency, lower costs and increased investment. But the establishment of ACFTA also brings new opportunities for trade between ASEAN and China, particularly for the major provinces in China. Several Provincial Governments of China—namely Guangdong, Hubei, Fujian and Shaanxi have initiated cooperation with the ASEAN Secretariat through Memorandums of Cooperation (MOCs)

The status and summary of MOCs with the Provincial Governments are as follows:

- **MOC with Guangdong Province:** signed on 5 September 2008 for an operational period of 3 years. Areas of cooperation include Agriculture; Information and communication technology; Human resources development; Trade and investment; Tourism promotion; Energy and environment; Logistics infrastructure; Education; Sciences and technology; Culture; and Public health.
- **MOC with Hubei Province:** signed on 11 May 2008 for an operational period of 3 years. Areas of cooperation include Investment and trades, including cooperation projects, market information, establishing international SMEs incubator; Cultural and tech-

nological exchanges; Information exchange and information telecommunication; Agricultural cooperation (techniques and staff) and trade of farming products; and Logistic and investment in logistic infrastructure

- **MOC with Fujian Province:** the Draft MOC for an operational period of 3 years not yet signed; Areas of cooperation include Agriculture; Information and communication technology; Human resources development; Trade and investment; Tourism promotion; Energy and environment; Logistics infrastructure; Education; Sciences and technology; Culture; Public health; and Communications between the Parties' industry associations.
- **MOC with Shaanxi Province:** This has been initiated but no further progress to-date. The areas of cooperation and the operational period have not been decided.

The MOCs were initiated in the spirit of fostering ASEAN-China good relations by engaging the provinces of China to help promote ACFTA. To move forward the established cooperation with the Chinese provinces, there is a need for the Parties to identify and consider specific areas of activities. Emphasis is placed on efforts to get the business communities from ASEAN and these provinces involved in the ASEAN-China cooperation process.

2010

1 January 2010 marked the establishment of ACFTA, the world's biggest free trade area of 1.9 billion consumers, a combined gross domestic product (GDP) of approximately US\$6 trillion and total international trade of US\$4.3 trillion. It is ranked as the largest free trade area, in terms of market size, and third—after the European Union (EU) and the North American Free Trade Area (NAFTA)—in terms of economic size.

This signifies the beginning of a deeper dimension in ASEAN-China trade relations. ACFTA aims to bring the countries together in a mutually dependent and beneficial relationship in an increasingly borderless global environment. This FTA has multifaceted roles which will not only create opportunities for regional businesses to be significant players in the global supply chain but will also support the narrowing of the development gap, promote greater cross-border investments and serve as a catalyst for East Asia economic integration together with the other key FTAs of ASEAN.

ONE-YEAR MARK

ASEAN-China relations have strengthened with cooperation, improving significantly over the last year. ASEAN ministers and leaders have held productive exchanges of views on how to further strengthen economic relations between China and ASEAN. It has been emphasised that there was still much room for the economic relations to grow since it was based on the principle of “good neighbours”. ASEAN-China trade has been growing with more opportunities on the horizon for as long as countries continue with their efforts as prescribed in the various ACFTA agreements.

In 2009, China emerged as ASEAN's largest trading partner accounting for 11.6 per cent of ASEAN's total trade while ASEAN rose to be China's fourth largest trading partner accounting for 9.7 per cent of China's total trade.

A mid-term review was undertaken to assess the trade impact of the tariff preferences under the ACFTA agreement after its first four years of implementation. The region's Trade in Goods agreement laid out the region's preferential tariff liberalisation, which is to be delivered in four tracks, namely the early harvest programme (EHP), the normal track (NT), and the tariff reforms in the sensitive (SL) and highly sensitive (HSL) goods.

In summary, the review brought attention to the need:

- to focus on making the existing TIG Agreement more productive—avoid accelerating or deepening the liberalisation process;
- to improve the utilisation of margins of preferences;
- to enhance trade facilitation, particularly in the areas of ROOs, SPS and TBT, customs clearance procedures including the use of single windows; and
- to continue monitoring the implementation and evaluation of the impact of the TIG Agreement.

In addition to the administrative procedures, there is a need to deliberate on the low utilisation of the preferential tariffs. Overall, it is important for ASEAN and China to understand the real concerns so as to improve the agreement in terms of its coverage, relevance and applicability.

The launch of ACFTA Business Portal (BIZ Portal) should also help to promote ACFTA by catering to businesses, thereby improving their understanding of the FTA.

ASEAN-CHINA ECONOMIC COOPERATION

With the establishment of ACFTA, the bigger challenge would be for ASEAN and China to collectively ensure a level playing field where all parties will benefit from the FTA. Acknowledging the disparity in capacity of the CLMV countries will necessitate a more deliberate and separate attempt in the areas of promoting ACFTA; targeting key groups to raise awareness of the business opportunities in the ASEAN-China FTA; and implementing activities that will build capacity of CLMV to trade with China.

There are existing initiatives that warrant further development to assist the CLMV countries. One example is the various ACFTA Outreach Activities. Public outreach activities should be encouraged, fully supported and continued. Among the recommended activities that should be pursued are the following:

- Enhance the BIZ Portal in the CLMV. When fully utilised, the BIZ Portal can become an efficient tool that can reach a wider public audience thus providing more information and eventually interest in the FTA. Activities will require creation of BIZ Portals that are comprehensible in the native languages of the CLMV and supporting CLMV officials with intensive trainings on business portals.
- Organise stand-alone policy briefings on ACFTA in the CLMV capitals to help provide good understanding of the commitments under the agreement.
- Organise workshops on SME financing targeting the utilisation of facilities set up by China to access credit and finance.

Trade facilitation is another area that deserves further attention. If not adequately addressed, non-tariff barriers and other forms of import control measures would only render meaningless the efforts and the achievements of tariff elimination. Existing working arrangements with China's Administration of Quality Supervision, Inspection and Quarantine can be relied on to facilitate joint cooperation.

Recommended activities in this area consist of:

- Organise workshops to exchange experience between China and CLMV countries on activities related to the development of standards, technical regulations and conformity assessment procedures. Exchange of information may also be conducted between parties on relevant standards and technical regulations imposed by regulating agencies.

- Organise training courses on TBT notification management system. CLMV countries need exposure in conducting the management of notification of TBT issues in WTO. Exchange of experience is very important to enhance their capability in performing the day-to-day activities as a TBT Notification Body and Enquiry Point.
- Conduct training courses and seminars to strengthen cooperation and consultation on ROOs between CLMV and China. Aside from ensuring public awareness on the benefits of ACFTA, issuing authorities of the Certificate of Origin (CO) at the exporting Party and the customs authorities who are the receiving authority at the importing Party must ensure that originating goods coming from the parties are accorded the preferential tariff treatment when traded in ACFTA through the appropriate application of the provisions of the ROOs.

Lastly, more focus must be paid to the development of trade and investment. Bilateral trade between China and CLMV has been growing rapidly in recent years. Under such favourable circumstances, efforts in specific areas to sustain the positive trend will need to be undertaken.

Recommended activities in these areas include:

- Explore the potential of e-commerce between CLMV and China by conducting technical cooperation activities to facilitate the uptake, feasibility and use of electronic commerce.
- Promote trade of agricultural products. According to the Chinese Ministry of Commerce, ASEAN-China bilateral trade in the first nine months of 2010 jumped 44 per cent y.o.y. to US\$211.3 billion, from which a major part were the imports and exports of agricultural products under ACFTA's zero-tariff arrangement. Cooperation in agriculture with China should continue to increase trade volume of agricultural products while attracting investment in the CLMV's agricultural sector. China should continue to provide CLMV countries with training on agricultural technologies and seed exports to establish a good relationship of mutual trust in the region.
- Organise business seminars/forums to attract more Chinese investors to CLMV countries in the manufacturing sector for exports.

CONCLUSION

The ASEAN-China FTA would create a sense of community among ASEAN member states and China. This provides another important mechanism for supporting economic stability in East Asia and allows both ASEAN and China to have a larger voice in international trade affairs on issues of common interests. The significant increase in the ASEAN-China bilateral trade is expected to continue to flourish under ACFTA.

In summary, ASEAN and China, through frequent and growing interaction, have developed a solid relationship that has been a constructive element in the peace, stability and prosperity of the region and of the world. The leaders of ASEAN and China are determined to strengthen their cooperation so that it can be an even more effective force for the advancement of their nations, the well-being of their peoples and the building of a more peaceful and prosperous world.

ASEAN-CHINA FREE TRADE AREA
CHALLENGES, OPPORTUNITIES AND THE ROAD AHEAD

PART 2

**Member Country
Perspectives**

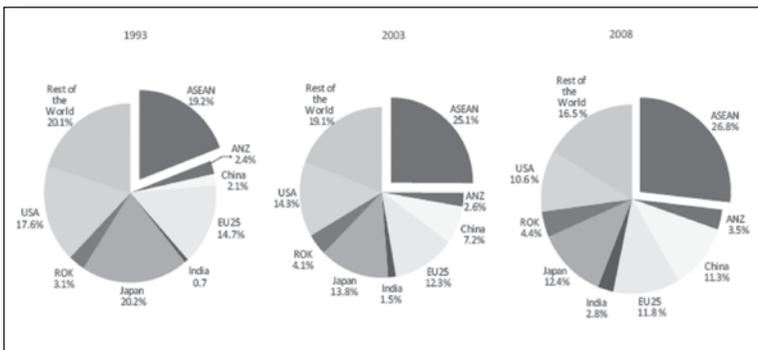
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INDONESIA

Tirta N. Mursitama and Ilham Y. Arif

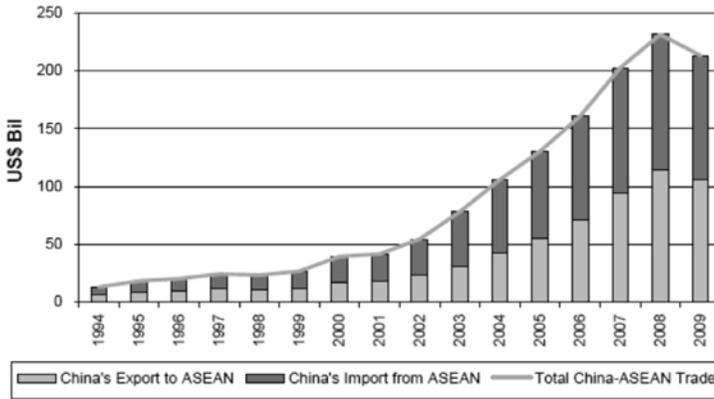
ASEAN and China have accelerated bilateral trade relations since the mid-1990s. Between 1995 and 2008, the trade has increased more than 10-fold from about US\$20 billion to US\$223 billion. Bilateral trade growth has been even more rapid since 2001, after China joined the World Trade Organisation (WTO) and after the initiation of efforts to create ACFTA. Between 2001 and 2008, the bilateral trade grew on average by around 30 per cent a year, in comparison to 15 per cent for the years between 1995 and 2001. The entry into force of ACFTA coupled with relative decline of the G-3 (Japan, the European Union and the United States) propelled China as the preeminent trading partner of ASEAN. According to the ASEAN Secretariat, in 2009 total trade

FIGURE 1
China's share to total ASEAN trade, 1993, 2003 and 2008



Source: ASEAN Statistical Yearbook, 2009

FIGURE 2
Dynamics of ASEAN-China trade (1994–2009)



Source: *Asian Development Bank (ADB), 2009*

between ASEAN and China reached US\$178.18 billion, which is 11.6 per cent of total ASEAN trade (the European Union: 11.2 per cent; Japan: 10.5; and the US: 9.7).

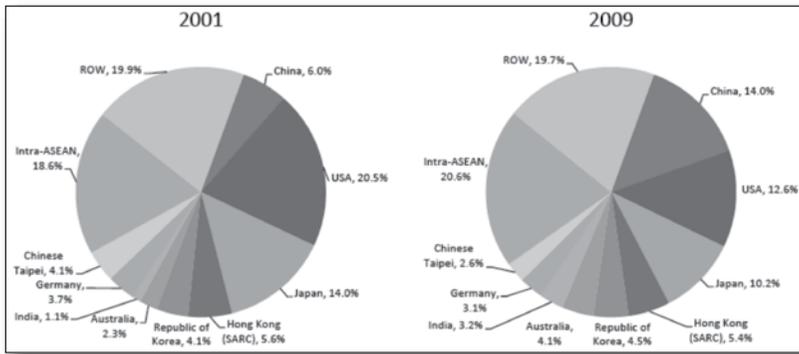
This dynamic trade relation has gained further momentum with coming into force of ACFTA. The following sections would review the establishment of ACFTA, including analysis of trade and investment issues. This analysis also endeavours to answer how the establishment of ACFTA affects the regional economic integration and the trade relations between Indonesia-China.

THE ESTABLISHMENT OF ACFTA AND THE IMPACT ON CHINA-ASEAN TRADE

Under ACFTA, ASEAN-6 and China agreed to establish the FTA through four stages: The first stage involved the reduction of tariff to 0–5 per cent for at least 40 per cent of tariff lines placed in the NT no later than 1 July 2005. In the second stage, the tariff was reduced to 0–5 per cent no later than 1 January 2007 for at least 60 per cent of tariff lines placed in the NT. From 1 January 2010, with the commencement of the third stage, each party agreed to eliminate all tariffs for tariff lines placed in the NT, with flexibility to have tariffs on some commodities not exceeding 150 until 1 January 2012. The final stage requires ASEAN-6 and China to eliminate all its tariffs for tariff lines placed in the NT no later than 1 January 2012.

As Figure 2 clearly shows, the tariff reduction and associated schemes under ACFTA has accelerated the growth of trade between ASEAN and China. After the implementation of the first stage in July 2005, ASEAN-China total trade reached US\$139.96 billion, an increase of 72.6 per cent compared to 2003. In the second stage (as of 1 January 2007), ASEAN-China trade stood at US\$171.12 billion, an increase of 18.2 per cent y.o.y. The bilateral trade expanded by US\$192.67 billion in 2008, an increase of 12.6 per cent y.o.y. However, ASEAN-China trade unfortunately declined in 2009 due to the 2008 global economic crisis.

FIGURE 3
 ASEAN's export destination, 2001 and 2009 (in US\$ billion)



Source: ITC Trademap Database, Nathan Calculations

In spite of an increase in bilateral trade volume, ASEAN also witnessed a constant rise in trade deficit. After the first stage, ASEAN was afflicted with a deficit of US\$9.94 billion in 2006, or about 7.10 per cent of the total bilateral trade. The second stage brought ASEAN a deficit of US\$15.23 billion in 2007, and the percentage rose by 8.90 per cent. ASEAN's deficit swelled by US\$21.56 billion, or about 11.19 per cent of ASEAN-China total trade. Although in 2009 ASEAN's deficit decreased, it was still high at US\$15 billion, or roughly 8.42 per cent of the bilateral total trade.

The major exports from ASEAN to China usually consist of electric machinery (in 2008 this category valued at US\$22 billion and comprised 26.0 per cent of ASEAN's total exports to China), non-electric machinery, mineral fuels, rubber and animal/vegetable fats and oils. China's largest import from the world is also electric machinery (in 2008, it amounted to

US\$266 billion i.e. about 23.6 per cent of China's total import). ASEAN's electric machinery export to China was more than 8 per cent of China's total electric machinery import. ASEAN's non-electric machinery contributed roughly 10 per cent to China's total non-electric machinery imports. Meanwhile, ASEAN's top 10 exports to China contributed 8.7 per cent (US\$57.41 billion) to China's top 10 imports (US\$662.66 billion) and ASEAN's top 10 imports from China comprised 8.0 per cent (US\$79.49 billion) of China's top 10 exports (US\$983.86 billion).

IMPACT ON INDONESIA-CHINA TRADE RELATIONS

Historically, China has always been a prominent trading partner for Indonesia. Between 2005 and 2009, the bilateral trade doubled from US\$12.5 billion to US\$25.5 billion, a 22.26 per cent increase; this was also a period when Indonesia enjoyed a trade surplus with China. However, since 2008 with winds of trade fortunes shifting direction, Jakarta witnessed a trade deficit of US\$3.61 billion in 2008 and US\$2.50 billion in 2009.

For the periods January–November of 2009 and 2010, bilateral trade increased by 41.98 per cent taking the value of total trade from US\$22.57 billion to US\$32.04 billion. Concomitantly, Indonesia's deficit rose by 103.14 per cent, from US\$2.35 billion in January–November 2009 to US\$4.78 billion in 2010 y.o.y.

Within Indonesia's exports to China, non-oil-and-gas sectors contributed the largest share of US\$12.38 billion, while oil-and-gas sectors share was US\$1.25 billion. In January–November 2010 the export of non-oil-and-gas sectors increased by about 60 per cent y.o.y., whereas oil-and-gas sectors experienced a decline of around 47 per cent.

In January–November 2010, Indonesia's imports from China rose by US\$18.41 billion, an increase of 47.76 per cent y.o.y. Among these imports, oil-and-gas imports increased from US\$453 million in 2009 to US\$731 million in 2010, an increase of 61.4 per cent. This is an interesting trend for oil-and-gas imports from China, which only had a negative growth averaging 27.30 per cent between 2005 and 2009. Indonesia's non-oil-and-gas imports from China grew on average 37.34 per cent in 2005–2009 and increased by 47.24 per cent between January–November 2009 and 2010. In January–November 2010, among Indonesia's imports from China, non-oil-and-gas sectors accounted for about 96 per cent (i.e. US\$17.68 billion) of Indonesia's total import from China or roughly 55 per cent of Indonesia-China total trade.

TABLE 1
Indonesia-China trade volume, exports, imports and trade balance
(2005–2010)

Categories	2005	2006	2007	2008	2009	Total per cent, 2005–2009	Jan – Nov 2009	Jan – Nov 2010	Change per cent, 2010–2009
Total	12,505,216.3	14,980,466.4	18,233,389.3	26,883,672.6	25,501,497.8	22.26	22,567,793.7	32,041,005.6	41.98
Oil and gas	3,994,183.4	4,011,873.8	3,612,035.6	4,148,600.9	3,090,052.2	-4.68	2,845,777.1	1,981,911.1	-30.36
Non-oil and gas	8,511,082.9	10,968,592.6	14,621,354.3	22,735,071.7	22,411,445.5	30.54	19,722,016.6	30,059,094.5	52.41
Export	6,662,353.8	8,343,571.3	9,675,512.7	11,636,503.7	11,499,327.3	15.31	10,106,393.9	13,628,514.2	34.85
Oil and gas	2,702,591.2	2,876,961.3	3,011,412.8	3,849,335.3	2,579,242.8	2.00	2,393,127.4	1,251,347.1	-47.71
Non-oil and gas	3,959,762.6	5,466,610.0	6,664,099.9	7,787,168.4	8,920,084.4	21.87	7,713,266.5	12,377,167.1	60.47
Import	5,842,862.5	6,636,895.1	8,557,877.1	15,247,168.9	14,002,170.5	29.43	12,461,399.9	18,412,491.3	47.76
Oil and gas	1,291,592.2	1,134,912.5	600,622.7	299,265.6	510,809.4	-27.30	452,649.7	730,563.9	61.40
Non-oil and gas	4,551,270.3	5,501,982.6	7,957,254.4	14,947,903.3	13,491,361.1	37.34	12,008,750.1	17,681,927.4	47.24
Trade balance	819,491.3	1,706,676.2	1,117,635.6	-3,610,665.2	-2,502,843.2	0.00	-2,355,006.0	-4,783,977.1	103.14
Oil and gas	1,410,998.9	1,742,048.8	2,410,790.1	3,550,069.7	2,068,433.4	15.92	1,940,477.6	520,783.2	-73.16
Non-oil and gas	-591,507.7	-35,372.5	-1,293,545.5	-7,160,734.9	-4,571,276.6	0.00	-4,295,483.6	-5,304,760.2	23.50

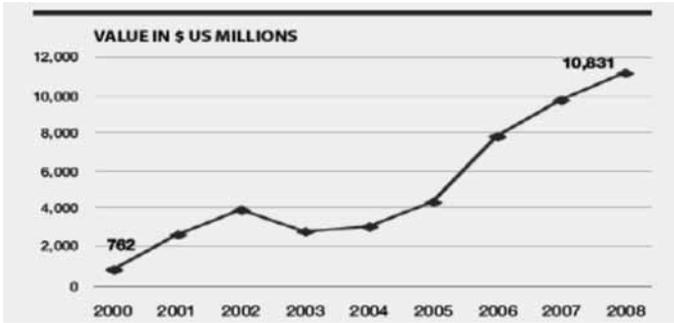
ASSESSING ASEAN-CHINA INVESTMENT

In the last one decade, China's investments into ASEAN have increased considerably. In 2000, China's FDI to ASEAN amounted only US\$0.76 billion, but by 2008 it increased to US\$10.8 billion. China's non-financial direct investment in ASEAN amounted to US\$1.2 billion. In the first half of 2010, ASEAN's FDI in China was US\$3.1 billion.

As evident from Figure 5, between 2000 and 2009, FDI from ASEAN to China was not only substantial and higher than China's FDI to ASEAN but also had shown a continuous upward momentum. China's FDI has only begun to climb since 2007.

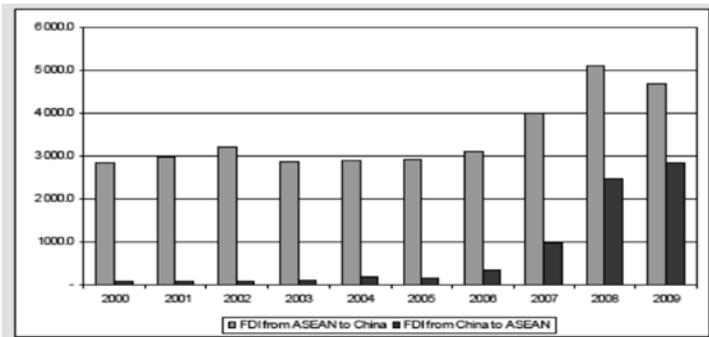
In terms of country-specific FDI among ASEAN, Singapore's FDI to China at US\$4.4 billion is the largest. Between 2002 and 2008, Singapore's FDI to China nearly doubled from US\$2.3 billion to US\$4.4 billion. In this category, Singapore is followed by Malaysia (US\$0.98 billion), Brunei (US\$0.52 billion), Philippines (US\$0.50 billion), Thailand (US\$0.41 billion) and Indonesia (US\$0.38 billion). In 2008, ASEAN's FDI contributed about 6 per cent of total FDI inflow to China. The share has relatively declined compared to ASEAN's contribution in 1998, which amounted to 9.4 per cent of total FDI to China.

FIGURE 4
FDI inflows to ASEAN from China, 2000–2008 (US\$ million)



Source: *ASEAN FDI Database, 2009*

FIGURE 5
FDI flows between ASEAN and China, 2000–2009 (US\$ million)



Source: *World Investment Report, UNCTAD, 2010*

Compared to the flow of FDI from ASEAN to China, FDI from China to ASEAN was historically at lower levels until 2007. China's FDI to ASEAN forms only 3.38 per cent of China's total outward FDI. Nevertheless, the FDI inflow from China in 2008 could possibly be the start of a new trend. In 2008, among the recipients of China's FDI in the ASEAN, Singapore tops the list with US\$1.5 billion (3.38 per cent of share in total), followed by Indonesia, Thailand and Vietnam.

Despite this new momentum in China's FDI into ASEAN, it is still not quite significant in terms of FDI inflows for ASEAN. In 2009, China's

TABLE 2
ASEAN's FDI to China (US\$ million)

	Total FDI to China	ASEAN's FDI to China									
		Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	LCM*	Brunei	Sub-total	% in total
1995	48,133	112	259	106	1,861	288	28	0	0	2,654	5.5%
1998	45,463	69	340	179	3,404	205	14	9	2	4,223	9.3%
2002	52,743	122	368	186	2,337	188	3	36	17	3,256	6.2%
2005	60,325	87	361	189	2,204	96	1	7	160	3,105	5.1%
2008	92,395	167	247	127	4,435	129	2	13	340	5,461	5.9%

Source: *China Statistical Yearbook, 2009*

TABLE 3
China's FDI to ASEAN (US\$ million)

	China's total outward FDI	China's FDI to ASEAN					
		Indonesia	Singapore	Thailand	Vietnam	Sub-total	Share in total
2004	5,497	62	48	23	17	150	2.73%
2005	12,261	12	20	5	21	58	0.47%
2006	17,633	57	132	16	44	248	1.41%
2007	26,506	99	398	76	111	684	2.58%
2008	55,907	174	1,551	45	120	1,890	3.38%
Accumulated stocks end 2008	183,971	543	3,335	437	522	4,837	2.63%

Source: *China Statistical Yearbook, 2009*

share of FDI inflows into ASEAN was 3.2 per cent, which is lower than the other major economic partners of ASEAN. The largest FDI provider for ASEAN is the European Union (21.1 per cent) followed by Japan (11.5 per cent), the United States (10.1 per cent), Cayman Island (5.6 per cent) and the Republic of Korea (3.5 per cent).

In the case of Indonesia, China's FDI is not yet significant. Between 2006 and 2008, China's FDI in Indonesia was the lowest among Jakarta's major economic partners. As Table 5 clearly illustrates, ASEAN has always been the largest source of FDI for Indonesia. After the ASEAN-China investment agreement had come into effect in 2010, China's investment in Indonesia reached US\$16.8 million in the first quarter of

TABLE 4
ASEAN's top 10 FDI source countries, 2007–2009
(as of July 2010) US\$ million

Country/region ¹	Value				Share to total inflow			
	2007	2008	2009	2007–2009	2007	2008	2009	2007–2009
European Union (EU)-25	17,765.5	9,520.1	7,297.2	34,582.8	23.9	19.2	18.4	21.1
ASEAN	9,682.0	10,461.5	4,428.9	24,572.4	13.0	21.1	11.2	15.0
Japan	8,828.7	4,657.8	5,308.4	18,794.9	11.9	9.4	13.4	11.5
USA	8,067.8	5,132.6	3,357.7	16,557.9	10.8	10.4	8.5	10.1
Cayman Island	1,595.4	4,605.4	3,015.2	9,216.0	2.1	9.3	7.6	5.6
Republic of Korea	2,715.5	1,583.5	1,421.8	5,728	3.7	3.2	3.6	3.5
China	1,684.3	2,109.5	1,509.5	5,303.3	2.3	4.3	3.8	3.2
Hong Kong	1,495.6	1,447.3	1,582.1	4,525.0	2.0	2.9	4.0	2.6
Bermuda	3,259.2	58.6	1,164.4	4,482.2	4.4	0.1	2.9	2.7
Taiwan (ROC)	784.8	1,745.1	687.9	3,217.8	1.1	3.5	1.7	2.0
Total top 10 sources	55,878.6	41,321.6	29,773.1	126,973.3	75.1	83.5	75.1	77.7
Others ²	18,516.7	8,178.3	9,849.9	36,544.8	24.9	16.5	24.9	22.3
Total FDI inflow to ASEAN	74,395.3	49,499.8	39,623.0	163,518.1	100.0	100.0	100.0	100.0

Source ASEAN Foreign Direct Investment Statistics Database (compiled/computed from data submission, publications and/or websites of ASEAN member states' central banks, national statistics offices and relevant government agencies through the ASEAN Working Group on Foreign Direct Investment Statistics)

Symbols used

— Not available as of publication time

n.a. Not applicable/not available/not compiled

Data in italics are the latest updated/revised figures from previous posting

Notes

Details may not add up to totals due to rounding off errors.

1. Ranked according to cumulative FDI inflows from 2007 to 2009; covers countries on which data is available.
2. Includes inflows from all other countries, as well as total reinvested earnings and inter-company loans in the Philippines.

2010, which is only 0.4 per cent of total FDI in Indonesia. Indonesia's top-three FDI source countries in the first quarter of 2010 were Singapore (US\$676.8 million; 18 per cent of total FDI in Indonesia), Mauritius (US\$446.6 million; 11.8 per cent) and the United States (US\$436.9 million; 11.6 per cent).

TABLE 5
FDI realisations in Indonesia (US\$ million)

Country	2006	2007	2008	2009	Quarter 1, 2010	Total 2006–2008
ASEAN	926.5	4,028.4	1,855.7	4,536.6	768.4**	11,347.2
Japan	902.8	618.2	1,365.4	678.9	97.7	3,565.3
South Korea	475.7	627.7	301.1	624.6	86.4	2,029.1
China	31.5	28.9	139.6	65.5	16.8	265.5
European Union	821.2	1,871.6	1,018.7	1,972.6	282.5***	5,684.1
United States	65.8	144.7	151.3	171.5	436.9	533.3
Total FDI Realization	5,991.7	10,341.4	14,871.4	10,815.2	3,770.2	42,019.7

** Singapore, Malaysia, Thailand and the Philippines

*** United Kingdom, Netherlands, Italy, Belgium, Germany, Sweden, France and Spain
Source: *Investment Coordination Board/Badan Koordinasi Penanaman Modal (BKPM), 2010*

However, trends in recent years suggest that China has initiated plans to change this prevailing situation of playing a negligible role in contributing FDI to ASEAN and is planning to increase her overseas investments. According to the Chinese Ministry of Commerce, the turnover of China's overseas contracted projects amounted to US\$92.2 billion in 2010, an increase of 18.7 per cent y.o.y. Additionally, the value of newly signed contracts reached US\$134.4 billion, an increase of 6.5 per cent y.o.y.

CONCLUSION

Since the initial stages, ACFTA played a catalyst for the expansion of bilateral trade relations between ASEAN and China, which reached US\$139.96 billion in 2006 and peaked to US\$192.67 billion in 2008. The growing bilateral trade could further enhance regional integration of ASEAN + China and potentially attract other actors in East Asia like Japan and South Korea to join in the FTA.

Among the key drivers for China in initiating the establishment of ACFTA, a strategic motive involving enhanced political and economic relations with her neighbours emerges as the predominant factor. As an emerging economy and growing military power, China is at times

perceived as a “threat”. For example, the United States perceives China as a hegemonic rival that could pose a threat to the United States and its allies in Asia including Japan, South Korea and Taiwan. Therefore, ACFTA has been conceived by China as one of the tools to construct the idea of “friendly and peaceful rising China”, which continues its economic development and growth.

ACFTA has been a part of China’s foreign policy of “peaceful development”, where Beijing has realised that her rise has created apprehensions within the Asia Pacific and China’s development can only be accomplished if the region is peaceful and continues to develop. In addition to bringing the idea of “peaceful development” into the popular discourse, China also made efforts to expand her influence in the region to counter the prevailing U.S. influence. The United States has established an FTA with Singapore and offered FTA initiatives to Malaysia and Thailand. Additionally, the United States also announced the Enterprise for ASEAN Initiative (EAI) with an objective to strengthen trade and investment relations between the United States and ASEAN.¹

In order to achieve her objectives towards ASEAN, China was willing to accept costs and open the huge domestic market to her neighbouring countries. For China, trade with ASEAN contributes only 7.5 per cent and 8 per cent of China’s total trade volume in 2008 and 2009 respectively. The utmost indication of China’s resolve was the initiative of EHP. The programme provided ASEAN an early access to China’s huge domestic market, especially for ASEAN agricultural commodities. By July 2004, ASEAN exported EHP commodities to China valued at US\$0.68 billion, an increase of 49.8 per cent of the same period of 2003.² ASEAN could

- 1 On 2 November 2002, the United States announced EAI. EAI is a kind of “roadmap” for ASEAN countries required to pursue an FTA with the United States. In order to establish an FTA with the United States, a country must be a member of WTO and hold the Trade and Investment Framework Agreement (TIFA) with the United States. In August 2006, the United States and ASEAN completed a regional TIFA that showed both parties’ commitment to strengthen trade and investment and to promote ASEAN economic integration. See Ilham Yulhamzah Arif, *Perundingan dan Penandatanganan Free Trade Agreements (FTAs) oleh Amerika Serikat, Periode 2002–2007*, (Depok: Universitas Indonesia, December 2009).
- 2 Raul L. Cordenillo, “The Economic Benefits to ASEAN of the ASEAN-China Free Trade Area (ACFTA)”, Bureau for Economic Integration, Jakarta: ASEAN Secretariat, 18 January 2005, www.aseansec.org/17310.htm

potentially benefit more from this programme, since agricultural products have been ASEAN's comparative advantage.

While China emphasised more strategic and political considerations, ASEAN concentrated on economic issues. One of the critical questions was how could ASEAN countries, especially Indonesia, gain favourable trade and investment through ACFTA. ASEAN countries, developing slower than China, must calculate benefit and cost in the framework of zero-sum game. Therefore, in order to succeed in the fierce competition, ASEAN countries must work hard by enhancing the competitiveness of their domestic industries.

ACFTA would also provide substantial imperative in increasing ASEAN-China investment relations. Although not as significant as the European Union, Japan and the United States, China has the potential to emerge as a key investment source over the long-term for ASEAN. China's FDI in ASEAN countries is mostly related to the growing intra-regional trade, which currently holds a large share of ASEAN-China trade.³

ACFTA could also assist in enhancing ASEAN's economic efficiency and competitiveness. The proliferation of regional trade arrangements demonstrates tremendous competition in the world's market and has two implications for a trade regime: trade creation and trade diversion. Economist Jacob Viner in his study "The Customs Union Issue" found that a customs union could promote new trade among members—trade creation, but also divert trade from more efficient producers outside the agreement.⁴ ASEAN is expected to expand trade with China and replace the less-efficient importers in China, given the new economic efficiencies of ASEAN companies, efficiencies that are partly derived from the reduced tariff regime under ACFTA. Furthermore, trade creation and diversion under ACFTA has been supported by increasingly intensive regional production network between multinational companies from ASEAN and China.

According to the government agencies in Jakarta, Indonesia is already

3 Sarah Y. Tong and Catherine Chong Siew Keng, "China-ASEAN Free Trade Area in 2010: A Regional Perspective", *EAI Background Brief No. 519*, East Asian Institute, Singapore: National University of Singapore, 12 April 2010.

4 Jacob Viner, *The Customs Union Issue*, (New York: Carnegie Endowment for International Peace, 1950).

benefiting from the reduction of tariffs; however, this positive impact is not uniform among all the commodities. Indeed, ACFTA assisted expansion in trade also contributed to a trade deficit for Indonesia—albeit tolerable at present.

In addition, most of the trade agreements between Indonesian and Chinese partners have been made before ACFTA; therefore, the immediate impact for business community was relatively limited, particularly during the first year. In short, we still need more time to assess the advantage and disadvantage of ACFTA for Indonesia.

RECOMMENDATIONS

ASEAN countries, particularly Indonesia, must ensure and enhance their competitiveness in order to compete with China. As we live in the world of competitive advantage, a country must possess competitive advantage in an industry to benefit from exports and foreign investments. According to Michael Porter's Diamond Model, there are four conditions affecting the competitiveness of a country: factor conditions; demand conditions; related supporting industries; and firm strategy, structure and rivalry. Nowadays, international markets are imperfectly competitive, which implies that trade between similar countries is forced by economies of scale rather than comparative advantage.⁵

Competitive advantage of ASEAN countries is diverse, some countries are capital-intensive and others are labour-intensive; China is mostly labour-intensive. ASEAN countries like Malaysia, Indonesia and Vietnam must focus on raw-material-based and labour-intensive exports such as manufacturing products involving input assemblies with a little value-added, while China can undertake manufacturing of products with high-tech value-added. Among the main export commodities, ASEAN with less labour productivity exports little value-added products to China while China exports highly value-added ones. With high domestic demand in ASEAN and China, economies of scale in manufacturing would increasingly play a major role and ACFTA has the potential to help multinational companies in restructuring supply chains and rationalise production networks—efforts that could eventually lead to a single ASEAN-China market.

5 For further reading, Paul Krugman (Ed.), *Strategic Trade Policy and the New International Economics*, (Boston: The MIT Press, 1986).

The model of regional production network is a modality for achieving ACFTA objectives of improving ASEAN-China trade and investment based on mutual benefit. Regional production networks have developed in East Asia by the multinational companies from Japan, China and South Korea through engaging the ASEAN countries. The establishment of ACFTA can further help to nourish the production networks and to intensify the activities of Chinese multinational companies in ASEAN countries by exporting ASEAN products to China and channelling FDI from China into ASEAN. This process benefits ASEAN countries by reducing unemployment, enhancing infrastructure and maintaining the tempo of economic development and growth.

With respect to the sustainability of the agreement, there must be reviews and/or evaluations on the agreement from both sides. For some parties, ACFTA contains costly provisions. For example, in Indonesia the Chamber of Commerce and Industry fearing a deluge from Chinese goods demanded renegotiation of the implementation of some tariff categories. Several Indonesian businesses were afraid that they might not be able to compete with cheaper Chinese goods as tariff reduced to zero per cent.

The local businesses in Indonesia had proposed that the government had to delay the implementation on 228 tariff categories covering various industries,⁶ especially for steel, textiles and shoes. ACFTA concurred with zero tariffs on 6,682 tariff posts in 17 sectors, including 12 manufacturing and five agricultural, mining and maritime sectors.⁷ Despite the huge pressure to renegotiate the terms and conditions of ACFTA, the Indonesian Trade Minister Mari Elka Pangestu, noted that the renegotiation of ACFTA would be a burden and too costly. She said that if the government chose renegotiations, the option must be done in line with the articles of ACFTA. According to Article 6 of ACFTA, Indonesia must increase the compensation value close to the modification

6 Arti Ekawati and Camelia Pasandaran, "Indonesian Chamber of Commerce Disappointed with Failure to Renegotiate ACFTA," *Jakarta Globe*, 5 April 2010, www.thejakartaglobe.com/business/indonesian-chamber-of-commerce-disappointed-with-failure-to-renegotiate-acfta/367730

7 "RI send letter to China to Renegotiate ACFTA," *Jakarta Post*, 2 September 2010, www.thejakartapost.com/news/2010/02/09/ri-sends-letter-china-renegotiate-acfta.html

value. The value of the 228 tariff posts was expected to go up to US\$1.2 billion upon renegotiation, as relative to only US\$43 million without the renegotiation. The minister argued that the option would also hurt the country's image as it would demonstrate Jakarta's uncertainty, and this could affect other sectors including foreign investments.⁸

Indonesia must be cognizant of protecting domestic industries particularly strategic sectors and infant industries that may be harmed by Chinese products. In protecting the domestic industries from the competition within an FTA regime, we recommend the government of Indonesia to follow the tenants of strategic trade theory. This theory suggests that certain types of state intervention have the potential to shift gains from foreign to domestic firms. With imperfect competition and super-normal profits, the government can help threatened industries by enhancing the global competitiveness of domestic firms through a variety of initiatives such as improving capacity building, developing infrastructure and supervising businesses.

The strategic trade model suggests the combination of trade and industrial policies; therefore, this requires well-established synergy and coordination among stakeholders, especially the Ministry of Trade and the Ministry of Industry. The capacity building improvement could be achieved by emphasising labour skills, technological trajectory and "local values". The development of infrastructure would be able to reduce production costs and assist in providing economies of scale for domestic industries.

Finally, the government should enhance governance issues pertaining to the implementation of FTA, including the provision of information, the ease of business documentation and services, and the bureaucratic professionalism. Furthermore, the government must ensure that the governance is effective, efficient and affordable.

THAILAND

Paisan Rupanichkij

China has emerged as the factory of the world. There are virtually no countries in the world where there are no Chinese products. China is now the world's number one exporter and number two importer, rising from number 29 in 1978.

ACFTA is the first FTA proposed by an ASEAN dialogue partner. Currently, it is the largest FTA in the world in terms of population. ACFTA is driven by China's desire to forge a closer economic tie with ASEAN and to alleviate ASEAN's concern over the rise of China.

ACFTA allows ASEAN to have greater access to China's gigantic and rapidly growing market, while China will also have access to ASEAN's growing market and rich natural resources. From China's perspective, its relations with ASEAN as a whole are more valuable than the sum of its parts (bilateral ties with each of the 10 member countries).

OVERVIEW OF THE THAI ECONOMY IN 2010

The year 2010 was a dramatic year for Thailand. During the first half of 2010, the country went through the most turbulent political upheaval in living memory. However, it managed to quickly recover from the crisis. Thailand's economic growth rate in 2010 was nearly 8 per cent, the highest in recent years in spite of the political turmoil and a sharp appreciation of the Thai baht (almost 10 per cent).

Thailand's main engine of growth was, is and will continue to be the export sector, which accounts for more than two-thirds of the country's GDP. Though in the past few years Thailand's main traditional export markets—

such as the European Union and the United States—have experienced slow growth and sluggish recovery, Thailand's exports still grew by 30 per cent.

Like other export-dependent countries in the region, Thailand has benefited considerably from China's early rebound through close trade linkages. From January to November 2010, exports to China grew at a hefty rate of around 40 per cent with a value of US\$19.40 billion, accounting for 10.90 per cent of Thailand's total exports. For the first time, China has surpassed the United States as Thailand's number one export market.

ACFTA FROM THAILAND'S PERSPECTIVE

ACFTA (NT) which came into effect on 1 January 2010 provides an impetus for growing trade ties between ASEAN and China. China and ASEAN are each other's number three trading partner. From 2003–2007, ASEAN-China trade had increased on the average of 30 per cent per year. During the first half of 2010, mutual trade between China and ASEAN reached US\$136 billion, a y.o.y. increase of 55 per cent. China's imports from ASEAN during the first half of 2010 increased by 64 per cent, while exports to ASEAN increased by 45 per cent, compared to the same period of 2009.

Trade

Overall, ASEAN has enjoyed a trade surplus with China. This surplus may arise from a so-called "trade triangle" in which China imports capital and technology from its north-eastern neighbours and natural resources and intermediate goods from Southeast Asian countries and then assembles them for export to the rest of the world. Under this trade triangle, China enjoys a trade surplus with the rest of the world, while running an overall deficit with countries in the East Asian region.

Like other ASEAN member states, Thailand has enjoyed healthy economic relations with China. Since the signing of the ASEAN-China Agreement on Trade in Goods in 2004, Thailand-China total bilateral trade more than doubled from around US\$15 billion in 2004 to US\$33 billion in 2009. In 2010, China surpassed the United States as Thailand's number one export market. In ASEAN, Thailand is China's number three trading partner after Malaysia and Singapore. On the global level, Thailand is China's number 14 trading partner.

Thailand was one of the countries to join then EHP which was

introduced prior to the signing of ASEAN-China Agreement on Trade in Goods in 2004. The EHP allowed early tariff reduction on agricultural products which started in January 2004 and completed in January 2006. Under EHP, Thailand and China agreed to reduce tariff on 116 items of fruits and vegetables, effective on 1 October 2003. With a completion of EHP in January 2006, Thailand has enjoyed a trade surplus on primary agricultural produces, but running overall deficit with China.

Thailand's top 10 exports to China, in descending order, are: automatic data processing machines and parts; rubber; chemical products; polymers of ethylene; rubber products; tapioca products; electronic integrated circuits; refined fuels; wood and wood products; and other electrical equipment and parts.

In the first 10 months after the entry into force of ASEAN-China FTA on 1 January 2010, Thai exports to China increased to US\$17.42 billion, or an increase of around 39 per cent, while imports rose to US\$20 billion, or a rise of about 46 per cent. Thailand ran a deficit of US\$2.58 billion, compared to US\$1.73 billion in the same period of the previous year (2009). Thailand's exports under ACFTA have increased by 91.75 per cent with a value of US\$5.9 billion, which clearly indicated the huge benefits of ACFTA.

Rising trade between ASEAN and China has made the two partners even closer economically and highly inter-dependent. China's rapid and solid growth, deepening regional production network and the introduction of institutional support (e.g. the formation of ACFTA and the establishment of ASEAN-China Centre) have all contributed to ASEAN-China closer economic ties.

For many people, the deepening of ASEAN-China ties is essential as it helps lessen the impact of slow growth and sluggish recovery in the United States and the European Union and contributes to the deepening of regional integration. However, for some others, it causes a concern as ASEAN may have become too reliant on China for growth.

Investment

It is a massive inward FDI that has propelled China into the world's largest exporter and the second biggest economy. As the Chinese economy becomes more developed, it begins to face a number of pressures, such as a rising wage, environmental problems and anti-sentiment towards

“Made in China” products. China has, therefore, decided to adopt a “Going Global” policy by encouraging outward FDI.

China’s outward investment policy seems to be driven by a desire to promote exports, a need for natural resources, a search for technology and a way to alleviate sentiment against “Made in China” products. In 2008, more than 8,500 Chinese investors and 12,000 firms invested overseas in 174 countries with a total investment of US\$55.9 billion in 2008. China’s FDI in Asia accounts for 77.9 per cent of China’s total investment. Hong Kong, South Africa and Virgin Island are the top three destinations for China’s outward FDI.

ASEAN-China Agreement on Investment, signed in 2009, is expected to help promote investment between China and ASEAN. At present, China is relatively a small player in terms of inward FDI in ASEAN, but there is a trend of China’s rising investment overseas. From 2003–2009, ASEAN’s FDI in China increased from US\$2.93 billion to US\$4.68 billion, while China’s FDI in ASEAN increased from US\$230 million to US\$3 billion.

During the first half of 2010, ASEAN’s FDI in China increased by 24.9 per cent (US\$3.13 billion), whereas China’s FDI in ASEAN rose by 125.7 per cent (US\$1.22 billion). As of June 2010, ASEAN’s total FDI in China was around US\$60 billion, while China’s total FDI in ASEAN was US\$9.6 billion. Thailand is number 5 destination for China’s FDI in ASEAN with a total investment of US\$437 million in 2008.

Over the past few years, China has actively expanded its FDI, especially in resource-related industries. China has already become the largest foreign investor in some East Asian economies, such as Cambodia, Laos and Myanmar. China’s investment could potentially serve as another major engine for East Asia’s economic growth in addition to East Asia’s exports to China. It could help to stimulate the region’s growth like Japan’s FDI to the region in the 1980s.

In Thailand, China has recently decided to make a major investment in wholesale trade by building a large wholesale trade centre worth up to US\$1.5 billion near Bangkok’s new airport to re-export its goods from Thailand to other ASEAN markets and beyond. The planned wholesale trade centre, expected to be completed in 2013, will have a total space of 700,000 square metres, equivalent of 100 football fields. It will be the largest distribution centre in ASEAN and the second largest in Asia.

The centre will be divided into different clusters of products, such

as garments, jewellery, toys, lifestyle goods, automobile parts and food. More than 70,000 Chinese traders are expected to operate in the centre. The centre will help China to re-export its goods and avoid costly tariffs by making full use of ACFTA. This massive investment project was given a warm welcome by the Thai Government, but a cool response from the Thai private sector which had a great concern over its impact on the local economy.

CHINA'S ROLE IN PROMOTING CONNECTIVITY

At the 17th ASEAN Summit in Hanoi, Vietnam, in October 2010, the Master Plan for ASEAN Connectivity was adopted with the aim to promote a more competitive and resilient ASEAN that brings people closer together, promotes flows of goods, services, and capital and ensures continued peace and prosperity for peoples in ASEAN. The Master Plan covers three key elements: physical connectivity, institutional connectivity and people-to-people connectivity.

China is one of the dialogue partners eager to contribute to the implementation of the Master Plan. ASEAN-China Foreign Ministers' Meeting on Connectivity was held in Kunming on 25 January 2010 to discuss how China and ASEAN can work together to promote connectivity among ASEAN member states and between the two sides.

ACFTA is an important part of soft infrastructure support that can play an important role in promoting ASEAN-China economic ties, which should be further harnessed along with the development of hard infrastructure. China is one of ASEAN's two dialogue partners that share land borders with ASEAN. Various road links are being developed to connect China with ASEAN, through various "Rs", such as R3A [Thailand-Laos-China (Kunming)], R3B [Thailand-Myanmar-China (Kunming)], R8 and R9 [Thailand-Vietnam-China (Guangxi)]

Moreover, rail links are also being developed. Apart from a well-known Singapore-Kunming Rail Link (SKRL), there is a new rail route being contemplated, i.e. Kunming-Laos-Thailand (Bangkok) High-Speed-Rail Link. Thailand and China are expected to sign an MOU to jointly develop 615-kilometre High Speed Rail linking Bangkok and Nong Khai, a province in North-eastern Thailand, in March or April 2011. This High-Speed Rail Link has the potential to be extended to Southern Thailand to connect with rail link to Malaysia and eventually to Singapore.

A feasibility study of the project, survey and design is expected to take one year and construction is expected to be completed in four years. The high-speed train is expected to begin its service in 2015.

As part of the activities to commemorate the 20th anniversary of ASEAN-China relations, the ASEAN Foreign Ministers' Road Trip from Northern Thailand to Southern China was organised on 23–25 January 2011 with the aim to promote ASEAN-China connectivity.

CONCLUSION

With the entry into force of ACFTA in 2010 and the 20th anniversary of ASEAN-China relations in 2011, ASEAN and China should take a fresh look at their growing economic ties. ASEAN-China economic relations are likely to become even stronger and deeper owing to China's continued high growth, ASEAN member states' continued efforts to integrate their economies and the implementation of ACFTA, which is currently the world's largest FTA.

The centre of the world's economy is shifting back to Asia with East Asia as the hub. The history of the twenty-first century will be written in Asia. Countries in the region should, therefore, work together to ensure that the twenty-first century will be a century defined by enduring peace, mutual prosperity and sustainable progress, different from the twentieth century which was a century defined by hot and cold Wars and confrontation between the two blocs.

In the first decade of the twenty-first century, we have already seen many important changes and developments that will have a profound impact on regional and global landscape. China has now emerged as the world's largest exporter and second largest importer and economy. Holding by far the largest foreign reserves in the world, China is now looking for more investment opportunities overseas.

The global economic and financial crisis has offered an important opportunity for ASEAN and China to rethink about growth strategies. "*Rebalancing growth*" appears to be a catch phrase in the region, which involves not only shifting from exports to domestic demand but also making the region's growth less dependent on import demand from the United States and the EU markets.

East Asia should look more to itself to maintain the momentum for economic growth. Like other ASEAN member states, Thailand has

enjoyed a booming trade with China and other ASEAN member states. Intra-regional trade has now been the main engine of growth not only for Thailand but also all other countries in the region.

The region's growing middle class would be a major boost for intra-regional trade. In the past, East Asia's intra-regional trade used to be dominated by trade on intermediate goods as countries in the region are part of the regional production network. With a slow and uncertain recovery in the West and its rising middle class within the region, East Asia should be able to consume more of its own final products.

In 2007, the World Bank estimated that in 2030 around 38 per cent of the world's middle class will be in China. About half of the world's new middle class (740 million) will come from China (50 million from Indonesia, 20 million from Malaysia, 25 million from Thailand). With this growing middle class and a solid growth prospect, the goal of increasing ASEAN-China mutual trade to US\$500 billion by 2015 is likely to be achieved. If China can significantly increase its domestic spending, this will help rebalance the global economy and reduce China's reliance on export for growth.

Over the medium to long term, the prospect for growth and development in East Asia remains bright, provided that the region can continue to enjoy a sound regional environment. Without such an environment, China and the other countries in the region can hardly achieve sustainable growth. Countries in the region should, therefore, continue to engage actively in the existing regional frameworks and forums to enhance mutual trust and promote closer cooperation. ASEAN-China cooperation can serve as one of the cornerstones for East Asia's economic integration and community building.

MALAYSIA

Mahani Zainal Abidin and Nor Izzatina Aziz

The ASEAN-China Free Trade Agreement (ACFTA) is the first economic integration initiative that Malaysia had entered into through the ASEAN mechanism. This economic integration is important because of its size: in 2010, ACFTA represents a market of 1.9 billion consumers with gross output of US\$6 trillion. The region is highly connected with an annual total trade of US\$4.5 trillion in 2010. The high trade value is significantly contributed by intra-industry trade generated by the multinational and supplier companies engaged in the regional production network.

The large size of ACFTA and the high growth rate of the Chinese economy are among the key reasons for Malaysia to participate in this integration. The Chinese economy sustained high growth and consequently the rising affluence of its consumers is likely to demand more imports. Another compelling reason for Malaysia to join ACFTA is the diversification of its export markets: Malaysia has been very dependent on the United States, the European Union and Japanese markets for its exports. ACFTA will improve Malaysia's market access into China and this will help its export market diversification effort. With the implementation of ACFTA, the removal of trade barriers and improvement of trade facilitation between ASEAN and China is expected to lower costs and subsequently increase trade and investments.

Malaysia's participation in ACFTA presents opportunities for it to be a part of and benefit from China's high economic growth. Even though ACFTA is only one year in its implementation, it is, nonetheless,

important to examine whether the regional integration can produce the outcome that Malaysia is expecting. In this respect, it is not possible to see the full impact due to the early stage of implementation but indications of likely outcome can be a useful milestone.

MALAYSIA LIBERALISATION COMMITMENTS IN ACFTA

The Framework Agreement on Comprehensive Economic Cooperation signed by ASEAN and Chinese leaders in November 2002 marked the first formal effort by ASEAN to be economically integrated with other regions or countries. ACFTA Agreement on Trade in Goods and Dispute Settlement Mechanisms was signed in November 2004. With the signing of this agreement, ACFTA was implemented in stages beginning with the EHP in 2005 and it serves as a springboard for future tariff reductions.

Under the EHP, China has agreed to reduce and eliminate tariffs on agricultural products from ASEAN and this was reciprocated by several ASEAN members. In addition, some manufactured goods were also included in the EHP. EHP covered about 600 agricultural products including livestock, meat, fish and dairy products. Malaysia has listed 503 unprocessed agricultural products such as coffee, animal and cocoa preparation and 87 manufactured goods such as glass envelopes for Cathode-Ray Tubes (CRT) to be eligible for tariff reduction.

TABLE 1
Schedule of tariff reduction for China and ASEAN-6 under the Normal Track

Schedule	Commitments			
Jan 2010	• Eliminate all tariff lines			
Jan 2007	• At least 60% of its tariff lines reduced to 0–5%			
Jul 2005	• At least 40% of its tariff lines reduced to 0–5%			
Applicable Tariff Rates	ACFTA Preferential Tariff Rate			
	2005	2007	2009	2010
20% and above	20	12	5	0
15% (inclusive) – 19.99%	15	8	5	0
10% (inclusive) – 14.99%	10	8	5	0
5% – 9.99%	5	5	0	0
4.99% and below	standstill	0	0	

Source: Association of Southeast Asian Nations

Malaysia's tariff reduction commitments fall under the NT where tariff reduction began in 2005 and was eventually eliminated in 2010. Table 1 shows the stages and rate of tariff reduction under ACFTA for six ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Thailand, Singapore) and China.

The majority of Malaysian import duties have been eliminated since 2009, while the remaining ones are in the 0–5 per cent range, with the exception of products in the automotive industry.

To help Malaysian industries adjust to the increased competition as a result of liberalisation, the time frame for tariff reduction has been extended for not more than 150 tariff lines. Tariff lines under this extended timeframe will be eliminated before 2012. The products under this category include polyethylene, polypropylene, polystyrene, rubber tires and tubes, textiles and fabrics, footwear, ceramic products, articles of iron and steel and electrical products.

As in any integration agreement, there are industries that are carved out due to sensitivities or their strategic importance. These are products that are placed in SL and HSL. Currently, Malaysia has 416 products in the SL and 285 in the HSL. Tariff rates for these products will be reduced but will not be eliminated. Iron and steel and automotive products are among products listed under SL. Duties for Sensitive products will be reduced to 20 per cent by 2012 and to between 0 to 5 per cent by 2018. On the other hand, tariffs for the Highly Sensitive products will be reduced to 50 per cent by 2015.

ACFTA also included services liberalisation but the agreement was only signed in 2007. The ASEAN-China Services Agreement is an important step forward for Malaysia considering the commitments it made are deeper than those made under the General Agreement in Trade in Services (GATS). The sectors committed are architecture, engineering, telecommunications, financial services, education, health, tourism, computer services, management consulting services, environmental services, recreational services and transport services. For architecture, engineering, financial services and education, their liberalisation commitments are expected to be even deeper once the Protocol to Implement the Second Package of Specific Commitments under the Agreement on Trade in Services is signed in August 2011. The Services Agreement, however, excludes liberalisation in government procurement and government related services.

ASSESSMENT OF ACFTA AFTER ONE YEAR OF IMPLEMENTATION

Trade in Goods

Malaysia's total trade with China had increased from RM23.8 billion in 2000 to RM147 billion in 2010—a six-fold increase—as shown in Table 2. It is unclear whether this huge increase was attributed only to ACFTA, because China's accession into the WTO in 2001 and its phenomenal growth rate have substantially expanded China's trade with the region and the world. The WTO accession had made China a very competitive and attractive manufacturing location and it became a critical node in the regional production network. The resulting high growth of China's manufacturing exports might serve as the catalyst for higher exports from other countries in the regional production network such as Malaysia to supply intermediate goods for further processing in China.

However, it is noteworthy that the rate of export growth from Malaysia to China has risen significantly after the signing of ACFTA. The low export growth in 2009 was due to the global financial crisis but exports rebounded strongly in 2010. In contrast, the rate of import growth is very much lower compared to exports. This trend had turned the negative trade balance into a positive one from 2009.

TABLE 2
Malaysia's exports to and imports from China (RM million)

	Export	Growth rate (per cent)	Import	Growth rate (per cent)	Total trade	Trade balance
2000	11,507.2		12,320.5		23,827.8	(813.2)
2005	35,153.1	8.8	49,879.9	27.1	85,032.9	(14,726.8)
2006	42,612.0	21.2	58,259.6	16.8	100,879.6	(15,639.6)
2007	53,037.9	24.4	64,712.7	11.1	117,750.6	(11,674.7)
2008	63,435.0	19.6	66,853.7	3.3	130,288.7	(3,418.6)
2009	67,241.1	6.0	60,660.0	(9.3)	127,901.1	6,581.1
2010	80,595.1	19.9	66,432.9	9.5	147,027.9	14,162.2

Source: Malaysian Statistical Department

This rising trade has made China a significant trading partner for Malaysia. In 2000, China was ranked the ninth most important market for Malaysian exports and the sixth most important source of import. By 2010, China has become the second largest export market and import

source for Malaysia: China's share in Malaysia's total exports and imports was 12.6 per cent and 12.5 per cent respectively.

Although Malaysia's exports to China have increased significantly, its structure remains largely unchanged as shown in Table 3. These 10 products constitute more than 60 per cent of Malaysian exports to China and they are electrical and electronic machinery (8471, 8473, 8525 and 8542), vegetable products, mainly palm oil (1511 and 1516), petroleum products (3910 and 3901) and rubber products (4005 and 4001). This shows that ACFTA does not change the structure of exports by improving market access for other export products from Malaysia. The increased export value may be attributed to either ACFTA or the high Chinese growth or both.

The share of the top 10 imports from China is much less than that of exports: the share is about 45 per cent of total imports from China as shown in Table 4. Although the size of the top 10 imports is less than the top 10 exports, the same observation can be made, namely the import structure has not changed much since 2005. These imports are electrical machinery and equipment, telecommunication equipment, sound recorders and televisions, either as a whole or as parts and components. Unlike exports, the values of these top 10 imports have not increased

TABLE 3
Top 10 Malaysian Exports to China (HS4 digit), 2005–2010

Rank	2005	2006	2007	2008	2009	2010
1	8,542	8,542	8,542	8,542	8,542	8,542
2	1,511	1,511	1,511	1,511	1,511	8,474
3	8,473	8,473	8,473	8,471	8,471	1,511
4	4,001	4,001	4,001	8,473	8,473	8,471
5	8,471	8,471	8,471	4,001	4,005	4,001
6	1,516	4,005	4,005	4,005	2,709	4,005
7	3,901	2,710	1,516	2,709	4,001	2,709
8	8,529	3,910	2,709	1,516	1,516	1,516
9	4,403	1,516	3,901	3,901	2,711	2,711
10	2,711	9,030	2,905	8,525	3,901	2,710
Total RM million	20,130	27,368	36,782	46,022	49,794	55,595
Per cent of export to China	57.3	64.2	69.4	72.6	74.1	69.2

Source: Department of Statistics, Malaysia

very significantly from 2006 to 2010. In other words, the import pattern from China is becoming more diverse.

TABLE 4
Top 10 Malaysian imports from China (by HS4), 2006–2010

Rank	2005	2006	2007	2008	2009	2010
1	8,473	8,473	8,473	8,473	8,473	8,542
2	8,542	8,542	8,542	8,542	8,542	8,473
3	8,471	8,471	8,534	8,471	8,471	8,471
4	8,529	8,531	8,529	8,529	8,517	8,529
5	8,531	8,534	9,800	8,517	8,529	8,517
6	8,534	8,529	8,504	8,534	8,504	8,541
7	8,525	9,800	8,525	8,504	8,541	8,504
8	9,800	8,525	8,501	8,536	8,536	8,534
9	8,504	8,504	8,536	8,501	8,501	8,536
10	2,709	8,541	8,544	8,531	8,443	8,901
Total RM million	26,084	31,421	28,528	30,137	27,314	25,675
Per cent of import from China	52.4	53.9	44.1	45.1	45.0	38.6

Source: Department of Statistics, Malaysia

The matching of exports to and imports from China indicated a strong intra-firm trade in intermediate inputs for the electrical and electronic industry. This may lead to concern about low value added as the imports only undergo modest processing before being re-exported to China.¹

It is too early to derive any conclusive observation about the impact of ACFTA from the pattern of Malaysian trade with China because this economic integration has only been implemented a year ago. What is clear is that the trade relationship is growing strongly but this could have been the result of the strong Chinese economic growth that spurred higher domestic demand as seen by the expanding demand for primary commodities and agricultural products. The rising trade could also be attributed to the strong growth of Chinese exports, where Malaysia is part of the regional production networks that supplies inputs for final processing in China.

1 Shimelse Ali and Uri Dadush, “Trade in Intermediaries and economic policy”, *VoxEU*, 9 February 2011, www.voxeu.org/index.php?q=node/6088

Investments

Another key element in ACFTA is the investment component. For Malaysia, the inclusion of this chapter is expected to enhance Malaysia as an investment location and attract more Chinese funds to Malaysia. Table 5 shows investment from Malaysia into China and vice versa from China into Malaysia. From 2005 to 2007, Malaysia's investment into China was much larger than that from China into Malaysia. One could say that Chinese investment was almost negligible. However, Chinese investment into Malaysia jumped in 2008 and 2009.

Most of the Chinese investments were in infrastructure projects, utilities and resource industries and not in manufacturing. The State Grid Corporation of China will invest up to US\$11 billion to develop the Sarawak Corridor of Renewable Energy. However, China's investment in Malaysia has yet to overtake that from the United States, Japan, Hong Kong and Singapore. A further positive development is that the China Banking Regulatory Commission has approved Malaysia as an approved investment destination under China's Qualified Domestic Institutional Investor scheme. With this move, more funds from China are expected to flow into Malaysia. This shows that the liberalisation of the manufacturing sector through reduction of tariff rates (i.e. ACFTA) is not a factor in attracting Chinese investment but instead other strategic factors and measures are responsible for the larger inflow.

Malaysia's investments in China continue to be high and they are in

TABLE 5
Chinese and Malaysian direct investment (RM million)

Investment	2005	2006	2007	2008	2009	2010 (Q1 to Q3)
Malaysia into China	821	1,022	681	1,063	1,435	547
Annual growth rate (per cent)	—	24.5	(33.4)	56.1	35.0	(61.9)
China into Malaysia	23	42	59	1,106	1,239	914
Annual growth rate (per cent)	—	82.6	40.5	1774.6	12.0	(26.2)

Source: Bank Negara monthly statistics

Note: Figures before 2008 are from reported equity investment. After July 2010, Bank Negara Malaysia, the Malaysian central bank, made some changes to its reporting format.

manufacturing and services sector. In the retail sector, Parkson Retail Group, controlled by Malaysia's Lion Group has 47 self-owned and managed stores in China and in 2010 it invested 300 million yuan for expansion. Malaysia's Sime Darby Group has also ventured into logistics and utilities services in China. Currently, it operates the Weifang port near Weifang city and its water treatment plant provides treated water for industrial use at the Shandong Hai Hua Development Zone and Hanting Northern District in Shandong province. Sime Darby's operation in Weifang has grown ever since and in 2009, the company was offered a multi-billion dollar development project there, which included township projects. Like the Chinese investment, Malaysian investors went to China not because of ACFTA; the attraction was and is the large Chinese domestic market. Investment by Malaysia and China is expected to grow but this growth is not driven by ACFTA.

FEEDBACK FROM INDUSTRIES

The implementation of ACFTA has caused some concerns among Malaysian businesses. Malaysian business associations continue to voice their fear of unfair competition and uneven level playing. The complaints against implementation of ACFTA are likely due to:

- lack of preparedness among Malaysian industries; and
- aggressive selling of Chinese products

The Malaysian steel and iron manufacturers are reportedly facing a stiff competition operating in ASEAN and even domestically. Despite huge capacity upgrading, ACFTA is forcing these manufacturers to upgrade further and install new steel-making capacities. ASEAN steel manufacturers are worried about China's ability to export steel at a lower price to ASEAN.² Apparently, China is facing 55 trade actions on steel products filed by the United States, the European Union and several ASEAN countries.

In another complaint, the Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCIM) has been calling for a limit of 10 per cent annual growth of imports from China to ensure that dumping of China's goods does not happen. The ACCIM also admitted that local industries are not fully prepared for the removal of import tariffs for 90

2 "Local steel companies face tough outlook", *The Star*, 1 January 2011, biz.thestar.com.my/news/story.asp?sec=business&file=/2011/1/1/business/7700928

per cent of the goods traded in ACFTA.³ Despite the figures showing Malaysia to be a bigger beneficiary of ACFTA since its implementation, the grievances reported by the small and medium enterprises continue to grow. Some reported of having to deal with high export standards requirements upon entry to China, but the same standards are not implemented in Malaysia for imports.

CONCLUSION

The review of one year of ACFTA's implementation must ask two questions:

1. Has it increased trade?

The evidence shows that Malaysia's trade with China is growing. However, the expansion is not entirely due to ACFTA because part of this trade increase is linked to China's recovery from the global financial crisis which has boosted imports by China from ASEAN countries. The Malaysian case shows that ACFTA has not changed the structure of Malaysian exports to China.

2. Has it increased investment?

Chinese investment into Malaysia has increased. However, like trade between Malaysia and China, the impact of ACFTA on investment between the two countries is still inconclusive. The investment relationship between China and Malaysia has become stronger, although most investments are in resource-based sectors, services and infrastructure and not in manufacturing.

This review could not provide a conclusive answer about the impact of ACFTA because of the short period of implementation (12 months). However, there are indications that this regional integration initiative can produce the benefit envisaged by the member countries.

While there are concerns about the losses that might be experienced by the manufacturing sectors, ACFTA can provide large benefits to Malaysia particularly in services trade. Currently, Malaysia has a comparative advantage in education, health and tourism services and Islamic finance and banking. With greater progress in the trade in services agreement made under ACFTA, Malaysia may increase its services trade with China.

3 "Businesses need to adjust to new market realities", *The Star*, 22 February 2010.

For ACFTA to be fully effective, significant progress is needed. Among the areas that can bring immediate benefit is improvement in trade facilitation, which the private sector considers as a key obstacle to trade. ACFTA started with the low-common denominators among the 11 nations and these commitments must be continuously improved, especially in tackling complex issues like the environment, labour standards, health standards, government procurement, and investment and competition policy.

THE PHILIPPINES

Amado M. Mendoza Jr. and Richard Javad Heydarian

This chapter reviews the first year of ACFTA from the Philippines viewpoint. It notes that prior to the inking of ACFTA, Philippines-China relations followed a roller-coaster pattern. It locates the agreement within the context of two triangular relationships: the U.S.-Philippines-China triangle and the China-Philippines-Taiwan triangle and notes that the Philippines seeks to maintain a balancing act within both triangles according to how it perceives is required by the national interest.

OVERVIEW OF THE PHILIPPINES-CHINA RELATIONS

The Philippines and China established diplomatic relations on 9 June 1975 with the signing of the Joint Communiqué by leaders of the two countries. Since then, bilateral relations between the two countries have developed steadily despite some difficulties. Both countries have maintained high level contacts and exchanges.

Several major bilateral agreements were signed between the two countries over the years, such as: Joint Trade Agreement (1975); Scientific and Technological Cooperation Agreement (1978); Postal Agreement (1978); Air Services Agreement (1979); Visiting Forces Agreement (1999); Cultural Agreement (1979); Investment Promotion and Protection Agreement (1992); Agreement on Agricultural Cooperation (1999); Tax Agreement (1999); and Treaty on Mutual Judicial Assistance on Criminal Matters (2000). In May 2000, on the eve of the 25th anniversary of their diplomatic relations, the two countries signed a Joint Statement defining

the framework of bilateral relations in the twenty-first century.

If one takes a longer view,¹ a roller-coaster pattern has characterised the Philippines-China relations (including economic) since 1975. They were generally warm and robust during the Marcos years. However, they turned lukewarm during the presidency of Corazon Aquino as her administration tilted to Taiwan's side. Her successor, President Fidel Ramos, repaired ties and reinvigorated the relationships to compensate for the loss of American financial aid following the termination of the U.S.-Philippines military bases agreement in 1991. What was intriguing was that the burgeoning bilateral economic relations were not adversely affected by diplomatic rows in the South China Sea.

Bilateral relations between the Philippines and China have significantly progressed in recent years. The growing bilateral relations were highlighted by the state visit to China of the Philippines President Gloria Macapagal-Arroyo on 29–31 October 2001.

Officially, both governments have a positive view of their recent relationships. The Chinese government cites with favour the frequent exchange of high-level visits between China and the Philippines.² During President Jiang Zemin's state visit to the Philippines in 1996, leaders of the two countries agreed to establish a cooperative relationship based on good-neighbourliness and mutual trust towards the twenty-first century, and reached important consensus and understanding of "Shelving disputes and going in for joint development" on the issue of South China Sea. In 2000, China and the Philippines signed the "Joint Statement between China and the Philippines on the Framework of

1 Such as the view taken by Lim, Benito, "The political economy of the Philippines-China Relations", *PASCN Discussion Paper No. 99-16* (1999).

2 President Marcos (June 1975), President Aquino (April 1988), President Ramos (April 1993), President Estrada (May 2000) and President Arroyo (November 2001 and September 2004) visited China. Premier Li Peng (December 1990), Chairman of the Standing Committee of the Eighth National People's Congress Mr. Qiao Shi (August 1993), President Jiang Zemin (November 1996), Premier Zhu Rongji (November 1999), Chairman of the Standing Committee of the Ninth National People's Congress Mr. Li Peng (September 2002), Chairman of the Standing Committee of the Tenth National People's Congress Mr. Wu Bangguo (August 2003), President Hu Jintao (April 2005) and Premier Wen Jiabao (January 2007) visited the Philippines.

Bilateral Cooperation in the Twenty-First Century”³, which confirmed that the two sides will establish a long-term and stable relationship on the basis of good neighbourliness, cooperation, mutual trust and benefit. During President Hu Jintao’s state visit to the Philippines in 2005, both countries were determined to establish the strategic and cooperative relations aimed at peace and development. During Premier Wen Jiabao’s official visit to the Philippines in January 2007, both sides issued a joint statement, reaffirming the commitment of taking further steps to deepen the strategic and cooperative relationship for peace and development between the two countries.

In April 2007, President Arroyo attended the annual meeting of the Boao Forum for Asia. In June 2007, President Arroyo visited Chengdu and Chongqing, and in October, Her Excellency attended Shanghai Special Olympics and paid a side trip to Yantai, Shandong province. In August, President Arroyo attended the opening ceremony of the Beijing Olympic Games and paid a side trip to Chengdu. In October, Her Excellency President Arroyo attended the Asia-Europe Summit Meeting in China and had a side trip to Wuhan and Hangzhou. In December, President Arroyo went to Hong Kong to attend the Clinton Global Initiative Forum-Asia Meeting.

China’s Ministry of Foreign Affairs and the Department of Foreign Affairs of the Philippines set up a consultation mechanism in 1991 and 15 rounds of diplomatic consultations have been held since then. Apart from reciprocal establishment of embassies, China has a consulate general in Cebu, and established a consulate office in Laoag in April 2007. The Philippines have consulate generals in Xiamen, Guangzhou, Shanghai, Chongqing, Chengdu and Hong Kong SAR respectively.

As reported by the Chinese, bilateral trade volume in 2007 was US\$30.62 billion. From January to October 2008, bilateral trade volume reached US\$25.3 billion, an increase of 1.4 per cent as compared with the same period last year. By the end of September 2008, the actually utilised value of accumulative investment from the Philippines to China reached US\$2.5 billion.

3 Ministry of Foreign Affairs, People’s Republic of China, “Joint Statement Between China and the Philippines on the Framework of Bilateral Cooperation in the Twenty-First Century”, 15 November, 2000, www.fmprc.gov.cn/eng/wjbj/zjzg/yzs/gilb/2762/2763/t16139.htm

In 1999, China's Ministry of Agriculture and the Department of Agriculture of the Philippines signed the Agreement on Strengthening Cooperation in Agriculture and Related Fields. In 2000, relevant government agencies signed an agreement whereby China offers the Philippines US\$100 million credit facility. In March 2003, China's aid project, the China-Philippines Agricultural Technology Centre, was completed. With its successful trial planting in the Philippines, China's fine hybrid rice and corn have been growing over large areas in the country. In 2004, both sides signed the MOU on Fisheries Cooperation. In January 2007, Chinese and Philippines Ministries of Agriculture signed the MOU on Broadening and Deepening Agriculture and Fisheries Cooperation.

In August 2003, the two countries signed the MOU on Cooperation in Constructing the Northern Luzon Railway Project. In April 2005, the two countries signed the MOU on Cooperation in the field of Infrastructure between the Ministry of Commerce of the People's Republic of China and the Department of Trade and Industry of the Republic of the Philippines. The enthusiasm was shared by the Philippines side. The country has sustained a trade deficit with the rest of the world for much of the 1990–2009 periods. But it apparently enjoys an upper hand in its trade with China. GACC statistics revealed that trade between the two countries during the first half of 2010 was in favour of the Philippines, as China's exports to the Philippines was valued at US\$5.6 billion, while China's imports from the Philippines was pegged at US\$7.5 billion. According to Chinese statistics, bilateral trade reached US\$30.6 billion in 2007, achieving the target three years ahead of schedule. In 2008, total trade was US\$28.6 billion, decreasing further in 2009 to US\$20.5 billion following the global economic downturn.

Top exports of the Philippines to China as of June 2010 are electrical machinery and equipment, mechanical appliances, ores, copper, minerals, plastics and electronic goods. Meanwhile, China's top exports to the Philippines are electrical machinery and equipment, mechanical appliances, iron and steel, minerals and clothing accessories.

The General Administration of Customs of China also reported that from January to November in 2010, bilateral trade between China and ASEAN totalled US\$263.01 billion, achieving a y.o.y. increase of 40.6 per cent. During the period, China exported commodities with a total value of US\$124.45 billion to ASEAN, securing an increase of 33.6 per

cent, while ASEAN's export to China amounted to US\$138.56 billion, increasing by 47.5 per cent.

"It was right under this circumstance that trade between China and the Philippines in the same period totalled US\$25.23 billion, achieving a y.o.y. increase of 38.8 per cent, with China exporting goods worth US\$10.51 billion to the Philippines while importing from the Southeast Asian country commodities worth US\$14.72 billion, which helped the Philippines enjoy a surplus of US\$4.22 billion," Wu Zhengping, Economic and Commercial Counsellor of the Chinese embassy in the Philippines, told Xinhua in a recent exclusive interview.⁴

Currently, China is the third largest trade partner of the Philippines, while the Philippines ranks sixth among the ASEAN countries in terms of trade ties with China. From January to September in 2010, China's newly increased non-financial direct investment to the Philippines totalled US\$72.94 million, achieving a y.o.y. increase of 315.9 per cent, which is second only to Malaysia in the ASEAN region. Meanwhile, China introduced from the Philippines contracted foreign capital amounting to US\$63.35 million, which secured a y.o.y. increase of 177.4 per cent—the highest speed in the region. "It's fair to say the Philippines is becoming one of the main destinations for Chinese companies to make overseas investment, and the Southeast Asian country has very big potential," Wu said, adding Chinese investment in the Philippines mainly focuses on manufacturing and mining, while the Philippines investment in China prefers retailing, catering and real estate industries.⁵

ASEAN and China both rely heavily on third markets in the United States, the European Union and Japan. The export composition of ASEAN and China shows considerable overlap in manufactures, especially textiles and clothing and other labour intensive products⁶ which demonstrate the growing overlap in exports of manufactures to the U.S. market between 1990 and 2002 with the increasing technological sophistication of China exports. The export structures of ASEAN and China are largely competitive. In particular, China and Indonesia show an 83.5

4 Liu Peng, "China-ASEAN FTA adds new vitality into Sino-Philippines economic and trade cooperation: official", *Xinhua News Agency*, 16 January 2011.

5 Ibid.

6 Chia, Siow Yue, "ASEAN-China Free Trade Area". Paper presented at the AEP conference, Hong Kong (2004).

per cent overlap, followed by Thailand (76.1 per cent), the Philippines (57.0 per cent) and Malaysia (54.5 per cent). The lowest overlap is with Singapore (44.2 per cent). These overlaps with ASEAN countries have grown considerably since 1990, spilling over into electrical and electronic products and other more sophisticated products. While ASEAN's electronics exports have slowed down in recent years, China's exports are still climbing.

An Asian Development Bank study surveyed some 841 firms in East Asia to find out their usage of FTAs and impediments (if ever) to FTA use. On average, 28 per cent of the responding East Asian firms used FTAs and Thailand (at 25 per cent) and the Philippines (at 20 per cent) were the highest users in ASEAN. According to Kawai and Wignaraja,⁷ the relatively-low rate of FTA use by firms in the Philippines may be due to several factors. For example, the Philippines exports are concentrated in electronics, which already enjoy low most-favoured-nation (MFN) tariffs. The lack of information was overwhelmingly cited by the Philippines firms as the most important impediment to FTA usage (at 70 per cent) followed by delays and administrative costs and complicated rules of origin (ROOs).

RECENT DEVELOPMENTS

Under newly elected President Benigno C. Aquino III, the Philippines is also looking to leverage and expand dynamic trade and investment ties with China, now the world's second largest economy after the United States.

As pointed out earlier, China-Philippines trade had recovered last year from a drop in the 2008–2009 periods. Meanwhile, Filipino businessmen led by ethnic Chinese taipans Henry Sy, Lucio Tan and John Gokongwei are pouring capital into China in bids to cash in on its huge and fast expanding consumer market. As of August 2010, Filipinos had invested PHP 2.7 billion in China, the bulk of which was accounted for by the three tycoons who all traced their family origins to Amoy, now China's Fujian province.

7 Masahiro Kawai and Ganeshan Wignaraja, "Asian FTAs: Trends, Prospects and Challenges", *ADB Economics Working Paper Series No. 226*, Manila: Asian Development Bank, 1 October 2010.

Ayala Land, a unit of home-grown Philippines conglomerate Ayala Corp, has also embarked on expansion forays into mainland China, including a PHP 200 million venture to develop a 9.78-hectare residential complex in Tianjin province in partnership with Chinese and Singaporean investors.

On the other hand, Chinese investments in the Philippines have recently slowed, amounting to only PHP 202 million in this year's first eight months. Chinese firms have shied from new ventures amid allegations that some of them paid bribes to corrupt Philippines officials to clinch lucrative government deals. For instance, China's state-linked ZTE Corp was accused in 2007 of paying bribes to Juan Miguel Arroyo, then President Arroyo's husband, in exchange for a PHP 325 million project to build broadband internet services for the government.

Miguel Arroyo denied the allegations and the national ombudsman cleared him for lack of evidence. However, the Arroyos now face investigations by the Truth Commission formed by Aquino to look into past-alleged corruption-tainted deals, including the ZTE scandal. Prosecutors have said they intend to invite ZTE officials who signed the contract to testify, a move that could impact on broad Manila-Beijing commercial relations. Some analysts believe the case could drive away prospective Chinese investors in other projects on fears of getting trapped in legal woes.

Others believe China's investments will surge under Aquino's self-proclaimed reformist administration, particularly in energy, agriculture, tourism and infrastructure projects under his government's new public-private partnership scheme.

China's state-run Export-Import Bank is already financing a PHP 1.8 billion railway project that will link Metro Manila to the country's northern Luzon region, passing along the way through former U.S. military bases at Subic and Clark, now state-run special economic zones. However, there are similar allegations that this project was attended by fraud since the contract was awarded to a Chinese company without a public bidding. China is also known to be keen to bankroll the proposed rehabilitation of another railway connecting the metropolis to its southern provinces.

Mining is another area where Chinese interests are expected to make substantial new investments to help power its voracious appetite

for coal and other mineral resources. The state-owned China Metallurgical Group Corp recently expressed strong interest in pursuing new Philippines-based investment ventures in mining. Two Chinese companies—Polyard Petroleum International Co. Ltd. and China International Mining and Petroleum Corp—are now drilling for oil in areas north and south of Manila believed to potentially contain millions of barrels of oil in partnership with Australian firms.

ACFTA: PERSPECTIVES FROM THE PHILIPPINES

We have noted a recovery in bilateral trade in 2010 after a predictable slump in the 2008–2009 periods. However, one cannot conclude that this recovery is entirely due to the formal implementation of ACFTA.

Second, the ADB study shows that firms in the Philippines, while the second highest user in ASEAN, use FTAs below the regional average. And that lack of information regarding the FTAs (including ACFTA) is the single most important impediment to FTA usage among firms. Complicated ROOs and administrative costs are just second.

What is below the radar, since both governments do not address it, is the smuggling (and some say hoarding) of cheap and mixed-quality Chinese products in the Philippines.⁸ This may be true in other parts of the region as well. Domestic manufacturers and traders have time and again complained but the Philippines government had been unable to offer a lasting solution save for occasional raids and confiscations here and there. Since these smuggled goods do not figure in official trade statistics, one suspects that the Philippines trade surplus vis-à-vis China is over-stated.

And last but not least, there is strong suspicion that the recent burgeoning of bilateral economic ties was tarred by unethical and corrupt practices, with the Chinese as the bribers and top Philippines officials as the willing recipients. So if the top firms are enjoying MFN tariffs anyway and could not care less for ACFTA ‘privileges,’ local firms producing for the home market are generally unprotected. And it is suspected that such lack of protection is the quid pro quo for the bribes.

8 Bello, Walden, “The China-Asean Free Trade Agreement: Propaganda and Reality,” *Inquirer*, 14 January 2010, www.opinion.inquirer.net/viewpoints/columns/view_article.php?article_id=247344

The ZTE scandal, however, was a party spoiler. At one point, the U.S. Ambassador to the Philippines Christie Kenney complained of the competitive disadvantage of U.S. suppliers who must comply with strict RICO laws back home vis-à-vis unencumbered Chinese suppliers. The Americans were also apparently leery of the possibility that the Chinese would be able to eavesdrop on every communication that goes through the national broadband network.

In summary, there is more to the Philippines-China economic relations than just ACFTA. The bilateral relations between both nations are also circumscribed by third parties, external forces and influences.

VIETNAM

Chu Minh Thao

Since China was given the status of “Consultative Partner” of ASEAN in 1991 and later the full Dialogue Partner status in 1996, ASEAN and China have accelerated their trade relations. This chapter aims at providing an overall review of ACFTA after one-year of implementation from the perspective of Vietnam.

TARIFFS UNDER ACFTA 2010

As per the requirements of ACFTA, from 1 January 2010, China has eliminated tariffs for more than 90 per cent of goods imported from ASEAN (excluding some sensitive products for a slower pace). Extended timeframes are granted for 150 tariff lines up to 2012 for ASEAN-6 and China, and until 2018 for CLMV. Vietnam has agreed to reduce 50 per cent of its tariff lines under the NT to 0–2 per cent no later than 1 January 2009.¹ In addition, a further 45 per cent of Vietnam’s NT tariff lines will be eliminated by 1 January 2013.² This is a great opportunity in the short-term for Vietnam to take full advantage of the protection guaranteed under the early harvest provisions of ACFTA.

This paper reflects the point of views of the author, and therefore, in no way represents the views of the Diplomatic Academy of Vietnam or the Ministry of Foreign Affairs of Vietnam.

1 Paragraph 6(b)(i) of Annex 1 of the TIG Agreement as amended.

2 Paragraph 6(b)(iii) of Annex 1 of the TIG Agreement as amended.

TABLE 1
Vietnam's tariff

Tariffs levels	Vietnam	
	Agricultural products	Non-agricultural products
Simple average final bound	18.5	10.4
Simple average MFN applied 2007	24.2	15.7
Trade weighted	14.5	12.6
Two highest frequencies MFN applied	15–25% 25–50%	Duty free 25–50%

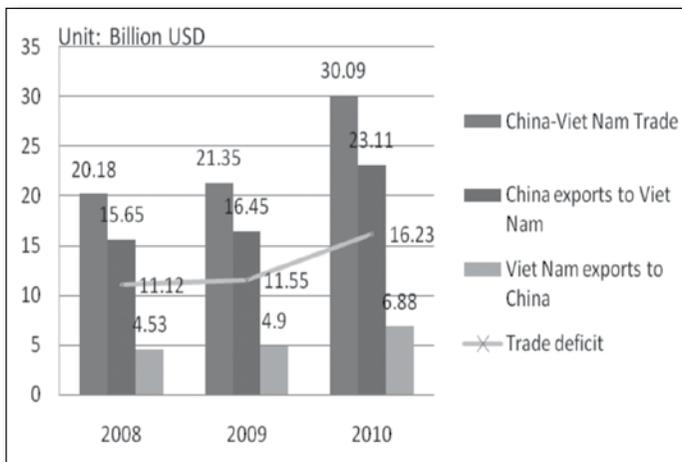
Source: WTO

Note: Vietnam imposes import-weighted tariffs as high as 20 per cent against some countries (China). Tariffs on Vietnam's exports are much lower, around five per cent.

VIETNAM'S TRADE WITH CHINA

Vietnam shares land borders with China and geographic proximity with ASEAN, making both of them our natural trade partners. ACFTA facilitates the immense opportunities for trade that already exists with our regional neighbours and promotes prosperity and stability for the region. ACFTA is important for Vietnam to implement the international economic integration policy.

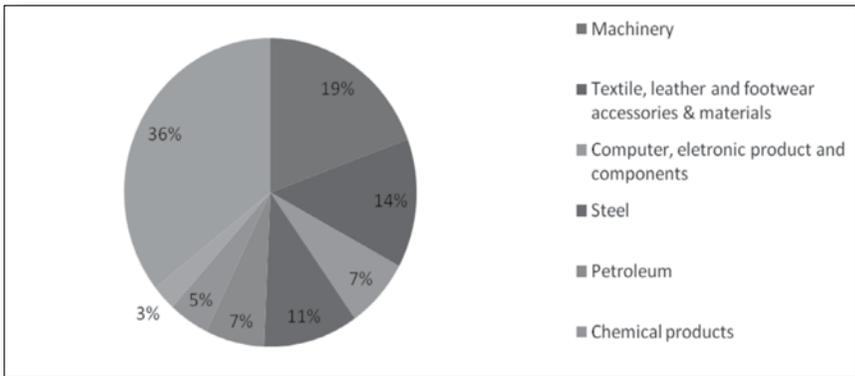
FIGURE 1
China-Vietnam trade



Source: Author's compilation

Vietnam is a small developing country with a rapidly expanding economy, whereas China is the world’s second largest economy after the United States. In this scenario, ACFTA stands out as an ambitious and well-constructed free trade agreement, facilitating trade in goods and thereby increasing trade turnover.

FIGURE 2
 The structure of import from China (2010)



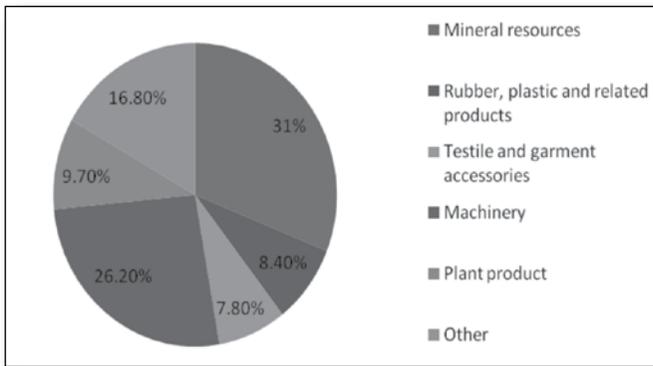
Source: Author’s compilation

The year 2010 witnessed the recovery of both Vietnam’s imports from and exports to China in the aftermath of the global financial crisis. The two-way trade increased by 42 per cent, from US\$21.35 billion in 2009 to US\$30.09 billion in 2010³ (accounting for 19.2 per cent of Vietnam’s trade). Moreover, exports from China and Vietnam increased by 41.8 per cent and 47 per cent respectively y.o.y. Vietnam has reduced 30 per cent of tariff lines for imports from China.

Currently, China provides nearly 27 per cent of the inputs and materials for Vietnam’s economy, a role more critical than that of even ASEAN (accounting for 18.9 per cent) and the European Union (accounting

3 “Total bilateral export and import between Vietnam and China in 2010”, 28 January 2011, www.ttnn.com.vn/nuoc-lanh-tho/52/tin-tuc/29503/tong-kim-ngach-xuat-nhap-khau-song-phuong-giua-viet-nam-va-trung-quoc-trong-nam-2010.aspx

FIGURE 3
The structure of exports to China



Source: Author's compilation

for 7.2 per cent). However, an issue of concern for policymakers is the increasing trade deficit of 41 per cent over 2009. This will create more risks for Vietnam's existing trade imbalance.

With regards to the structure of imports from China, as shown in Figure 3, Vietnam's main imports are essential materials that are required not only for domestic use but also for production of products for exports; this category accounts for nearly 70 per cent of total imports from China. With such a huge supply covering from essential goods such as consumer products to machinery, parts and accessories, the growth of Vietnam's economy has been increasingly dependent on China for the supply of key industrial materials. Some sectors such as textiles and garments have become a de facto extension of Chinese economy as Vietnam uses accessories from China for processing, production and re-export to the European Union and the United States. In other words, Vietnamese and Chinese economies have increasingly become closer.

However, Vietnam is at risk of becoming destination for obsolete technology from China, a trend that could have adverse impact on the ongoing efforts towards industrial modernisation. Currently, Vietnam faces three challenges emanating from closer economic relations with China: increasing trade deficit, import of low-quality products and transfer of obsolete technology. This long-term import surplus, especially

with the elimination of all tariffs under ACFTA from 2015, will create more pressures for domestic producers and will negatively affect macro economy, especially the foreign exchange rate.

With regard to the structure of exports, in 2009, energy and mineral resources (coal, rubber and crude oil) constituted nearly 55 per cent of total exports to China.⁴ However, due to the energy security considerations Vietnam made efforts to reconstitute this trade structure. Therefore, in 2010, the main exports included low value added products such as fruits, coffee, pepper, etc. Further, agro-fishery products accounted for only 15 per cent and industrial products accounted for 10 per cent of total exports to China. Most of these exports to China are raw materials or low value added products; therefore, the turnover cannot be high. China is one of the leading export countries to Vietnam, accounting for 31.8 per cent of Vietnam's total import, while Vietnam's exports to China account for only 7.2 per cent of Vietnam's total export turnover. China's trade accounts for 14.07 per cent of Vietnam's total trade turnover while Vietnam's trade accounts for only 0.78 per cent of China's total trade turnover.⁵ As such, China is a big promising market for Vietnam to further accelerate exports to China.

Historically, enterprises from Vietnam and China have conducted border trade for centuries. According to the statistics of the Ministry of Industry and Trade in Vietnam, during 2006–2008, border trade has increased 40 per cent annually in absolute terms. In 2008, the informal border trade between Vietnam and China accounted for one third of the total trade turnover between the two countries; by 2010, this border trade reached US\$10 billion, accounting for 30 per cent of the total trade.⁶ This situation is mainly influenced by China's border trade policy and Sino-Vietnam border resident's trade practices.

4 Pham Huynh, "Choáng ngợp voi nhập siêu tu Trung Quoc", *Vietnam Economic Forum*, 27 December, 2010, <http://vef.vn/2010-12-27-choang-ngop-voi-nhap-sieu-tu-trung-quoc->

5 "ACFTA, opportunities and challenges", *QuangTri*, 12 February 2010, www.baoquangtri.vn/default.aspx?TabID=85&modid=389&ItemID=19991

6 "Vietnam-China border trade in the context of ACFTA", *Tinh Loa Cai*, 18 January 2010, egov.laocai.gov.vn/hoptacdautu/hoptaclaocai%28vn%29vannam%28tq%29/thongtinkinhthethuongmaitrungquoc/khuvucmaudichtudoaseantrungquoc/Trang/634046203074334190.aspx

FACTS PERTAINING TO ACFTA IMPLEMENTATION

ACFTA is adopted at an appropriate time to cater to Vietnam's needs for sustainable development, progressive market opening, economic and production adjustments, and socio-economic management.

Out of the three agreements signed within ACFTA, Vietnam has benefited mainly from Trade in Goods Agreement. Because of the weak competitiveness, Vietnam's exports in services and foreign investment is limited and therefore failed to take complete advantage of the Trade in Service Agreement and the Investment Agreement.

FIGURE 4
Value of exports beneficial from FTAs

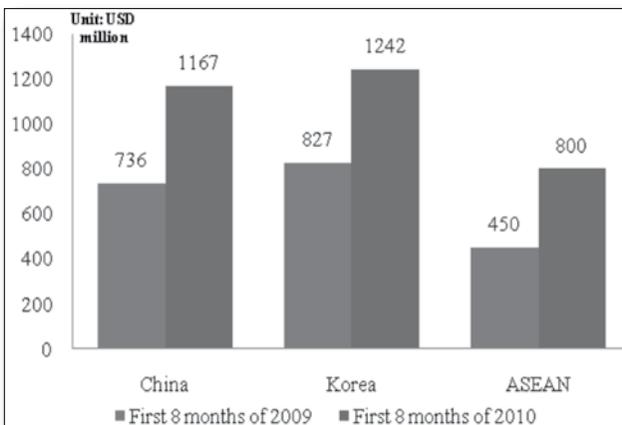


Figure 4 reflects the value of exports beneficial from all FTAs, including ACFTA. China and ASEAN has increasingly benefited from FTAs with a growth rate of 59 per cent and 78 per cent respectively for y.o.y.⁷

In general, ACFTA has produced positive effects by facilitating Vietnam's exports to ACFTA member countries and providing market access concessions with timetables for tariff reduction tailored to the protectionist needs of Vietnam. It is recognised that competing in ASEAN + China market under ACFTA is vital for Vietnam to prepare for its full

7 "Free Trade Agreement between Vietnam and partners: Finding changes from tariff reduction", *Smartax*, 12 October 2010, www.smartax.vn/index.php/2010/10/12/hiiep-dinh-thuong-mai-tu-do-giua-viet-nam-voi-cac-nuoc-tim-co-hoi-tu-giam-thue/

market economy status and competition in the global market.

ACFTA creates a challenge to balance the “safe” import surplus without serious impact on the stability of the macro-economy. Vietnamese businesses are under higher import pressure, and it is not easy to maintain a safe import surplus.

IMPACT OF ACFTA ON TRADE

1. ACFTA has facilitated trade between Vietnam and China, with exports increasing 40 per cent with regard to trade with China in 2010. On the other hand, growth of imports to Vietnam from China and ASEAN during 2010 partly reflects the relative recovery of Vietnam’s economy and the subsequent demand, rather than just the impact of ACFTA. Vietnam has one main advantage in its trade with China compared to other ASEAN countries—geographical proximity, which aids in reduction of transportation costs and time. Vietnam is becoming a supplier for production corporations in leading economic centres in China.⁸
2. Since 2010, although trade with China and ASEAN has increased, imports grew faster than exports resulting in a trade deficit. While Vietnam has only 800 products for export to China, the latter has more than 4,000 products for export to Vietnam. This situation will prevail for a long-time as Vietnam’s strong growth stimulates demand for imports from China. In addition, the relative depreciation of Chinese RMB makes products from China cheaper compared to those from Vietnam.

IMPACT OF ACFTA ON INVESTMENT

China’s FDI to Vietnam has reached US\$365 million, an increase of 74 per cent y.o.y.;⁹ however, this accounts only for 2 per cent of total investments

8 “Opportunities for export to China and ASEAN markets”, *CUTS Hanoi Resource Centre*, 2010, cutshrc.org/index.php?option=com_content&view=article&id=410%3Atrin-vng-thng-mi-t-acfta-&catid=78%3Avietnamese-news&Itemid=215&lang=vi

9 “China’s direct investment in Vietnam surges 74.3 per cent in 2010”, *VOA News*, 30 December 2010, www.voanews.com/vietnamese/news/china-direct-investment-in-vietnam-surges-12-30-10-112656419.html

into Vietnam in 2010 (US\$17.23 billion).¹⁰ In other words, ACFTA does not seem to have a major impact on FDI from China, which is surprising because of the guarantees offered by ACFTA's Investment Agreement.

REASONS FOR NOT TAKING FULL ADVANTAGE OF ACFTA

1. The main reason for the failure to take full advantage of preferential tariff under ACFTA is due to the structure of exports of the countries. Vietnam's main exports to China and ASEAN are raw materials, low-valued added products and agro-fishery products. Since 2004, Vietnam's agro-fishery products are beneficial from the EHP. Accordingly, tariff for products from Chapter 1 to Chapter 8 of the Schedule has been eliminated before full launching of ACFTA. Therefore, the effectiveness of tariff reduction under ACFTA is modest for Vietnam's export stimulation.
2. Export of agro-fishery products (mainly fruits, rubber, coffee, cashew, etc.) account for 15–20 per cent of Vietnam's total exports to China. These products must comply with China's requirements relating to SPS, labelling, packaging, etc. To meet these standards, Vietnamese exporters should make investments in advanced technologies, laboratories, lab-testing equipment, as well as develop the related knowledge and skills. This is a very difficult requirement beyond the financial capacity for many enterprises in Vietnam, especially small and medium enterprises.
3. Chinese enterprises are relatively stronger than enterprises in Vietnam, even in areas that the latter traditionally displayed competitive advantage, such as textiles and garments and consumer products. This is because of the limited quality of private enterprises as well as market weaknesses such as production factors and export promotions, especially the limited capacity of effective development policymaking and implementation.
4. Given a choice between border trade and ACFTA, most Vietnamese enterprises (especially those with poor quality exports and less competitiveness) are opting for border trade because of

10 "2010:Vietnam's GDP growth is 6.78 per cent", *Agri Bank*, 30 December 2010, www.agribank.com.vn/31/824/tin-tuc/tin-tuc-khac/2010/12/3105/nam-2010--tang-truong-gdp-cua-viet-nam-la-6-78-.aspx

simple customs and sanitary procedures, which lower the trading costs.

5. Complicated procedures and longer time for certificate of origin (CO) create additional burdens and constraints for exporters.
6. Many small and medium enterprises lack adequate information and necessary skills to maximise the benefits accruing from ACFTA. Sometimes the enterprises fail to prepare CO for tariff preferential, a situation partly attributed to the failure of the State to disseminate information about ACFTA.

CONCLUSION

During a period when the region was reeling under the stress of global financial crisis, the launch of ACFTA benefited ASEAN and China. ACFTA proved beneficial through the continuation of openness, facilitation of trade, market access, cooperation for rapid recovery, and creation of more efficient trade through access to low-cost suppliers and production network.

Together with Vietnam's policy of Doi Moi (renovation), which preceded ASEAN and WTO accession, ACFTA is expected to act as a "building" block rather than a "stumbling" block for Vietnam's multilateral liberalisation policy. Moreover, it could also be a useful instrument to address issues such as trade deficit, which is of prime concern for Vietnam, by promoting exports to regional countries.

China is seen not only as an economic threat but also as a huge market with growing opportunities. Vietnam's exports will increase further with greater integration between the two countries and through participation in production networks.

China, Vietnam and ASEAN have potential for trade cooperation due to differences in their economic structure; 80 per cent and 65–75 per cent of Vietnam's imports from China and ASEAN are materials and machinery for industrial production. In return, most of Vietnam's exports to China and ASEAN are intermediary products. Therefore, the benefits from strengthening the cooperation with ASEAN and China will contribute to increasing Vietnam's export and production capacity. Vietnam, ASEAN and China will participate more effectively in the regional and global supply chain. As ASEAN steps to an in-depth integration phase, economic structure in Vietnam will also witness changes.

In case of a surge in imports, causing serious damage to the domestic industry, Vietnam might resort to ACFTA-specific safeguard measures, but with careful consideration of the implications. A strategy for narrowing trade deficit is critical for Vietnam to ensure stable trade relations with China, with emphasis on exports.

CAMBODIA

Suon Sophal

Cambodia and China have a long history of bilateral relations dating back to the thirteenth century when Chinese diplomats under the Temur Kahn, Emperor of Chengzong of Yuan visited Angkor in August 1296. Modern Cambodia-China relations began in the 1950s after Cambodia gained independence from France. Cambodia-China economic relations are based mainly on business cooperation and trade relations between the ethnic Chinese community in Cambodia and the mainland Chinese. Ethnic Chinese constitute approximately 3–5 per cent of Cambodia's population or 350,000 people. They are mainly traders and retailers.

China and ASEAN are joined by common mountains and rivers, with good communications. Many Chinese products can be seen everywhere in Cambodia as well as in the ASEAN region, since they are cheaper compared with other imported products and more reasonable for consumers in general. About 60 per cent of the products in Cambodian markets are made in China. Implementation of the ASEAN-China Free Trade Area is providing greater access to markets in the region and is conducive to both enterprises' trade and investment cooperation. It also facilitates the flow and exchange of goods, services and technologies and is beneficial for enterprises to reduce costs, improve competition capacity and go out to develop themselves.

In recent years, bilateral political, economic and cultural relations have been in a state of comprehensive development. The two sides are highly complementary in economy and trade with vast cooperation.

Local Chinese businessmen have an important position in Southeast Asia's economy with shared language and similar cultures.

The average tariff on goods from the ASEAN countries to China has been cut down to 0.1 per cent. Tariffs of about 93 per cent of the commodities traded between the two sides have been eliminated. China has provided Cambodia duty free access to over 400 items and Cambodia continues to negotiate to gain more access to Chinese market. More than 7,000 trade tariffs were lowered to nil, enabling 99.11 per cent of all goods to cross the borders of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand for free. As part of the Common Effective Preferential Tariffs for ASEAN Free Trade Area, launched in 1993, Cambodia will reduce many of its tariffs to five per cent in 2011, before lowering them to zero in 2015. Since ACFTA entered into force, bilateral trade and investment cooperation between ASEAN and China has been developing rapidly and efficiently. ACFTA has greatly contributed to the fast growth of trade and investment within the region.

According to China Customs statistics, from January till September 2010, China's import and export value totalled US\$2,148.68 billion, up 37.9 per cent y.o.y. Therein, the export value totalled US\$1,134.64 billion, up 34 per cent y.o.y.; the import value totalled US\$1,014.04 billion, up 42.4 per cent y.o.y.; and the trade surplus totalled US\$120.6 billion, down 10.5 per cent y.o.y.

In the meantime, the bilateral trade between China and ASEAN has increased up to 43.7 per cent accounting for US\$211.31 billion y.o.y. In that, China's exports to ASEAN increased by 36.2 per cent accounting for US\$99.53 billion y.o.y.; imports from ASEAN increased 51.1 per cent accounting for US\$111.78 billion y.o.y.; and the trade deficit with ASEAN totalled US\$12.25 billion, while the trade deficit over the same period of 2009 was only US\$900 million. These showed that ASEAN has become the fourth largest trade partner of China after the European Union, the United States and Japan.

In terms of investment cooperation, ASEAN investment in China amounted to US\$3.1 billion in the first half of 2010, while Chinese firms' non-financial investment invested in ASEAN has reached US\$1.2 billion, increased by 125.7 per cent over the same period of 2009.

In the context of Cambodia, figures released by the International Monetary Fund, using data from the National Bank of Cambodia, show

that Cambodia is already strengthening its economic ties with China. Its merchandise imports from China have risen every year for the last nine years, rocketing from just US\$86.9 million in 2001 to US\$1.2 billion in 2008, accounting for 18.4 per cent of total merchandise imports that year. That figure was dwarfed, however, by US\$4.74 billion in merchandise exports from other ASEAN countries, or 72 per cent of all imports.

According to statistics from the General Department of Customs and Excises of Cambodia, bilateral trade volume reached a remarkable record in which Cambodia imports from China accounted for US\$739 million in 2007 and US\$947 million in 2008, US\$881 million in 2009 and US\$843 million for the first three quarters of 2010. Cambodia has a significant trade deficit with China, although China has provided preferential tariff treatment for 418 Cambodian products. Cambodian exports to China accounted for only US\$16 million in 2009 and US\$38 million for the first three quarters of 2010, which was a double increase. During the state visit of Cambodia's Prime Minister to China on 15 December 2010, China and Cambodia proposed to further increase bilateral trade to US\$2.5 billion by 2015. Cambodia will work with China to push ASEAN-China ties to a higher level, maintain regional peace and stability and promote common development.

As Cambodian exports have been significantly affected by the crisis, the country needs to take immediate measures to diversify its markets by creating greater demand in the region. It should commit to the expanding intra-regional trade, enhancing trade in services through the simplification and facilitation of cross-border trade and development of logistics across the region. Under the Greater Mekong Sub-region (GMS) cooperation programme, trade in logistics has been actively discussed as to how to develop and simplify trade flow among GMS countries. These above-mentioned initiatives require a stronger push and sooner completion of cooperation and regional economic integration process in accordance with initiatives and action plans that the region has adopted.

Presently, China is the biggest trading partner of ASEAN while ASEAN is China's fourth-largest trading partner. China's direct investment in ASEAN has exceeded US\$10 billion in a wide range of areas including agriculture, manufacturing, processing and services. Investment cooperation is a strong booster to China-ASEAN trade and economic cooperation. Direct investment between the two sides will be

further expanded due to the enforcement of the China-ASEAN Investment Agreement.

Mainland China is one of the biggest investors in Cambodia having cumulative investment capital of about US\$7.719 billion for over 367 investment projects registered at the Council for the Development of Cambodia at the end of 2010. Chinese investment ranked number one in Cambodia. For the last three years, Chinese FDI in Cambodia decreased due to the world economic crisis, which amounted to only about US\$694 million in 2010, compared to US\$892 million in 2009 and US\$4,371 million in 2008.

TABLE 1
FDI flow into Cambodia, 1994–2010 (US\$ million)

	1994–2010	2008	2009	2010
ASEAN	4,396	150	671	321
China	7,719	4,371	893	694
EU	1,403	177	235	42
Other Asia	15,659	5,280	4,845	970
South Korea	3,894	1,238	121	1,027
USA	1,140	4.5	1.2	36

Source: Cambodian Investment Board, Council for the Development of Cambodia, 2010

Cambodia enjoys excellent geographic position and has political stability, as well as preferential policies for foreign direct investment. Advantageously, Cambodia is geo-physically well placed to be a beneficiary of China's economic development, the rapid recovery from the global crisis and economic downturn in Asia, the entrepreneurship of the private sector and the great potential for growth in the region. The duty-free status for goods will attract and encourage more Chinese investors to invest in Cambodia, helping Cambodia expand manufacturing. At the same time, investors in Cambodia can produce and export large numbers of high quality products not only to China but also to more than 560 million people in the ASEAN regional markets.

As Cambodia is located in the centre of the region, it provides favourable conditions for investors in exporting their products to 310 million people in the Greater Mekong Sub-region and 560 million people in

ASEAN, as well as other countries around the world where Cambodia has MFN and GSP status.

To open their markets to each other, both consumers and businesses from China and ASEAN are increasingly feeling the benefits of a free trade area. Due to tariff reduction, consumers can consume each other's products cheaper, and enterprises can import duty-free products for their products and thus lower production costs, improving product competitiveness, and gain greater market development. The building of the ASEAN-China FTA will not only be a great impetus for the trade and economic cooperation between China and ASEAN, but will also play a key role in promoting the region's economic growth as well as the capacity to resist such attacks as that from the world financial crisis.

The sub-regional economic cooperation between China and ASEAN member states has played an increasingly important role in bilateral relations. The Chinese government is also actively adopting measures to encourage enterprises to participate in the ASEAN sub-regional cooperation, while at the same time working with ASEAN countries to actively promote the construction of the Greater Mekong Sub-region (GMS). Sub-regional economic cooperation will become a highlight of China and ASEAN economic and trade cooperation. The founding of ASEAN-China Free Trade Area aims to quicken the pace of restructuring and industrial upgrade and improving productivity and competitive capacity. The building of the FTA is beneficial for forging new industry chains and more trade creation. Hereafter, the two sides will accelerate the pace of industry cooperation and intensify their coordination with a rational distribution of labour, so as to raise the productivity of products within the region.

Cambodia has invested heavily on infrastructure, and it has to continue to do so to meet future development demand. In this spirit, Cambodia totally supports the prospect of an integrated ASEAN-China market and the linkage of physical infrastructure such as roads, bridges, railways, air and sea within the whole ASEAN-China. This will bring about enormous benefits to ASEAN and China, through the promotion of intra-trade, investment and tourism as well as narrowing of development gap among the countries.

Moreover, Cambodia must maximise gains from the vast economic potential in the region, focusing on soft infrastructure, especially trade

facilitation, customs procedures simplification and automation, investment and SMEs promotion and strengthening economic integration. Moreover, investment and trade in services sector will flow significantly into both ASEAN and China.

Furthermore, the Cambodian government needs to deepen its financial system, which was less affected during the crisis. Regulations and supervision need to be stricter. Cooperation among different countries in the areas of comprehensive economic surveillance and greater policy coordination in the financial sector needs to be strengthened and reformed further.

In achieving the objective of a more integrated, prosperous and equitable region, ASEAN and China need to ensure that this development process is equitable and efficient whereby the environment and social interests will need to be fully respected.

Cambodia recognises the necessity of structural reform in order to accelerate the transformation of the ASEAN-China region, particularly in the areas of public financial management, trade, legal systems, investments regimes and civil service reform. These are critical for the sustainability of economic growth and integration as well as for the development of human capital. Cambodia commits to working closely with regional partners in finding ways to integrate its economy and expedite development in all economic sectors including services. Cambodia strongly believes in regionalism and integration that enables the expansion of opportunities in terms of increasing economic activities and market space, thereby helping to transform society and human resource development.

The Cambodian government welcomes public-private dialogue and is paying great attention to the business environment as well as promoting and supporting the private sector to compete fairly and freely. Thus, Cambodia has established the Government Private Sector Forum, in which the entire cabinet, chaired by the Prime Minister, meets twice a year with the business community to consider the private sector development, trade, investments and issues that the Private Sector is faced with. Since its inception, the Forum has been convened 15 times and the last forum was held recently on 27 April 2010.

Cambodia has opened its economy to all investors and treats both local and foreign investors equally. It has opened its economy for foreign

direct investments in all sectors including tourism, travel and related services, construction and related engineering, transportation, banking, insurance and telecommunications when in many countries, in such sectors, foreign investors are not allowed to control 100 per cent of the shareholding, without local participation requirement.

The following are some of the potential benefits which Cambodia has to offer, not only under the ASEAN-China FTA, but also in all other areas of cooperation, for attracting investment and to develop trade in services, as well as its policy and measures in place to promote and facilitate private investment activities in all economic sectors:

1. Cambodia has become a country with peace, security and stability in all four corners; a country that has enjoyed stable macroeconomic developments, with a firm vision for medium and long-term economic growth.
2. The Royal Government of Cambodia is supportive of the private sector. The Royal Government's philosophy is to consider the private sector as an important engine to generate economic growth. That is why considerable efforts have been made to strengthen the judicial system, develop Cambodia's legal framework and institutions, in order to provide a favourable environment for the private sector and protect their investments and business activities in Cambodia.
3. Cambodia has comparative advantages and some important potentials in the agriculture and agro-industry, labour-intensive industries, processing, tourism, mining, and in some sections of the manufacturing and service sectors which are linked to the favourable condition of land, weather, natural resources; cheap, honest and disciplined labour forces that are willing to learn; historical heritages and beautiful sceneries of the sea, mountains and forests.
4. The Royal Government of Cambodia has adopted the following policies:
 - to promote private participation in the Provision of Infrastructures (BoT, Boo.).
 - to provide “national treatment” which means that foreign and domestic investors enjoy the same rights

- no requirement for local participation or partnership: foreign investors can do business with or without Cambodian partners. In the case of local participation, the level of equity will be up to the foreign investors.
- to allow free movement of capital and foreign exchange, without any restriction.

Cambodia is ready to engage in future ASEAN-China integration in all areas of cooperation. As part of the Greater Mekong Sub-region (GMS) Economic Cooperation, Cambodia is actively participating in such transport and trade facilitation, which helps facilitate the flow of trade and services across the region.

In conclusion, stress must be placed on the importance of maintaining a high level of complementarity with regard to development basis, industrial structure and development stage between China and ASEAN. In what ways could Cambodia and China cooperate more? There is great cooperation potential in tourism, finance, education, environmental protection, construction, transportation, business services and other service areas. With the deepening of the FTA, the broadened liberalisation of two-way trade and other services will bring a large number of new business opportunities for bilateral enterprises, boosting the greater development of cooperation and the industry levels in the field of services. Both parties should keep more engagements to broaden its collaboration in working towards building up systems and making coordination policies efficiently and effectively workable. It is recognised that sharing supply chains rather than competing against each other is the key to further development of China-ASEAN trade. ASEAN and China need to pay attention to the new round of industrial restructuring to improve this cooperation under the framework of the ASEAN-China FTA, and successfully achieve its ultimate goal.

SINGAPORE

Yang Mu and Catherine Chong Siew Keng

In 2010, Singapore's exports reached a seven-year high with 22.8 per cent growth rate.¹ In the first six months of 2010 China's export to Singapore increased by 27.2 per cent while Singapore's exports to China grew by 54.7 per cent y.o.y.² One reason for the high growth of Singapore's exports in 2010 was the low base in 2009 when Singapore's exports declined by 10 per cent owing to the global financial crisis. ACFTA was the other enabling factor. With China being part of the regional production networks, strong performance of China's manufacturing sector has led to an increase of its imports from Southeast Asia, especially in parts and components of electronic products, of which Singapore is a main supplier to China.³

INSTITUTIONAL MECHANISMS TO DEEPEN SINO-SINGAPORE COOPERATION

The development of Sino-Singapore ties is overseen by high-level institutional mechanisms especially the Joint Council for Bilateral Cooperation

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- 1 "Growth in exports hits 7-year high", *The Straits Times*, 18 January 2011, admpreview.straitstimes.com:90/vgn-ext-templating/v/index.jsp?vgnextoid=0481f1f40749d210VgnVCM100000430a0a0aRCRD&vgnnextchannel=f9a0758920e39010VgnVCM1000000a35010aRCRD
 - 2 From *China's Custom's Statistics* (Series No. 250), June 2010.
 - 3 "China's Trade Prospect and Sino-ASEAN Trade Relations", *China and the Global Economic Crisis, Series on Contemporary China Vol. 22*, 201X, pp. 179–212.

(JCBC).⁴ The Council provides a useful platform for political leaders, officials and businessmen from the two countries to have a better understanding and explore avenues for collaboration on joint projects. This network of interactions has helped to lay the groundwork for stronger political and economic ties. Singapore has also established cooperation councils with seven provincial governments in China to enhance business and trade opportunities.⁵

Moreover, Singapore has also been proactive in encouraging its companies to invest in China. For example, Singbridge International (a subsidiary wholly owned by Temasek Holdings⁶) has signed a MOU with the Jilin Municipal Government to conduct a planning study and assess the commercial feasibility of jointly developing a proposed 1,450 sq km modern agricultural and food zone in Jilin, Jilin province.⁷ These projects brought closer cooperation between China and Singapore and additional investment opportunities for Singaporean investors in China. IE Singapore (an agency under the Ministry of Trade and Industry in Singapore) helps Singaporean enterprises export their products, develop business capabilities, find overseas partners and enter new markets. In an attempt to open new markets for Singaporean food manufacturers, IE Singapore brought 21 Singaporean food companies to China on a Singa-

4 The JCBC was launched by then Prime Minister Goh Chok Tong and Premier Wen Jiabao in November 2003 and has enabled both sides to periodically review the state of bilateral ties. It also proactively suggests ways to improve existing cooperation or identify new areas to work on.

5 The seven provincial governments are Shandong, Sichuan, Liaoning, Zhejiang, Tianjin, Jiangsu, and Guangdong. For more information, refer, IE Singapore website: www.iesingapore.gov.sg/wps/portal/PressRelease?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/ie/My+Portal/Main/Press+Room/Press+Release/s/2010/38+companies+head+to+Nantong+Jiangsu+province+to+explore+business+opportunities

6 Temasek Holdings is an investment company owned by the government of Singapore. The company currently manages portfolios worth US\$157 billion including investments in China and other Asian economies.

7 Additionally, on 30 June 2010, Singbridge also signed agreements with Guangzhou Municipality to jointly invest in and develop the Sino-Singapore Guangzhou Knowledge City in Guangzhou, China For more information, refer, Singbridge website: www.singbridge.sg/portfolio.html

pore Food Promotion campaign in July 2010.⁸ With ACFTA in place, the elimination of tariffs has also greatly benefited these enterprises. From January to June 2010, Singapore's total food exports reached SGD 3.94 billion, of which China accounted for around 11 per cent (SGD 447.98 million)—this is an 26.6 per cent increase y.o.y. (during January – June 2009, Singapore food exports to China was SGD 353.81 million).⁹

THE BENEFITS OF ACFTA FOR SINGAPORE

Since the late 2008, China's decade-long trade expansion has relatively slowed due to the global financial crisis and the accompanying deceleration in the global economy. Domestically, this has led to not only a considerable downward moderation in China's economic growth but also rising concerns about employment and potential social instability. Concomitantly, China's sluggish pace in exports has become a cause of concern among its regional trading partners due to the expansion of the highly inter-dependent regional production networks. With the growing threat of trade protectionism across the world, China and its Asian neighbours including ASEAN countries have little choice but to continue their commitment to free trade and economic integration in both intra-regional and extra-regional perspectives. At the same time, the region as a whole also needs to develop their own consumer market to reduce reliance on the markets of the advanced economies.¹⁰

Since China joined the WTO in 2001, Singapore's economy has been gradually integrated into the China centric regional production networks of Asia. The largest part of Singapore's exports to China is in parts and components. For the period between January and June 2010, Singapore's exports of electronics and machinery (including parts and components)

8 As part of the promotional campaign more than 20 brands of Singaporean food and beverage products went on the shelves of 15 Jusco supermarkets in Guangdong province; later the campaign moved on to Beijing and Shanghai. For more information refer "Singapore's food products hit shelves of over 20 supermarkets in Guangdong, Beijing and Shanghai", IE Singapore, 26 July 2010, www.iesingapore.gov.sg/wps/portal/PressRelease?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/ie/My+Portal/Main/Press+Room/Press+Releases/2010/Singapores+food+products+hit+shelves+of+over+20+supermarkets+in+Guangdong+Beijing+and+Shanghai

9 Ibid.

10 "China's Trade Prospect and Sino-ASEAN Trade Relations".

constituted 47.8 per cent¹¹ (US\$7.7 billion) of its total exports to China. These imports from Singapore are further processed by China into finished goods such as laptops, iPods etc. and then exported. This is why high growth of China's exports is said to also lead to a high growth of Singapore's exports.

In 2009, Singapore and China started their bilateral free trade agreement (FTA); therefore, the launch of ACFTA in 2010 has relatively limited impact on their bilateral trade. Moreover, historically Singapore's exports to China have always been in single digits—albeit has witnessed a steady increase in the last 20 years—compared to its exports to the ASEAN-4 (refer to Table 1). Singapore's export of electronics and machinery (including parts and components) constitute only slightly above 1 per cent of China's total imports. Between January and June 2010, even with ACFTA in full force, Singapore's export of electronics and machinery (including parts and components) declined to US\$7.72 billion from US\$8.13 billion during the same period in 2008. Its share in China's exports also dipped from 1.4 per cent to 1.2 per cent amid China's growth in exports (see Table 9.2). Nevertheless, Singapore does have its competitive advantages including reliability (good governance), trade experiences and connections, port management, etc., and thus it remains a key partner for China.

Although the Singaporean government believes that there is a great potential for ACFTA, nevertheless the benefits can only be reaped in the future and not in the short-term. One of the primary drivers for this cautious outlook is due to the huge disparities in GDP and income per capita between the member states of ASEAN. The institutional arrangements and procedures also widely differ among the member states. ACFTA is an important step towards an enhanced economic cooperation between ASEAN and China; however, more time, effort and resources have to be invested to improve the present institutions and upgrade the industries to reap the complete benefits associated with ACFTA. For example, some Singaporean companies have relocated their production factories to neighbouring countries to exploit the advantages of raw materials and lower labour cost. Even with ACFTA in full force, these overseas Sin-

11 Authors' own computation using data from China's Customs Statistics (No. 250) June 2010.

TABLE 1
Origins and destinations of East Asian intra-trade

Origin of regional exports	Year	Total exports (US\$ million)	Share of regional exports designated for (per cent)							EA SUM	
			Japan	China	Korea	Taiwan	Hong Kong	Singapore	ASEAN-4*		
China	1980	18099	22.3	—	—	—	24.1	2.3	4.3	53	
	1988	47540	16.9	—	—	—	38.4	3.1	2.8	61.2	
	2000	249203	16.7	—	4.5	2	17.9	2.3	3.7	47.1	
	2004	593439	12.4	—	4.7	2.3	17	2.1	4.1	42.6	
	2006	969380	9.5	—	4.6	2.1	16	2.4	4	38.6	
	2008	1428686	8.1	—	5.2	2.2	13.4	2.3	4.4	35.5	
	Singapore	1980	19375	8.1	1.6	1.5	—	7.7	20.8	20.3	39.7
		1988	39306	8.6	3	2	2.8	6.2	20.3	20.3	42.9
2000		137804	7.5	3.9	3.6	6	7.9	24.9	24.9	53.8	
2004		179615	6.4	8.6	4.1	4.6	9.8	21.7	21.7	55.2	
2006		271799	5.5	9.8	3.2	3.5	10.1	28.3	28.3	60.4	
2008		338176	5.0	9.3	3.7	1.4	10.5	29.0	29.0	59.0	

Source: Direction of Trade Statistics Yearbook 2007, IMF; UN ComTrade; ADB Key Indicators 2009.

Taiwan's data is obtained from Bureau of Foreign Trade's Website.

Regional Export for Indonesia's export to Hong Kong not available for 2008.

* ASEAN-4 denotes Indonesia, Malaysia, the Philippines and Thailand.

gaporean companies still prefer to export their goods to China through Hong Kong (see Table 3). Many Singaporean exporters prefer Hong Kong as an entry point into China because custom officers in some Chinese cities still lack complete understanding of ACFTA including tariffs for imports and exports under this new regime; thus going through Hong Kong saves time and effort.

TABLE 2
Singapore's Export by region / country (S\$ billion)

	Year	Total import (US\$ million)	(per cent)						
			Japan	Korea	Taiwan	Hong Kong	Singapore	ASEAN-4*	EA SUM
China	Jan	567,549	3.6	1.8	1.0	9.9	1.4	2.2	19.9
	- Jun 2008								
	Jan	649,792	3.3	2.1	1.0	8.9	1.2	2.2	18.7
	- Jun 2010								

Source: Singapore Yearbook of Statistics, 2010

TABLE 3
Singapore's export by region / country (S\$ billion)

	1999	2004	2005	2006	2007	2008	2009
Singapore's total export	194.3	335.6	382.5	431.6	450.6	576.8	391.1
U.S.	37.2	37.5	39.0	42.8	39.5	33.5	25.5
EU	31.8	46.2	48.8	51.5	51.5	52.0	40.7
China	6.6	26.0	32.9	42.1	43.5	43.8	38.1
Hong Kong	14.9	29.8	35.8	43.3	47.2	49.5	45.3
India	4.2	7.1	9.8	12.2	15.0	16.8	13.4
Indonesia	NA	32.1	36.8	39.5	44.3	50.3	37.9
Malaysia	32.2	46.1	50.6	56.4	58.1	57.6	44.8

Source: Singapore Yearbook of Statistics, 2010

OPPORTUNITIES FOR ENHANCED COOPERATION BETWEEN SINGAPORE AND CHINA

There are several areas in which China and Singapore can enhance their cooperation. Tapping into China's rising investments into ASEAN countries is one of the ways. China's investments in ASEAN are motivated by the necessity to access natural resources; construction of infrastructure projects; promotion of trade, and to acquire technology as well as market access through investing in targeted sectors and industries. The following are some of the potential areas of cooperation between China and Singapore.

Firstly, food security will be a good opportunity for cooperation between Singapore and China. With China's growing population, rapid industrialisation and urbanisation, there will be storage in food supply in the years to come. The Southeast Asian countries are situated in tropical and sub-tropical regions and are endowed with abundant annual rainfall of 1,500–2,000 mm and an arable land of 153 million hectares (only 65 per cent of this land is utilised). Thailand, Vietnam and Myanmar are world-renowned rice producing countries. ASEAN also produces tropical fruits, timber and sea products. Primary industry contributes around 12 per cent of ASEAN's GDP, 13 per cent of its exports and employs 45 per cent of its labour.¹² If efficient modern agricultural enterprises can be established, then productivity could be greatly increased and a portion of ASEAN labour can be transferred to manufacturing and service industries, industries in which Singapore has a leading edge.

China is rich with temperate produce and fruits but lacks adequate water resources (especially in northern China) and sufficient arable land. China could potentially emerge as the largest as well as a stable market for ASEAN's tropical produce (such as fruits from the Philippines, rice from Vietnam, Thailand and Myanmar, etc.); while exporting temperate produce and fruits to Southeast Asia. China could also assist ASEAN countries in increasing their agricultural output by exporting produce from traditional industries (such as hybrid-rice production) where it has technical advantage, which would help the farmers increase their profits. For example, China's Guangxi State Farm Group has developed the cas-

12 ASEAN Stats, Jakarta: ASEAN Secretariat, www.aseansec.org/22122.htm

sava industries in Thailand, Myanmar and Laos, expanding their sources of modified starch by providing them with better planting technology.¹³ With ACFTA in force, China and ASEAN's cooperation in food production will be more beneficial and a win-win for all.

Singapore and China have signed a MOU to conduct a study to assess the commercial feasibility of jointly developing a modern agricultural and food zone in Jilin city (Jilin province). This initiative could potentially pave the way for China to bring in other ASEAN member states (such as Indonesia, Myanmar and other countries) to jointly develop food supply chains. This is a win-win situation for China and ASEAN states, as China will be able to ease some of its demand for food and ASEAN states would have a guaranteed stable market for their products.

Secondly, since the establishment of ACFTA in January 2010, most goods traded between China and ASEAN have been subject to zero or very low tariffs, which has also contributed to the free flow of capital, resources, technology and talent. For example, Ashima Yunnan Cultural Industry Group (from Yunnan province in China) has invested 45 billion baht (SGD 1.9 billion) to establish a huge China city complex of 104,000 square metres on the outskirts of Bangkok. The trade centre alone is expected to create 70,000 new jobs and 45 to 50 billion baht worth of intra-ASEAN trade annually.¹⁴ This trade centre could act as a springboard for Chinese goods not only to ASEAN countries but also to third-party countries within ASEAN community, thus enhancing closer cooperation. It is also speculated that investors from Wenzhou (in Zhejiang province of China) will establish a China city wholesale complex in Malaysia. With a cost of RMB100 million (about US\$14.6 million), this wholesale centre can accommodate 300 wholesalers creating a trading place for Chinese goods in Malaysia.¹⁵ Singapore is also contemplating setting a trading hub for Chinese products. With Singapore's strong association with Guangdong, Zhejiang and Jiangsu provinces, established international trade connections and a large

13 "Beijing keen to unlock ASEAN Investment doors", *Asia Times*, 6 November 2006, www.atimes.com/atimes/China_Business/HK02cb01.html

14 "China to build massive trading complex in Bangkok", *Thailand Business News*, 6 January 2011, www.thailand-business-news.com/news/top-stories/28129-china-to-build-massive-trading-complex-in-bangkok

15 "Zhongguo wai bin guo touzi xincelu", *Yazhou Zoukan*, 28 March 2010.

number of FTAs in force, such a project is feasible.

Thirdly, China has also been engaging with ASEAN countries at the sub-regional level. China has established a US\$10 billion fund for ASEAN Cooperation Fund and has plans to invest another US\$15 billion in ASEAN's infrastructure; energy and natural resources; and information and telecommunication industries. At the provincial level, Yunnan and Guangxi taking advantage of their geographical proximity have been playing a proactive role in enhancing sub-regional cooperation to optimise economic benefits under the China-ASEAN framework. While Guangxi has been trying to attract ASEAN through the Nanning-Singapore Corridor initiative, Kunming is embracing ASEAN countries by connecting the region with roads, rails and bridges. These initiatives are in line with the *ASEAN Connectivity*,¹⁶ a concept that was mooted by the ASEAN state leaders in 2009 to enhance intra-regional connectivity within ASEAN and its sub-regional groupings through overland transport linkages, which would benefit all ASEAN member states through enhanced trade, investment, tourism and development. An illustration of these infrastructural development initiatives is the new bridge over the Mekong River with a cost of US\$47.4 million. When completed, this bridge will form the last link making it possible to drive through the 1,018 kilometres from Chiang Rai (in northern Thailand) to Kunming (in southern China), resulting in a near-seamless road travelling from Singapore to Kunming. Another project is a Thailand-China joint venture in high-speed rail, which is expected to be completed by 2015.¹⁷

Guangxi has also linked up the logistics system between China and the ASEAN countries. Already 10 major ports in the region including

16 The concept of "ASEAN Connectivity" was mooted by the ASEAN state leaders at the 15th ASEAN Summit (in Cha-am Hua Hin, Thailand) on 24 October 2009. Enhancing intra-regional connectivity within ASEAN and its sub-regional grouping would benefit all ASEAN member states through enhanced trade, investment, tourism and development. As all of the overland transport linkages will have to go through the mainland Southeast Asian countries of Cambodia, Laos, Vietnam and Myanmar, these countries stand to benefit the most through infrastructure development, and the opening up of remote inland and less-developed regions. All these efforts would significantly narrow the development gap within ASEAN. Also see "ASEAN's Leaders' Statement on ASEAN Connectivity". Jakarta: ASEAN Secretariat, 24 October 2009, www.15thaseansummit-th.org/PDF/24-07ASEAN_Connectivity_with_Logo.pdf

17 "ASEAN by road, rail and bridge", *Straits Times*, 27 January 2011.

Beihai, Fangchenggang and Qinzhou in China; Cai Lan, Hon Gai and Ho Chi Minh City in Vietnam; Sihanoukville in Cambodia; Bangkok in Thailand, and Port Klang and Penang in Malaysia are in the network. With the improvement of the road and railway network, more ports will be able to integrate into the network. This new transportation network will reduce the overall transportation costs, launch new routes, boost port storage and improve cargo transportation facilities. On the one end of the Nanning-Singapore economic corridor, the Pan-Beibu ports will serve as distribution points for Guangxi, Yunnan, Sichuan, Guizhou and Chongqing provinces and Singapore; on the other end, the corridor will serve as the distribution point for the ASEAN countries.¹⁸

Fourthly, the government of Singapore has been paving the way for both government-linked companies and small and medium enterprises to go abroad. Companies such as Singapore Airlines (SIA), the Maritime and Port Authority of Singapore (MPA), Keppel and others have already made their presence in many parts of China. More than 40 food and beverage (F&B) companies from Singapore have already established their presence in China. F&B brands like Bee Cheng Hiang, for example, have 65 stores in various parts of China including in second and third-tier cities.

Although some remain sceptical about the implementation of ACFTA and its impact on trade and industries in ASEAN countries, many ASEAN countries have been adjusting their economic structures and activities to remain competitive and to complement the Chinese economy.¹⁹ With China increasingly connected to this region, ASEAN countries including Singapore would gain much in terms of trade and investments with China becoming a huge market for Singapore's home-grown brands and products such as Bee Cheng Hiang and 77th Street.

18 "Linking up the western route", *The Star online*, 21 August 2010, thestar.com.my/news/story.asp?sec=focus&file=/2010/8/21/focus/6892109

19 S. Y. Tong and C. Chong, "China-ASEAN Free Trade Area in 2010: A Regional Perspective", *EAI Background Brief* No. 519, Singapore: East Asian Institute, National University of Singapore, April 2010.

CHINA

Liao Shaolian

The first year of ACFTA implementation witnessed a good start in strengthening bilateral economic relations. This chapter discusses the progress made in economic ties between China and ASEAN, highlights the problems for resolution in the years to come and concludes with some policy recommendations.

PROGRESS IN THE BILATERAL ECONOMIC COOPERATION

The expansion of trade in goods, rapid development of trade in services and improvement in investment environment are some of the major achievements of ACFTA during the first one year of implementation.

The tariff reduction and elimination programme resulted in unprecedented increase of bilateral trade in goods between China and ASEAN in 2010. In the first 10 months of 2010, the Chinese inspection and quarantine administration issued around 410,000 COs for exports to ASEAN, an increase of 79 per cent y.o.y. As a result, Chinese exports of commodities with COs increased by 120 per cent.¹ According to the statistics of China Customs, bilateral trade totalled US\$292.8 billion in 2010, an increase of 37.5 per cent. ASEAN's export to China grew by 44.8 per cent while China's export to ASEAN rose by 30.1 per cent. Since many Chinese manufacturing industries rely heavily on raw materials and intermediate goods from ASEAN, the establishment of ACFTA substantially reduced the production costs for these enterprises. Another important emerging

1 *International Business Daily*, 15 February 2011, p.9.

trend is the change in the trade commodity structure. The statistics of China Customs show ASEAN's export of higher value-added machinery and electrical appliances to China reached US\$82.9 billion, an increase of 39.4 per cent; this trade item accounts for 53.7 per cent of its total exports to China. This illustrates that diversity of manufactured products makes trade expansion possible despite similar export profiles; moreover, intra-industry trade has gradually become a major part of the two-way trade. Additionally, 2010 also witnessed the flourishing of border trade along the Chinese south-western border areas.

The expansion of trade has not just been limited to goods; in 2010, ACFTA has also witnessed a rapid development of trade in services. By the end of 2010, the two sides have opened more than 60 sectors for trade in services. Cooperation has expanded from marine and air transportation, telecommunications, tourism, development projects (e.g. power plants, dams, bridges) to insurance, finance and logistics. More market access has been provided to foreign investors. The Chinese government has decided to cooperate with three ASEAN countries (i.e. Indonesia, Cambodia and Vietnam) to establish cooperative development zones, where both manufacturing and service industries will develop. Many more development projects, especially in infrastructure are either being implemented or under negotiations.

The two sides have also instituted efforts in improving investment liberalisation, facilitation and transparency resulting in improved investment environment in China and ASEAN. The member states of ASEAN have already become one of the most important destinations for Chinese capital outflow. In order to encourage Chinese enterprises to invest in ASEAN the Chinese government has established the China-ASEAN Cooperative Investment Fund. This US\$10 billion fund is intended to increase economic and technological cooperation projects between enterprises from China and ASEAN. In 2010, the Chinese investments in ASEAN increased by 12 per cent, reaching US\$2.57 billion, while investments from ASEAN in China rose to US\$6.3 billion, an increase of 35.2 per cent.² The Chinese investments covered a wide range of areas including agriculture, manufacturing, logistics, tourism, natural resources, transportation and infrastructure. For example, during the

2 Ibid.

first 10 months of 2010, investments from Thailand into China surged by a massive 119 per cent. In 2010, businesses from Singapore established more than 400 enterprises with a total investment of US\$5.66 billion in China, making Singapore the third most important source of overseas capital (ahead of Japan and the United States) in China.

PROBLEMS REQUIRING FURTHER ATTENTION

Although ACFTA has made a good start, there still exist challenges that require further efforts in the years to come. The following are the major problems:

First, there is a lack of understanding on ACFTA and market information pertaining to ASEAN within Chinese businesses. Notwithstanding China's efforts in strengthening its economic ties with ASEAN in the past few decades, many Chinese businesses still lack sufficient understanding about the business environment in ASEAN. This limited comprehension bedevils not only governmental laws and regulations but also the various arrangements within ACFTA. The trading companies using COs (Form E) account for less than half of the total trade. Frequent and direct contacts between chambers of commerce and business associations of the two sides have not yet been established, resulting in lack of mutual comprehension. Due to the heterogeneity and differentiation of manufactured goods, there are plenty of opportunities for intra-industry exchange. However, so far the countries concerned have not made adequate efforts in enhancing economic complementarity and tapping this huge potential for cooperation.

Second, all-round cooperation has to be further promoted. The purpose of establishing a free trade area is to promote free flow of commodities, services, capital and technology, and to achieve an increase in economic efficiency via rational allocation of factors of production. Until now, most of the attention was channelled for tariff reduction and trade in goods. In order to enhance benefits accruing from ACFTA, the markets for trade in services and investments have to be further opened, and steps should be taken to improve policy transparency in these areas.

Third, there is a lack of harmonisation of standards and technical requirements as well as an absence of mutual recognition arrangements. Differing standards and technical regulations between countries, if not properly managed, can constitute a barrier to trade and smooth economic

cooperation. At present, there is an increasing concern over disparities in quality control and inspection standards among ACFTA countries. Most of the complaints from businesses pertain to lack of common standards, conformity assessment, sanitary and phyto-sanitary standards and other technical regulations. For instance, different views on agricultural chemical residues may easily bring about disputes in trade of agricultural products. Besides, since ASEAN countries have not identified Chinese standards in some and the two sides have not yet established a mechanism for exchange of information on standards, the Chinese companies find it hard to obtain necessary information from ASEAN. If the Chinese manufacturers have access to information on technical standards prevalent in ASEAN countries, they can make necessary adjustments in production and consequently avoid non-tariff barriers.

POLICY RECOMMENDATIONS

In order to further strengthen the cooperation between China and ASEAN and enhance the benefits accruing from ACFTA to the businesses as well as to the people, the following policies are recommended:

First, establish closer ties between chambers of commerce and business associations from China and ASEAN. Frequent contacts will promote mutual understanding, help expand economic complementarity and explore more areas for cooperation. The China-ASEAN Business Council and national business associations and chambers of commerce should play a proactive role in providing information and consultative services to the businesses, especially small- and medium-sized enterprises. Taking agriculture as an example, there are ample opportunities for cooperation in hybrid rice cultivation, aquatic products, agricultural machinery and marsh gas utilisation. The cooperation could include R&D, training and exchange of information. Furthermore, collaboration can also be established in processing, packing, storage and transport of agricultural products.

Second, enhance cooperation in standardisation and mutual recognition. More efforts have to be made to reduce technical barriers to trade and increase cross-border procurement between countries. High up in the agenda is the harmonisation of standards and conformance of procedures, which are deemed to have direct impact on business transactions between the countries. This harmonisation process should also cover

technical regulations, metrology, and effective sharing of information and consultation between national authorities responsible for industrial standards. As an initial step, it is necessary to establish a framework for mutual recognition of conformity assessment principles and practices as well as calibration and test reports. This process could also ascertain how test capabilities within ACFTA countries can be complemented and how mutual confidence can be increased through training and inter-comparison programmes.

Third, additional measures are required to encourage investments and trade in services, especially in opening up more sectors and promoting investment liberalisation and facilitation. The businesses from both sides can make the best use of US\$10 billion of China-ASEAN Investment Cooperation Fund and the US\$15 billion of loans provided by the Chinese government in establishing joint ventures and other forms of cooperation. Moreover, the related government departments should make additional efforts in increasing awareness among businesses in ACFTA areas, of their policies that are instituted to attract more foreign capital.

Fourth, encourage additional initiatives for promoting people-to-people contacts. Despite geographical proximity and rapidly developing economic ties between China and ASEAN, there is a lack of mutual understanding among the people. Until now, the emphasis was mostly on visits and meetings at the official level (e.g. the mechanism of 11 meetings at ministerial level) without a corresponding effort to promote exchanges among the civil society. Although recent years have witnessed rapid growth in tourism, there is ample scope to enhance mutual understanding among people from all social strata within ACFTA areas; a process that should also involve the participation of government officials, scholars and practitioners for example, exchanges in mass media and education, training in different industries, cultural exchanges, especially exchange visits of the youth. In order to promote mutual trust and understanding, it is also essential to expand cooperation in non-traditional security, especially in environmental protection, energy security, health security and food security.

In conclusion, the implementation of ACFTA in the first year shows a good beginning for the further development of Sino-ASEAN relations. Both sides benefited from the rapid expansion of trade, investment and

cooperation in additional areas such as China-ASEAN Expo. However, various problems do exist, which require concerted efforts from all the concerned parties for resolution. As their relationship continues to grow closer, more and more cooperation mechanisms need to be established. Increased competition at home and in third-country markets can be expected. It will force both sides to engage in necessary adjustment to increase productivity and competitiveness of their products. From a long-term perspective, it is important that both sides exert greater efforts to expand mutual trust and define the norms that will guide their economic relations. In order to expand the economic complementarity it is essential to continuously search for new fields and ways for economic and technological cooperation.

ASEAN-CHINA FREE TRADE AREA
CHALLENGES, OPPORTUNITIES AND THE ROAD AHEAD

PART 3

**ACFTA in the Context of
Asia-Pacific Economic
Relations**

ACFTA IN THE CONTEXT OF ASIA-PACIFIC ECONOMIC RELATIONS

Noboru Hatakeyama

In May 2002, the author led a survey mission consisting of around 65 executives of Japanese small and medium-sized companies to visit the western part of China. During the visit, I had the honour of meeting Premier Zhu in Beijing. I took the opportunity to ask him a question: “The *Nikkei* newspaper reported that China and ASEAN would conclude a framework agreement for an FTA between them within one year. Could you comment on this? Or is this too minor an issue for the premier of China?” Premier Zhu responded as follows: “Yes, we are going to conclude a framework agreement for an FTA with ASEAN. However, although you said that we will conclude negotiations within a year from now, it will not be within one year but within this year.” I was very impressed, because he, the premier of China, who governs over 1.3 billion people, responded to my question without asking for any help from his staff and without looking into any papers. This demonstrated how important he thought it was to change China’s trade policy from protectionism to free trade. Later on, I heard from a Chinese friend that Premier Zhu thought it was very important to expose China’s fragile industries to the cold winds of international competition in order to strengthen them regardless of the WTO negotiations or FTAs.

As alluded by Premier Zhu, a framework agreement for comprehensive economic cooperation between ASEAN and China, including the future establishment of ACFTA, was signed in November 2002 and came into force in July 2003. An agreement on goods was signed in November 2004, and partial tariff reductions started in July 2005. In addition, an

EHP had already been started in November 2004. Since January 2010, the tariff rates for goods listed in the NT have been reduced to zero.

According to GATT's Article 24 for goods and Article 5 for services, an FTA should cover "substantially all" goods and services. "Substantially all" does not necessarily mean that literally all goods and services should be covered. In the case of goods, an interpretation has been established that "substantially all" means more than 90 per cent of trade in goods in terms of the amount of trade or custom tariff number. This means that 10 per cent of trade may be exempted from the obligation to liberalise based on the FTA.

ACFTA is no exception; it has two tracks, a NT and a sensitive track, which is further divided into two lists: a SL and a HSL. Since January 2010 those goods in the NT are supposed to have no tariffs, although each country is allowed to postpone the elimination by two years for 150 goods in the case of the original six ASEAN members and China and 250 goods in the case of the newer ASEAN members. Therefore, even when we limit the scope just to the NT, it cannot be said that there are absolutely no tariffs between China and ASEAN.

The handling of auto parts varies from country to country. While Thailand puts some auto parts (suspension shock absorbers, clutches, steering wheels, etc.) in the HSL, there is no reference to other auto parts in the SL or NT. What does this mean? There are two ways to interpret it. The first is that it means no referred goods are included in the category of the NT. The second is that since those goods are not referred to anywhere, there are no rules for them, including the obligations imposed by ACFTA. Therefore, the auto production network cannot be complete between ASEAN and China based on ACFTA.

Between ASEAN, China and Japan, ASEAN was the first to have an FTA. ASEAN had its first FTA among its members in 1992. Japan's first FTA, with Singapore, came into force in November 2002. China's first FTA, with Hong Kong and Macao, came into force in April 2004. In this regard, Japan was slightly ahead of China in terms of the timing of FTAs. However, when it comes to an FTA with ASEAN as a whole, China was earlier than Japan. The framework agreement on an ASEAN-China FTA came into force in July 2005, whereas the ASEAN-Japan FTA only became effective from December 2008 even for countries in the earliest group. Today, 25.7 per cent of China's exports are covered by its 10

FTAs with other economies, including Taiwan, whereas only 16.4 per cent of Japan's exports are covered by its 11 FTAs with other countries. Incidentally, 67.5 per cent of Singapore's exports are covered by its FTAs with other countries.

Initially, when ACFTA was negotiated, the average wage in China was lower than that of the major ASEAN countries. For example, the average wage in March 2003 in Kuala Lumpur was US\$208 per month, which was higher than the Beijing average of US\$83–178. Therefore, parts and components tended to be produced in China with the possibility of them being assembled in ASEAN countries.

Now the situation has changed dramatically. The average wage in China has become higher than that of the major ASEAN countries, not to mention the minor ones. The average wage in Beijing during April 2010 was US\$379.1, compared to US\$256.6 in Kuala Lumpur. Reflecting this change, exports from the ASEAN countries to China have increased more than imports from China to the ASEAN countries.

Since major Japanese companies have already established full-set production networks both in China and ASEAN, the full-fledged enforcement of ACFTA has not yet had a significant impact to the extent of forcing them to reorganise their networks.

The concept of an FTA was not fully understood at the initial stage of its implementation. For example, in Thailand the rate of ACFTA usage has increased drastically both in exports (12.3 per cent in 2005 to 24.8 per cent in 2009) and imports (0.7 per cent in 2005 to 8.7 per cent in 2009).

Incidentally, there is an opinion among Japanese companies that although the ROOs of ACFTA only admit added value criteria alone, custom number changing criteria should also be admitted.

WHERE TO GO FROM HERE?

ACFTA is one of five ASEAN "plus one" FTAs, the others being with Japan, Korea, India, Australia and New Zealand.

At present, there is a proposal to have an FTA among ASEAN, China, Japan and Korea. This would be called the East Asia Free Trade Area (EAFTA). But since countries in Southeast Asia have an intra-ASEAN FTA called the ASEAN Free Trade Area (AFTA) and have FTAs with the three bigger countries to the north, the EAFTA will be completed if China, Japan and Korea can conclude their own FTAs. Since May 2010,

joint studies among governmental officials, businesspeople and scholars have already been initiated with the aim of reaching a conclusion within two years. Therefore, ASEAN experts attending meetings for the EAFTA are limited in achieving substantial progress until the conclusion of a China-Japan-Korea FTA. On the contrary, the Comprehensive Economic Partnership in East Asia (CEPEA), which consists of ASEAN plus three plus Australia, India and New Zealand, requires the creation, in addition to the China-Japan-Korea FTA, of new FTA relationships between China and India, Japan and India, and Australia and Indonesia, for example. In this regard, the CEPEA is more ambitious and may be more conducive to increasing free trade in East Asia than the EAFTA. Of course, every member of ACFTA is a member of the CEPEA. If ACFTA members can contribute to establishing the CEPEA, building on their knowledge and experience regarding ACFTA, it would be very much appreciated.

On the other hand, the United States is not too happy with these developments of being left out of both the FTAs. It would be difficult geographically for the United States to join a group with "East Asia" in its title. Therefore, the United States came up with the idea of making use of APEC. At the APEC Leaders' Meeting in Hanoi in 2006, it proposed the establishment of the Free Trade Area of Asia-Pacific (FTAAP). Although China has replaced it recently, the United States used to be the biggest market for ASEAN, Japan and Korea; nevertheless, the United States continues to be the largest market for China. Therefore, it would be good for Asia to keep the United States legally bound not only in the security arena, as is the case with Japan, Korea and Australia, but also in the international trade. Accordingly, the U.S. proposal in Hanoi was accepted as a topic of study from a long-term perspective; on the contrary, EAFTA and CEPEA are being studied from a near-term perspective. Thanks to ASEAN "plus one" FTAs, including ACFTA and the ASEAN-Japan FTA, agreement on either the EAFTA or the CEPEA may be closer. That is why U.S. President Barack Obama accepted the advice from a leader of this country to join negotiations on the Trans-Pacific Partnership.

WHAT CAN ACFTA SHARE WITH FTAAP?

Ying Fan

This chapter underlines that the negotiations and implementation of ACFTA offers several lessons in developing a Free Trade Area of the Asia Pacific (FTAAP). The discussion also highlights the distinguishing features of ACFTA and the significance of the ASEAN-China Free Trade Area.

DISTINGUISHING FEATURES OF ACFTA

First, extensive and comprehensive FTA Framework: Agreements on ACFTA are the typical economic cooperation mechanisms with comprehensive functions, including not only 'Framework Agreement', 'Early Harvest Programme', 'Trades in Goods Agreement', and 'Dispute Settlement Mechanism', but also 'Trades in Services Agreement' and 'Investment Agreement', etc.

Second, flexible obligations: During ACFTA negotiations, the parties made efforts to be flexible and made necessary compromises along with some special exceptions given the uneven levels of economic development among ASEAN member countries. According to their own capacity, each member country can decide its pace of involvement in the economic integration. For example, Cambodia, Laos, Myanmar and Vietnam, as the new member states of ASEAN are allowed to enjoy a five-year transitional period in terms of tariff reduction. Thus, they will not implement zero tariffs on imports from China until 2015.

In the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, the agreement on trade in goods divided the tariff-reduced products into three categories: conventional

products, sensitive products and highly sensitive products. As to sensitive products, the tariff will be reduced from 2010 in a phased manner. The highly sensitive products (mainly rice, sugar, plant oil, automobiles and some petrol-chemical products) will still be under tariff protection until 2015, albeit the tariff shall not exceed 50 per cent of the current tariff.

Third, rapid results and instant effect: As China's first FTA with its trade partners, ACFTA has initiated negotiations and agreement implementation in a phased manner, beginning from the tariff reduction on agricultural products, then on industrial products, followed by liberalisation of service sectors. This phased approach enables ACFTA members to benefit from trade liberalisation in a short period. This mechanism has stimulated the enthusiasm of the members to promote economic integration and establish a demonstration effect, which creates a favourable atmosphere for furthering ACFTA process.

Fourth, diversified cooperation mechanisms: The building of ACFTA also resulted in a series of new cooperation projects such as Great Mekong Sub-region Economic Cooperation (GMS), Pan Beibu Gulf (PBG) Economic Cooperation and China-ASEAN Expo in Nanning (Guangxi province, China); as well as the US\$10 billion Infrastructure Investment Fund and US\$15 billion preferential loans.

SIGNIFICANCE OF ACFTA

First, deepen the economic and trade ties between China and ASEAN: According to Chinese statistics, the growth rate of China-ASEAN bilateral trade value and two-way investment value has increased by 172 per cent and 142 per cent respectively since 2003. With the implementation of ACFTA, the China-ASEAN engagement has developed into a new stage of comprehensive bilateral economic and trade cooperation. The mutual exchanges between China and ASEAN have reached an unprecedented level, characterised by a trend of sustainable development; it also enhanced people's confidence on both sides for future cooperation.

At present, the China-ASEAN economic and trade relations has undergone an essential change. In the early stage of reform and opening up, China depended more on ASEAN market and capital inflow from ASEAN countries; now China has transformed into a market provider for ASEAN countries, including trade and capital.

Second, contribute to the rebalance of the global economy: As a new

highlight of the South-South Cooperation in the post financial crisis era, ACFTA intensifies the role of East Asia's domestic demand. This increasing demand will facilitate the shift of economic growth mode in the region from export-led to domestically driven, thereby opening up a new path for the rebalance of the global economy.

Third, in 2001, the Chinese leaders proposed an innovative idea of 'ASEAN+1' that subsequently led to the establishment of ACFTA as well as activated the economic integration of the Asia-Pacific region and enriched the soft public goods of East Asian cooperation. Drawing on China's initiative, major powers such as Japan, South Korea, Australia, India, the United States, the European Union and even Russia started to focus more on ASEAN. Currently, most of these economic giants have reached FTA agreements with ASEAN and/or have started establishing their own 'ASEAN +1' FTAs.

Fourth, enhance the international status of ASEAN: In the recent years, ASEAN has greatly benefited in terms of economic strength and political status due to the expanding cooperation with major countries. Generally, 'ASEAN+1' FTA has not only generated steady economic growth and long-term dynamics for the 10 member states, but also cemented their comprehensive cooperation with other major global economies.

Fifth, the strategic spill over: The principle of 'give and take' on equal footing defines most of the FTA negotiations. However, to show its generous spirit to its neighbouring countries, especially the less developed countries, China adheres to the strategic principle of 'giving more while taking less', or at times only 'giving without any taking', and equality and mutual benefit all the time.

In fact, China sees ACFTA as an experiment and touchstone of its peaceful development. With sufficient sincerity and compromise, China is working hard to win its ASEAN partners' trust and support by sharing with them its development achievements, which will intensify Beijing's influence and soft power as an emerging power.

LESSONS FROM ACFTA FOR A FUTURE FTAAP

First, in 2010, the annual APEC meeting (at Yokohama, Japan) issued a statement mentioning the possibility of a Free Trade Area of the Asia Pacific (FTAAP), albeit without a timetable. According to the statement, "An FTAAP should be pursued as a comprehensive free trade agreement

by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership, among others”.¹ Nevertheless, FTAAP faces numerous challenges, some of which could be resolved through lessons learnt from ACFTA. The following are some of the important challenges:

- Huge developmental disparities define the Asia-Pacific economies; disparities that make it hard to achieve the goal by only enforcing trade and investment liberalisation without implementing special safeguard mechanisms under FTAAP framework. Thus, over the short run implementation of the FTAAP is a difficult task.
- The Asia-Pacific region is home to numerous bilateral and multi-lateral FTAs. It can be predicted that the road to FTAAP is far from flat and smooth since it still remains unclear how to coordinate this diverse range of FTAs.
- Until now, the economic dynamics in the Asia-Pacific region have largely been driven by the market forces without concurrent institutional arrangements. For the implementation of FTAAP, one of the first requirements for the Asia-Pacific economies would be the development of institutions.

Second, what can ACFTA share with FTAAP?

- Practicality and inclusiveness: It is necessary to follow the example of ACFTA while promoting FTAAP by giving the member states an equal sense of participation irrespective of the size, and encouraging them to overcome the huge discrepancy in political system, economic output, cultural tradition, religious belief, resource endowment and development levels, in an effort to speed up the process of FTAAP.
- Openness: All the free trade areas in East Asia are characterised by competitive liberalisation, which also allows members in the region to reach free trade agreements with the economies outside the region.
- Elasticity: The function of constructing while negotiating FTA can enable the member countries to enjoy the benefits, thereby motivating the countries to further promote the FTA.

1 “2010 Leaders’ Declaration: Yokohama Declaration – The Yokohama Vision – Bogor and Beyond”, Singapore: APEC Secretariat, November 2010, http://www.apec.org/Meeting-Papers/Leaders-Declarations/2010/2010_aelm.aspx

A LOVE TRIANGLE

ASEAN, CHINA AND THE TPP

Henry Gao

Among the many FTAs that have emerged since the signing of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China in 2002, the Trans-Pacific Strategic Economic Partnership (TPP) Agreement is rather unique. This chapter will argue that the TPP is not only unique but also the most important FTA in this region. What makes the TPP so special? This chapter endeavours to answer this question by first reviewing the history of the TPP, then discussing the differences between the TPP and the other FTAs. I will also examine the latest development in the expansion of the TPP, especially the involvement of the United States, and conclude with some preliminary thoughts on how ASEAN should respond.

FROM P4 TO THE TPP

The TPP (also known as the Pacific-4 or the P4) Agreement started as a free trade agreement between the four Pacific countries: Brunei, Chile, New Zealand and Singapore. The history of economic integration among the P4 members can be traced back to the 1990s as a joint-initiative by New Zealand, Chile and Singapore. Originally conceptualised as the “Pacific Three” (P3) Agreement, its proponents also hoped that the Agreement could pave the way for wider trade liberalisation in the APEC region that would lead to a P5 scheme with the inclusion of Australia and the United States. In 2002, the P3 negotiation was launched during the APEC leaders’ meeting in Mexico. From 2003 to 2005, five rounds of negotiations were held. Brunei joined just before the final round of

negotiations in April 2005. The Agreement was concluded in June 2005 and entered into force in 2006.

A UNIQUE AGREEMENT

Compared with most other FTAs in Asia, the TPP has several unique features:

- First, the memberships of the other FTAs are mostly restricted to the economies in Asia. In contrast, from the very beginning, the TPP is a trans-regional agreement that covers Asia (Singapore and Brunei), Oceania (New Zealand) and Americas (Chile).
- Second, other FTAs are mostly sponsored by a big power or a regional grouping, but the TPP is initiated by three smaller countries, which according to most common benchmarks such as land mass, population and GDP, are at best middle powers.
- Third, most FTAs are exclusive and automatically close their doors after the initial agreement is signed. If any other country wishes to join the FTA, it has to persuade all existing members to accept it, which is not an easy task. In contrast, the TPP was negotiated with an explicit clause that allows “any APEC economy or other state” to seek accession (Article 20.6).
- Fourth, while many FTAs have been criticised in one way or the other, the TPP has been widely hailed as a “high standard” agreement since the very beginning.¹ In an article published in 2010, I argued that this claim is largely a myth.² For example, in terms of the tariff reduction, the TPP only offers negligible benefits due to the low pre-FTA tariffs and small bilateral trade volumes. Why, then, did the parties negotiate the Agreement in the first place?

The answer was provided by Juan Salazar (the Chilean Ambas-

1 For more information, refer Ministry of Trade and Industry of Singapore, Media Info-note on the P4 Agreement, 18 July 2005; The Statement of USTR Susan Schwab on launch of the U.S. Negotiations to join the Trans-Pacific Strategic Economic Partnership Agreement, September 22, 2008, available online at www.ustr.gov/schwab-statement-launch-us-negotiations-join-trans-pacific-strategic-economic-partnership-agreement

2 Henry Gao, “The Trans-Pacific Strategic Economic Partnership Agreement: A Critical Analysis”, *Legal Issues of Economic Integration (Kluwer)* 37, No. 3 (2010): pp. 221–240.

sador to New Zealand), who argued that “the initiative was, from the very beginning, not supposed to be a typical Free Trade Agreement (FTA)” that aims at “increasing bilateral flows of merchandise”.³ Instead, the parties really wanted to use the Agreement to build “a larger scheme for a Closer Economic Partnership (CEP)” with the following goals:

- Use the Agreement as a benchmark for trade liberalisation among APEC economies and create a demonstration effect for the WTO.
- Use the Agreement to promote political cooperation between countries with similar political philosophies.
- Use the Agreement to forge potential strategic alliance on a wide array of areas ranging from agriculture, education to technology.⁴

Of the three objectives, the first one is most relevant from the perspective of trade policy and worth further discussion. As small, open and export oriented economies, the P4 countries are highly dependent on trade. For example, the trade to GDP ratio of Singapore is 10 times the world average, while those of Brunei and Chile are both twice the 43 per cent world average. Even New Zealand, the lowest among the four, has a ratio that is 30 per cent higher than world average. Thus, they have to push harder for world trade liberalisation than their larger and less export dependent trade partners. When multilateral negotiations stagnate, they will have to resort to bilateral or regional initiatives to create more market access opportunities for their exports and eventually increase the momentum for trade liberalisation on the wider platform. While the P4 countries themselves might not have sufficient political influence to move negotiations at the WTO, the initiative could serve as a stepping stone for an expanded “Px” agreement within APEC. Indeed, as we discussed in the previous part, one of the explicit objectives of the original P3 initiative was to entice the United States and Australia into joining the Agreement.

3 Juan Salazar, “A Chile-New Zealand CEP?: The Concept of Competition and The Politics of Trade Liberalization”, lecture at the course on “Diplomatic Conclusions”, at the Political Science and International Relations Programme of the Victoria University of Wellington (VUW), 15 March 2005, www.embchile.co.nz/documentos/CHNZCEP.doc

4 Ibid.

THE TPP AND THE UNITED STATES

Given the small size of the original P4 economies, it seems rather puzzling that the United States would pay attention to such an agreement. What is so special about the P4 Agreement? What is in it for the United States? In the author's viewpoint, the main benefits to the United States for joining the TPP are the following:

First, the Agreement can help the United States to continue its presence and engagement in the Asia-Pacific region. While Asia is a latecomer to regional integration compared to Europe and the Americas, the progress of regionalisation has intensified during the past decade. The United States has managed to score FTAs with Australia, Singapore and Korea, but so far, the United States has largely been left out in the integration efforts in the region. As noted by a U.S. Trade Representative (USTR) document, other than the three FTAs signed by the United States, there are now 175 FTAs involving Asia-Pacific countries, with more than 70 other agreements in the pipeline, all excluding the United States.⁵ Moreover, in the grand scheme of things, Asia-Pacific countries seem to grow accustomed to working without the United States. Currently, there are five competing models for region wide integration in the Asia Pacific: "ASEAN plus Three", i.e. the 10 ASEAN countries plus China, Japan and Korea; "ASEAN plus Six", i.e. India, Australia and New Zealand on top of the countries in the first model; the East Asia Community (EAC) backed by Japan;⁶ the Free Trade Area of the Asia-Pacific (FTAAP);⁷ and the recent Australian proposal for an Asia-Pacific Community (APC).⁸ Among these five models, only two— APC and the FTAAP—would involve the United States, albeit these two are also the

5 Letter by USTR Ron Kirk to Speaker of the House Nancy Pelosi (D-Calif.) and Senate President Professor Tempore Robert Byrd (D-W.Va.) on the TPP Agreement, 14 December 2009, www.ustr.gov/webfm_send/1559

6 For more information, refer to the website of the Council on East Asian Community, www.ceac.jp/e/index.html and Termsak Chalermphanupap, "Towards an East Asia Community: The Journey Has Begun", Jakarta: ASEAN Secretariat, www.aseansec.org/13202.htm

7 "APEC to Consider the Feasibility of a Free Trade Area of the Asia Pacific", *APEC Newsletter*, Issue 17, January 2007, www.apec.org/apec/enewsletter/jan_vol11/onlinenewsc.html

8 Richard Woolcott, *Towards an Asia-Pacific Community*, Hawaii: East West Centre, 12 October 2009, www.eastwestcentre.org/index.php?id=4376

least attractive. Given the extremely large and diverse membership of the two models, it is almost impossible for either model to lead to legally binding agreements. In contrast, the TPP Agreement provides the perfect vehicle for the United States to cherry-pick those Asian countries that are not only economically meaningful but also politically important to the United States and conclude the Agreement with them.

Second, the TPP can help the United States to achieve important strategic objectives. As argued eloquently by Fred Bergsten and Jeffrey Schott in their submission to the USTR in support of the TPP Agreement on behalf of the Peterson Institute for International Economics:⁹

“Since the beginning of APEC in 1989, many Asian countries have strongly advocated U.S. involvement in the organisation in order to ensure continued U.S. economic and military engagement in the region as a balance against Chinese hegemony. ... Economic tensions between the United States and China, and the increased risks of Asia-Pacific disintegration due to the advent of Asia-only economic arrangements, underline the need for effective transpacific linkages and institutional ties for security as well as economic reasons.”

In short, the P4 Agreement would help the United States to maintain its security ties in the region through enhanced economic integration with the economies in the region.

Third, negotiations on the TPP Agreement could also provide the United States with the testing ground for different types of trade agreements. While the Bush Administration has been criticised by many developing countries for trying to force the U.S. model on its FTA partners, one can still argue that the topics demanded by the United States in FTAs such as investment, services liberalisation, government procurement and intellectual property rights protection are trade issues. In contrast, the Obama Administration seems to be taking an even more radical view in defining the contours of FTAs. In a speech in December 2009, Ron Kirk from USTR summed up the new approach as “a true twenty-first century trade agreement” that “will reflect U.S.

9 C. Fred Bergsten and Jeffrey J. Schott, “Submission to the USTR in Support of a Trans-Pacific Partnership Agreement”, Washington DC.: Peterson Institute for International Economics, 25 January 2010, <http://www.iie.com/publications/papers/print.cfm?researchid=1482&doc=pub>

priorities and values, enhance American competitiveness, and generate job-creating opportunities for American businesses and workers". While this might sound rather ambiguous, Kirk provided some hints on the new strategy in his letter to the Congress on the TPP Agreement by noting that the United States will try to negotiate additional commitments on "environmental protection and conservation, transparency, workers' rights and protections, and development". As the first major trade agreement ever seriously negotiated by the Obama Administration, the TPP Agreement is very likely to have major implications on the future direction of the U.S. FTA policy or even overall trade policy.

Fourth, the economic potential of the TPP is also quite substantial. As the United States has long suffered from over-consumption and low savings rate, increasing exports is the only realistic way to accelerate the recovery of the U.S. economy, a key consideration that propelled Obama to launch the National Export Initiative in 2010 to double the U.S. exports in the next five years.¹⁰ This target cannot be achieved without engaging the Asia-Pacific region, which accounts for 60 per cent of the U.S. exports. While the U.S. exports to the P4 countries is only five per cent of its total exports, the TPP will be a much bigger game if other countries in the region also join in.

On 14 November 2009, Obama finally announced in Tokyo that the United States was ready to start the formal negotiations.¹¹ The first round of negotiations was held from 15 to 19 March, 2010 in Melbourne, Australia. In addition to the United States and the original P4 countries, Australia, Peru and Vietnam also joined at the negotiating table.¹² As of 15 June 2011, six rounds of negotiations have been held. In addition to these eight countries, Japan, Canada, Korea, Philippines, Thailand, Indonesia and Taiwan have all expressed interest in joining the Agreement at some point.

10 The White House, Office of the Press Secretary, "Remarks by the President in State of the Union Address", *Speeches and Remarks*, 27 January 2010, www.whitehouse.gov/the-press-office/remarks-president-state-union-address

11 Ibid.

12 Office of the United States Trade Representative, "USTR Negotiators Report Successful First Round Of Trans-Pacific Partnership Talks", *Press Releases*, 19 March 2010, www.ustr.gov/about-us/press-office/press-releases/2010/march/ustr-negotiators-report-successful-first-round-trans

ASEAN IN THE MIDDLE: NOODLE OR SPAGHETTI?

In summary, the TPP is going to be the primary instrument for the United States in its quest to “return to Asia”, a primary driver of TPP’s importance in the region. Can we shut the United States out? The answer is no. No one in Asia, not even China or ASEAN, can shut the United States out of Asia. In that case, how can ASEAN better prepare itself for the inevitable arrival of “the United States, the interloper”?

Before we can answer that question, we have to look at a multiple choice question: Is the United States returning as:

- A. a visitor;
- B. a distant relative;
- C. a close family member; or
- D. a new landlord of the house?

If the history of the U.S. engagement around the world since WWII teaches us anything, it is that the United States never plays the role of guest or visitor well. Instead, the United States always perceives itself as the rightful owner or at least part of the immediate family in almost every region of the world. The recent testimony on the U.S. approach came from Secretary of State Clinton, who noted in her recent speech at the East-West Centre in Hawaii that the United States is not only “back in Asia”, but also “back to stay”.¹³ As if this was not explicit enough, Clinton further noted that the United States would not only continue its “involvement in Asia-Pacific institutions”; but also must provide “leadership” in such institutions.¹⁴ More specifically, in terms of trade policy, as I noted earlier, rather than simply taking the existing TPP Agreement as it is, the United States will use the TPP negotiations to set a model for a “twenty-first century Trade Agreement”, and probably to reshape the FTA landscape in the region as well.

Put it another way, this means that the United States will try to “reinvent the wheel” through the TPP rather than simply piggyback on any of the existing FTA framework in the region. For ASEAN countries, this means that they have to wake up from their dream of ASEAN as an FTA

13 Office of the Spokesman, U.S. Department of State, “Secretary Clinton’s Remarks at East-West Center,” *Press Release*, 12 January 2011, www.america.gov/st/texttrans-english/2010/January/20100113082409bpuh0.0404169.html

14 Ibid.

hub in the region. The United States is not interested in negotiating with ASEAN as a whole. Instead, it will try to play “divide and rule” by cherry-picking among ASEAN members, i.e. Singapore, Brunei, Vietnam and Malaysia for now, maybe Thailand, Philippines and Indonesia to follow, but probably not the remaining three countries for the foreseeable future. Moreover, the template will be the American template, or more exactly the Democrats’ template, which means light on the traditional trade items and heavy on non-trade issues such as investment, IPR, environment, labour, transparency, etc. On the other hand, from a political and strategic view, enhanced U.S. presence in the region seems to be beneficial for most ASEAN countries, which generally perceive the United States to be a benign hegemony and view the U.S. presence in the region as necessary for the balance of power. Thus, to welcome the United States or not will be a difficult choice for ASEAN to make.

In comparison, while having a market that is as important as (if not more than) that of the United States to ASEAN, China is the exact opposite of the United States on everything else. Politically, we should not forget that one of the main reasons for the establishment of the ASEAN in 1967 was to counter the threat from the north (meaning China). While the China threat discourse has subsided in recent years, it has not totally disappeared. Instead, as we are reminded by, for example, the mass protests in Indonesia and Malaysia against China a year ago, when ACFTA entered into force, it never takes much effort to nurture and exploit the anti-China sentiment. The reasons for the hype are partly ideological and partly due to the geo-proximity of China.

The Chinese government also realises this dynamic, a realisation that resulted in the adoption of the so-called “offer a lot while demand very little” [多予少取] strategy in ACFTA negotiations. Moreover, for China, an FTA is about trade and trade only. China did not force ASEAN to accept side deals on non-trade issues. Nor did it try to impose its FTA template on ASEAN. Overall, ASEAN was treated as an equal negotiating partner in ACFTA negotiation and able to have a larger role in shaping the deal.

With both China and the United States courting the regional bloc, what should ASEAN do? First of all, I have to emphasise that ASEAN cannot afford to ignore either country. With that in mind, I think the answer is simple: ASEAN countries should try to maintain contacts

with both sides by entering into ACFTA and TPP together. At the same time, the best hedging strategy against any potential fallout with the two giants is to further strengthen the FTAs in the region. In this respect, serious thoughts must be given on promoting the establishment of an ASEAN+3 FTA; rather than the patchy ASEAN+1+1+1 deal we have at the moment.

In conclusion, all those who have hoped that the chaotic Asian “Noodle Bowl” would be untangled with the U.S. involvement will have to be disappointed. Instead, it turns out that Uncle Sam aka the Gatecrasher brings his own messy “Spaghetti Bowl”, even though this is not a popular food choice in this region. At the end of the day, how will the love triangle among China, the United States and ASEAN unfold? Like any complicated relationship, there is no ready answer. However, I hope our friends in ASEAN can find some comfort in the wise words of Shakespeare:

“O time! Thou must untangle this, not I;
It is too hard a knot for me to untie!”¹⁵

15 China Ministry of Commerce, “Comments by Minister Bo Xilai on the China-ASEAN FTA”, 24 July 2006, caefi.mofcom.gov.cn/aarticle/cz/yaowxx/200607/20060702722229.html

CONCLUSION

Kalyan M. Kemburi

The current momentum of economic relations between ASEAN and China traces its origin to the formal establishment of relations in 1991. This was followed by a process of political reconciliation initiated by China, which involved settlement of border disputes, signing of the Treaty of Amity and Cooperation, and the Declaration on the Conduct of Parties in the South China Sea. The political reconciliation paved the way to economic engagement, which reached a new milestone with the initiation of ACFTA. This agreement has the potential to not only accelerate but also deepen the economic engagement between ASEAN and China.

The three sections of this chapter endeavour to capture the essence of this monograph—evaluate the opportunities and challenges associated with ACFTA and provide recommendations. Section one provides an overview of the achievements that mark the first year of ACFTA's implementation. The following section discusses the concerns that were aired during the initial run-up to the treaty's entry into force and the existing and potential challenges in the coming years. While striving to provide an alternative explanation for some of these challenges, the final section concludes by summarising the various policy options put forth by the authors of this monograph. These recommendations aim to lessen the impact from the challenges and enhance the opportunities, which would strengthen the economic engagement between ASEAN and China.

ACHIEVEMENTS

In spite of the global financial crisis and the decline of demand in the advanced economies, the trade between ASEAN and China witnessed high growth. According to a March 2011 statement by Sun Yuanjiang, an official with China's Ministry of Commerce, the trade volume between China and ASEAN reached US\$292.8 billion in 2010, an increase of 37.5 per cent y.o.y.¹ Similarly, at the height of the financial crisis in 2008 when the United States, the European Union and Japan (G-3) have all taken a beating, China was the only country (among countries with substantial ODI inflows) to increase its value of FDI net inflow to ASEAN (amounting to US\$1.4 billion). ACFTA seems to reinforce this trend. In 2010, investments from China into ASEAN amounted to US\$2.57 billion.² Simultaneously, ASEAN countries have also not lost the opportunity to tap into the investment opportunities in China. ASEAN invested US\$6.32 billion in China during 2010, an increase of 35.2 per cent.³

In addition to trade and investment, China and ASEAN also initiated steps related to services. In January 2007, China and ASEAN signed an agreement to strengthen cooperation and trade in services. According to Liao Shaolian from Xiamen University, by the end of 2010, the two sides had opened more than 60 sectors in services. Additionally, cooperation has been strengthened in various service sectors ranging from marine and air transportation, telecommunications, tourism, and development projects to insurance, finance and logistics. Moreover, according to Rony Soerakoesoemah (from the ASEAN Secretariat), by creating economic efficiencies and lowering costs, ACFTA is not only promoting cross-border investments but also enabling regional businesses to play a greater role in global supply chains.

This high growth in trade, expanded investments and a huge trade surplus helped ASEAN to maintain a positive rate of GDP growth in 2009 and 2010. According to *ASEAN Statistics*, ASEAN economies posted a 1.5 per cent rate of growth in 2009 compared to 4.4 per cent in 2008.⁴

1 "China's Direct Investment Reaches D2.57 billion to ASEAN Countries", *CRI*, 02 March 2011, english.cri.cn/6826/2011/03/02/168s623650.htm

2 Ibid.

3 Ibid.

4 *ASEANstats*, Jakarta: ASEAN Secretariat, www.aseansec.org/22122.htm

The importance of this data lay not in the decrease of three points, but that the region registered growth in spite of the financial crisis and loss of markets in the advanced economies. Further, according to the IMF WEO database, in 2010 ASEAN is estimated to grow at 6.6 per cent.⁵ Although not all countries within ASEAN posted positive GDP growth rate during the financial crisis period, the region as a whole witnessed healthy growth, partly assisted by China's domestic demand for imports and outward FDI into ASEAN. An impetus from China had created buoyant expectations in certain quarters that ACFTA could potentially emerge as a protective measure against a future world financial crisis.

Although it is too early to share the optimism of ACFTA's potential to emerge as a panacea for future financial crises, a consensus is emerging within the region that ACFTA facilitates ASEAN's tapping into the huge Chinese market. If Southeast Asia succeeds in this endeavour, it would not only assist the region in diversifying its markets but also has the potential to rebalance the global economy.

Between 2001 and 2007, China's domestic consumption was on average only a fourth of the G-3's consumption, albeit with a steady increase. During the financial crisis period, however, China steadily held its consumption compared to the sharp decline in G-3. An important aspect of this trend is that the impetus for this growth was mostly from the inland and lower-tier cities; this is a positive sign, given that the major cities in coastal areas are primarily export-driven.

According to McKinsey Global Institute (MGI), in 2007 with a private domestic consumption of US\$890 billion, China ranked fifth largest in the world. Furthermore, MGI's forecast shows that by the end of 2020, this consumption will accelerate to US\$2.5 trillion, taking Chinese consumer spending prowess to third largest in the world.⁶ With an FTA providing comparatively better access to this expanding market, ASEAN entrepreneurs are set to gain. In fact, there might be an even bigger opportunity given that the government in China is undertaking a concerted effort through its eleventh and twelfth five-year plans to expand further this domestic consumption, an expansion that shall multiply the opportuni-

5 IMF WEO database, Washington DC.: International Monetary Fund, www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx

6 Jonathan Woetzel, et al., *If you've got it, spend it: Unleashing the Chinese consumer*, McKinsey Global Institute, August 2009, p. 16.

ties. According to a report from World Bank, “compared to 2007, exports to China now comprise a larger share of total exports in every economy in developing East Asia and the NIEs”. Nevertheless, this is not a one-way street. Since the financial crisis, the import demand in Asia, excluding China, also grew faster than the import demand in the G-3.⁷ If this trend is sustained, it offers an opportunity for the Chinese companies to diversify their markets, which currently are located primarily in advanced economies.

The cooperation between China and ASEAN is not just limited to the national level; ACFTA cooperative spirit and the desire to tap into the numerous opportunities have percolated to the provincial and sub-regional level as well as to the private sector. Furthermore, the implementation of ACFTA is acting as a catalyst for strengthening the understanding of ASEAN markets by Chinese provinces and cities.

In recent years, efforts for regional and sub-regional integration in Southeast Asia received a shot in the arm. To illustrate, the first meeting of China-ASEAN Industry Cooperation was held in Kunming on 17 September 2010, which aided progress for industrial connectivity between China and ASEAN. Additionally, several provincial governments in China—Guangdong, Hubei, Fujian and Shaanxi—have initiated cooperation with the ASEAN Secretariat through Memorandums of Cooperation (MOCs). The MOC with Guangdong Province, for example, signed in September 2008, focuses on cooperation in a wide range of economic and social issues including agriculture; information and communication technology; human resources development; education and public health. These initiatives shall further reinforce the existing sub-regional initiatives such as the Greater Mekong Sub-region (GMS) and Pan-Beibu Gulf (PBG) cooperation. The GMS cooperation aims at accelerating sub-regional infrastructural development, trade promotion and investment facilitation. The PBG cooperation, a more recent initiative, involves maritime Southeast Asia and aims to emulate GMS. These regional and sub-regional integration initiatives along with ACFTA have the potential to enhance a sense of community among ASEAN members and China, and provide another important mechanism for supporting economic stability in East Asia.

7 *Securing the Present, Shaping the Future*, World Bank East Asia and Pacific Economic Update 2011, Vol. 1, Washington DC.: The World Bank, 2011, p. 10.

At the institutional level, the entry into force of ACFTA accelerated efforts for further strengthening of FTA related initiatives. In October 2010, to facilitate improved trade, the two entities signed the “Second Protocol to Amend the Agreement on Trade in Goods”,⁸ which facilitates trade by improving operational certification procedures.

Finally, ACFTA also has positive externalities. The signing of ACFTA in 2002 has created a FTA domino effect in the region. ASEAN is in the process of either implementing or negotiating FTAs with major economies including the European Union, Japan, South Korea, India, Australia, New Zealand and Taiwan. Additionally, as highlighted by Henry Gao in Chapter 13, currently there are five Asia-Pacific region-wide FTA models at various stages of deliberations: ASEAN+3; ASEAN+6; the East Asia Community (EAC) backed by Japan; the Free Trade Area of the Asia-Pacific (FTAAP); and the recent Australian proposal for an Asia-Pacific Community (APC). Moreover, with wide economic disparities in the region, these endeavours would potentially face numerous challenges, some of which could be resolved through lessons learnt from ACFTA.

CHALLENGES

Trade deficit remains one of the most important concerns for ASEAN countries. Although historically the bilateral trade between ASEAN and China favoured the former, recent years witnessed a steady decline of this surplus. By the end of 2009, ASEAN’s trade surplus was only US\$0.417 billion, rebounding to US\$1.634 billion by the end of 2010.

Although ASEAN as an economic group maintained surplus with China, at the country level several Southeast Asian countries posted huge trade deficits with China. This trend created unease among these countries, especially with trade surplus affecting employment generations. To illustrate, between January and November 2010, Thailand posted a deficit of US\$2.58 billion with China compared to US\$1.73 billion y.o.y. Similarly, Indonesia has also reported a large trade deficit with China, albeit reportedly tolerable. Interestingly, even with the EHP under ACFTA, Vietnam and Cambodia reportedly had huge trade deficits with

8 For further information on Second Protocol refer, “Second Protocol to Amend the Agreement on Trade in Goods”, Jakarta: ASEAN Secretariat, www.asean.org/documents/acfta/2nd-Protocol-to-Amend-the-TIG-CTC.pdf

China and expressed concerns about its impact on foreign reserves and employment generations.

In spite of ASEAN's huge trade surplus in 2010, scholars from China sounded caution by noting Beijing could not control the surplus unilaterally and consistently. The main reason was because the primary trade items between China and ASEAN—electronic products—were controlled by the transnational corporations instead of Chinese firms. Nevertheless, data did not support the premise whether ACFTA had a role in influencing the trade deficit.

Additionally, the impact of trade growth between China and ASEAN was not uniform. The commodity exporters benefitted more than the economies that were dependent on export of intermediary goods. For example, the Philippines, where two-thirds of the exports to China consisted of electrical and electronic products, did not benefit from the expanded ASEAN trade with China.⁹

As mentioned in the previous section, in recent years China has steadily increased its investments in ASEAN. Although cumulatively it has yet to reach the levels of G-3, recent years have witnessed Beijing surpassing G-3 in terms of rate of growth for investments. Therefore, there was a natural expectation that the signing of the Investment Agreement in 2009¹⁰ would result in higher investment flows; current data did not support this outlook. To illustrate, Malaysia witnessed a dramatic increase in investments from China in 2008 and 2009. However, it seemed that the Investment Agreement was not responsible for these increases. Moreover, the money flowed into resource-based projects and infrastructure, not in the manufacturing sector. Similarly, China announced a US\$1.5 billion investment in Thailand to construct a large trade centre near Bangkok's new airport. Again, though the investment was substantial, it did not reflect that the Investment Agreement facilitated this decision.

9 *Securing the Present, Shaping the Future*, p. 10.

10 The agreement provides provisions for promotion and protection of investments as well as facilitates a liberal, transparent and competitive investment regime. For more information on this agreement, refer to "Agreement on Investment of the Framework Agreement on Comprehensive Economic Co-operation between the Association of Southeast Asian Nations and the People's Republic of China, Bangkok, 15 August 2009", Jakarta: ASEAN Secretariat, www.asean.org/22974.pdf

With regard to investments from ASEAN to China, an issue that requires a closer examination is why most of the investments from the region are limited to a select group of countries, especially Singapore, without a region-wide trend.

Since the announcement by China of the intention to engage in an FTA with ASEAN, Beijing made a concentrated effort to organise several outreach programmes. However, critics point out that in the past 10 years the process involving the establishment of ACFTA at times tended to be a one-sided affair, with ASEAN being a passive participant. To illustrate, the annual China-ASEAN Expo has been organised annually only at Nanning (Guangxi autonomous region in southern China) without an alternative venue in an ASEAN country. Although these activities greatly promoted the understanding of ASEAN by Chinese industries, scholars from China felt that lack of concomitant effort within the ASEAN region had limited the understanding of opportunities in China by ASEAN countries.

Similarly, there seems to be a general lack of understanding pertaining to various laws and regulations associated with ACFTA; thereby enterprises from both sides are not tapping into the full range of opportunities associated with ACFTA. Liu Jianren, from the Chinese Academy of Social Sciences (Beijing), in Chapter 1 cited a study that found only 20 per cent of companies in the Philippines taking advantage of ACFTA's zero-tariff benefits. Liu further highlighted that many Chinese enterprises still did not understand the laws and regulations related to ACFTA such as the ROOs.

Apart from impeding the expansion of trade and investment, this lack of understating also has other negative externalities. Since 2010, Beijing has increasingly faced the "China threat" theory in the context of ACFTA from various sections of industry in Southeast Asia; with businesses in Indonesia calling for protectionist measures against Chinese imports. Although the precise impact from ACFTA is hard to fathom at this moment, calls for protection from Chinese imports are also echoed in Malaysia, Thailand and the Philippines to a lesser extent.¹¹

In Malaysia, the iron and steel manufacturers claimed that they were facing stiff competition from their Chinese counterparts. Additionally, the Associated Chinese Chamber of Commerce & Industry of Malaysia

11 Lynn Lee, "FTA worries some", 6 January 2010 *The Straits Times*, www.straitstimes.com/BreakingNews/SEAsia/Story/STIStory_474038.html

(ACCIM) has called for a limit of 10 per cent annual growth in volume of imports from China. Vietnam expressed concerns not only from the possibility of cheap Chinese products flooding the Vietnamese markets but also worried that Vietnam is increasingly becoming the destination for obsolete technology from China; a trend that has the potential to stymie ongoing efforts towards industrial modernisation. Another concern rises from the large amount of low-cost and low-quality Chinese goods that are being smuggled into or hoarded in the region. According to Amado Mendoza (from the University of the Philippines Diliman), since these goods were not counted in official statistics, the Philippines trade surplus with China might probably be overstated; a trend that might be prevalent in other economies of the region.

One of the key propellers for the opposition in expanding trade relations with China within Southeast Asia is the wide regional economic as well as developmental disparities. Although ACFTA has made a good start by providing early harvest for CLMV countries, further efforts are needed because these disparities not only transcend countries but also different industries as well as sections of people within a country.

In spite of steady progress in lowering tariff rates, full realisation of trade potential between China and Southeast Asia requires measures to mitigate the existing non-tariff barriers (such as inefficient administrative barriers). Chu Minh Thao, from the Diplomatic Academy of Vietnam, has highlighted that many small and medium enterprises lack adequate information and necessary skills to maximise the benefits accruing from ACFTA. Minh Thao further notes that at times enterprises fail to prepare the CO for tariff preferential, a situation partly attributed to the failure of the countries to disseminate information about ACFTA. Similarly, Liao Shaolian from Xiamen University (China) underlines that lack of harmonisation of standards and technical requirements, absence of mutual recognition arrangements, and disparities in quality control and inspection standards inhibit the expansion of trade.

THE ROAD AHEAD

This section provides an alternative explanation for some of the challenges noted above, highlights the additional opportunities that ACFTA brings to the region, and finally provides selected policy options to lessen the impact from the challenges and strengthen the opportunities.

One of the puzzling trends in the first year of ACFTA's full implementation is the low utilisation of the tariff regime by the companies in the region. Although it requires a thorough assessment, it should also be noted that even before ACFTA came into effect the average tariff was only five per cent. Although companies would get additional five per cent reduction in tariff if ACFTA provisions are followed, it also requires more procedural work including filing information pertaining to ROOs. Hence, companies might prefer to continue their current trade practices rather than take advantage of the new tariff regime.

Similarly, the opposition to ACFTA within certain sections of businesses in Southeast Asia requires an impassioned response and evaluation. In fact, compared to other major regional FTA regimes in the world, ACFTA faces relatively less "vocal opposition", partly because of an already low-tariff regime.¹² Moreover, scholars note that the non-competitiveness in the region mainly arises from policy impediments and infrastructural bottlenecks. Rodolfo C. Severino, former Secretary-General of ASEAN, downplays the hysteria created by ACFTA and notes that tariffs were cut even in 2009, and 2010 merely marked the reduction from five per cent to zero. Indonesia witnessed the most vocal opposition, the largest number of items on which tariffs are to be eliminated only by 2012.¹³

With regard to the argument that the key trade item between ASEAN and China—electronic goods—is controlled by transnational corporations, and therefore China has limited influence on trade surplus is valid only at a broad level. The 2010 data offered a slightly different perspective that demands further study. It seemed the imports by these foreign-invested enterprises in China increased more slowly than imports by state and local enterprises. Moreover, China's imports grew much faster than exports to the advanced economies and these imports were based on the final demand in China.¹⁴

Despite the challenges ranging from trade deficits to regional eco-

12 Liz Gooch, "In Southeast Asia, Unease over Free Trade Zone", *New York Times*, 28 December 2009, www.nytimes.com/2009/12/29/business/global/29trade.html?_r=1&emc=eta1

13 Rodolfo C. Severino, "China-ASEAN FTA: Why the anxiety now?" *The Straits Times*, 23 February 2010.

14 *Securing the Present, Shaping the Future*, p. 10.

conomic disparities to inadequate understanding of ACFTA, Liu Jianren argues that the FTA laid a firm foundation for economic integration between China and ASEAN that would in turn lead to enhanced political relations as well as peace and stability in the region.

This optimistic outlook attracts a wide audience within the region; moreover, the genesis of this optimism lies not just in conviction but also in hard data. The rise of China offers multiple opportunities and this section provides a preview. First, the rise of wages in the southern export-oriented provinces in China presents new avenues of growth for Southeast Asian economies. With investment promotion and trade facilitation agreements in place, some of the industries from these southern provinces could relocate to the developing low-cost ASEAN economies. Second, Southeast Asia is currently one of the important suppliers fueling China's demand for raw materials to cater to its infrastructure and housing needs. While welcoming this demand and Chinese investments in raw material extraction projects, ASEAN could also invest and collaborate in raw material processing projects that would not only add value to its natural resources but also create more avenues for long-term sustainable development. Third, China's foreign exchange reserves and excess savings provide enormous opportunity. Rather than investing in low-return securities of developed economies, prudence dictates that China working with the regional governments can initiate policies to channel some of this money to finance developmental and infrastructural projects within the region.¹⁵ The situation also warrants governments limiting their roles in providing institutional and policy catalysts to the markets, rather than getting directly involved in these projects.

This chapter concludes by summarising some of the main policy options forwarded by various scholars from China and Southeast Asia. First, exercise caution in accelerating or deepening the liberalisation process and initiate efforts to install a monitoring system for continuous evaluation of the implementation and impact of ACFTA. Second, there is a need to strengthen the outreach programmes including enhancing ACFTA Business Portal and organising educational and capacity building workshops to raise awareness and disseminate information among the investors, entrepreneurs, as well as government officials. Third, we must

15 Ibid, p. 38.

explore the potential of e-commerce between the CMLV countries and China as well as promote agro-based trade with these countries. Fourth, increase investment in technology and capacity building to strengthen the competitiveness of exporters, especially the developing economies of Southeast Asia. Fifth, maintaining a high level of complementarity with regard to development and industrial structure between China and ASEAN would be the key to a successful supply chain.

ACFTA marks an important milestone in the long march towards economic integration between China and Southeast Asia. To strengthen the cooperation between the countries and accelerate the engagement among entrepreneurs of the region, governments while celebrating ACFTA's achievements must also pay attention to the challenges brought forward by scholars across ACFTA region in this monograph.

GLOSSARY

ACFTA	ASEAN-China Free Trade Area (also known as CAFTA: China-ASEAN Free Trade Area)
ACCIM	Associated Chinese Chambers of Commerce and Industry of Malaysia
ADB	Asia Development Bank
ASEAN	Association for Southeast Asia Nations
ASEAN 6	the founding members of ASEAN (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand)
APEC	Asia-Pacific Economic Cooperation
APC	Asia-Pacific Community
CEPEA	Comprehensive Economic Partnership in East Asia
CLMV	Cambodia, Lao PDR, Myanmar and Vietnam
CO	Certificate of Origin
Doi Moi	Also known as Policy of Renewal, it is a set of economic reforms initiated by the government of Vietnam in 1986 to establish a “socialist-oriented market economy”.
EAFTA	East Asia Free Trade Area
EAC	East Asia Community
EAI	Enterprise for ASEAN Initiative
EHP	Early Harvest Programme
FTAAP	Free Trade Area of the Asia-Pacific
G-3	Japan, the European Union and the United States
GATS	General Agreement on Trade in Services
JCBC	Joint Council for Bilateral Cooperation (between China and Singapore)
GMS	Greater Mekong Sub-region cooperation
NAFTA	North American Free Trade Area

NT	Normal Track
PBG	Pan Beibu Gulf Economic Cooperation
ROOs	Rules of origin
SKRL	Singapore-Kunming Rail Link
SL and HSL	Sensitive and Highly Sensitive goods
SPS	Strengthening Sanitary and Phytosanitary
TIG	Agreement on Trade in Goods
TPP	Trans-Pacific Partnership
TIS	Trade in services
TBT	Technical Barriers to Trade
TAC	Treaty of Amity and Cooperation in Southeast Asia
USTR	U.S. Trade Representative
WTO	World Trade Organisation

The full implementation of the ASEAN-China Free Trade Area in January of 2010 marked a major milestone in relations between China and Southeast Asian states. This monograph aims to help the reader better understand the path to the creation of what has become the world's largest free trade area by population, as well as explore its impacts on individual member countries and the region as a whole. Through in-depth analyses by some of the region's most knowledgeable scholars and practitioners, this monograph also reveals important details about the challenges and opportunities faced by the FTA going forward.



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