

## **Promoting China-ASEAN Economic Cooperation under CAFTA Framework**

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### **Abstract**

The implementation of China-ASEAN Free Trade Agreement in January 2010 marks an important milestone in their relations. CAFTA builds on and extends the growing economic relationships between the two sides. The agreement is expected to further promote China-ASEAN trade alongside intra-regional direct investment and extra-regional FDI. However, as a result of the 2008 financial crisis, global economic conditions have changed significantly from those prevailing at the time of drafting the agreement. This may represent new opportunities and challenges. Its future success depends on how its signatory members can work together to overcome the challenges and make good use of the opportunities. Further down the road, ASEAN and China can build on CAFTA to enhance their economic cooperation and integration through coordination in monetary and fiscal policies as well as industrial policies.

*Keywords:* regional integration, economic cooperation, free trade agreement

*JEL classification:* F15, F21, F36, F53

### **1. Introduction**

With the advent of China's economic reform three decades ago, trade and investment between ASEAN and China have been increasing year by year. The Asian financial crisis of 1997 acted as a catalyst to widen and deepen the relationship. There was also a strong move at the highest official level on both side to speed up the process and degree of economic cooperation. The most significant of this is the initiative to set up the China-ASEAN Free Trade Agreement (CAFTA), which formally came into being on 1st January 2010. The Agreement gave birth to the largest FTA in terms of population (1.9 billion), with a combined GDP of US\$5.6 trillion and total trade volume of US\$4.5 trillion. It is the third largest trading block after the European Union and North American Free Trade Agreement region in terms of GDP. CAFTA

has not disappointed its well-wishers. The first seven months of this year saw China's export to ASEAN went up by 43.2 per cent while ASEAN's exports to China grew to 56.1 per cent when compared to the same period in the previous year.

Besides trade, CAFTA represents a set of huge opportunities for the members of this huge geographical region and economy to increase their cooperation in the areas of investment and infrastructure development. This point takes on extra significance in the aftermath of the 2008 financial crisis.

## **2. Rapid Growth of China-ASEAN Trade in CAFTA Preparatory Years**

Ever since ASEAN as a group and China established official contact in 1991, the two sides have made remarkable progress in forging strategic partnership for peace and prosperity. This is manifested in their cooperation in trade, investment, and other issues of mutual interests ranging from maritime security to nontraditional security challenges. Trade and economic ties have enjoyed robust growth after the signing of the Framework Agreement on Comprehensive Economic Cooperation in November 2002 to establish the ASEAN-China Free Trade Area.<sup>1</sup>

China and ASEAN adopted an incremental approach to the FTA. Both sides started to implement the CAFTA's Trade in Goods Agreement with import tariff reductions from July 2005, with the five-year tariff reduction schedule entirely phased in from January 2010. The average tariff on ASEAN exports to China is slashed to 0.1 per cent in 2010, while the average tariff on China exports to older ASEAN-6 members is slashed to 0.6 per cent. Currently, around 7,000 items traded between China and ASEAN are zero-rated. By 2015, the policy of zero-tariff rate for 90 per cent of traded goods is expected to apply between China and the remaining four ASEAN members.<sup>2</sup> Because of such tariff lowering measures, many tariffs were already very low before 2010.<sup>3</sup> CAFTA may therefore be seen as a formalization of what has been going on for a decade.

CAFTA is an initiative to enhance economic regional integration, and like other such initiative, it has its economic and political background. The economic imperatives presented themselves in the form of the 1997 Asian financial crisis and the changes brought about by China's accession to the World Trade Organization. Relatively unaffected by the 1997 crisis, China was able to continue doing business with Southeast Asian countries badly affected by the crisis. What was more important, it kept its promise not to devalue the Chinese currency. Between them, these gave ASEAN countries a positive impression of China. It was a contrast to the bullying behaviours of the IMF which was widely believed to be a proxy of Washington (Lam, 2000). The political lesson was easy to learn.

Table 1 Major Activities Leading Up to CAFTA Implementation

1991	Chinese Foreign Minister Qian Qichen attended the opening session of the 24th ASEAN Ministerial Meeting in Kuala Lumpur. China expressed its keen interest to forge cooperation with ASEAN for mutual benefit.
1995	ASEAN and China established the ASEAN-China Joint Science and Technology to plan, approve, coordinate, monitor and evaluate joint cooperative programmes and activities. Since then, there have been many joint programmes and activities convened.
1996	China was accorded full Dialogue Partner status at the 29th ASEAN Ministerial Meeting in Jakarta, Indonesia.
1997	Chinese President Jiang Zemin and ASEAN leaders had their first informal summit and issued a joint statement to establish a partnership of good neighbourliness and mutual trust oriented towards the 21st century.
2000	Chinese Premier Zhu Rongji proposed setting up an FTA with ASEAN
2001	ASEAN and China formally agreed to set up an China-ASEAN Free Trade Agreement in 10 years' time
2002	Signing of the Framework Agreement on Comprehensive Economic Cooperation in November 2002 to establish the ASEAN-China Free Trade Area (ACFTA). Since then, trade and economic ties between ASEAN and China have been growing rapidly.
2003	Signing of Joint Declaration of the Heads of State/Government of the ASEAN Nations and China on Strategic Partnership for Peace and Prosperity at the 7th ASEAN-China Summit
2004	Adopted five-year (2005-2010) Plan of Action to implement the Joint Declaration at the 8th ASEAN-China Summit. The Plan has served as the master plan to broaden and deepen ASEAN-China dialogue relations in a comprehensive and mutually beneficial manner with the view to strengthen the strategic partnership for regional peace, development and prosperity.
2004-5	The Agreements on Trade in Goods and Dispute Settlement Mechanism between ASEAN and China were signed in November 2004, was implemented in July 2005.
2006	ASEAN and China celebrated 15 years of dialogue relations with the "Commemorative Summit Marking the 15th Anniversary of ASEAN-China Dialogue Relations" in Nanning, China. The Summit issued a Joint Statement to further strengthen ASEAN-China relations towards an enhanced strategic partnership.
2007	The Agreements on Trade in Goods and Dispute Settlement Mechanism between ASEAN and China was signed in January and came into force on 1st July.
2009	The ASEAN-China Investment Agreement was signed during the 41st ASEAN Economic Ministers Meeting. This completes the ASEAN-China negotiation processes on FTA as set in the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China.
2010	Implementation of CAFTA in January

Source: Official website of the Association of Southeast Asian Nations, <<http://www.aseansec.org/index2008.html>>, accessed 12th May 2010.

The 1997 Asian financial crisis prompted East Asian economies to increase their cooperation and they sought common grounds to guard against future crises. In 2000, ASEAN, China, Japan and South Korea launched a multilateral pact of currency swaps known as the Chiang Mai Initiative to pool their foreign reserves to help crisis-ridden East Asian countries.

With China joining the WTO in 2001, more transnational companies set up their production facilities in mainland China. Happening soon after the 1997 financial crisis, it made a lot of sense for Southeast Asian countries to broaden and deepen their trade with China. Besides being attracted to the economic potential of China's rapid growth and liberalization, they can become suppliers to feed the global production network centred in China. The final manufactured goods are then exported mainly to Europe and the USA from China. All these are happening in the context of globalization, with regional cooperation as part of the "game". Three crucial rationales are identified by Kevin Cai. First, CAFTA is a response to intensified regionalism elsewhere. Second, the FTA helps to cement the growing economic ties between ASEAN and China. Third, FTA helps to coordinate government policies – a point made very clear in the Asian financial crisis. (Cai, 2003)

From the Chinese side, there is an acute recognition that its economic well-being depends critically on a peaceful and stable global environment. Its embrace of globalization means the need to do more business with the outside world, especially its neighbours. It is also keen to ensure a reliable source of raw materials. The end of 2001 was a good time for China to broach the idea of FTA to ASEAN. "The timing is ideal, as the United States is distracted by the war on terror, Iraq, Iran, and North Korea, while Southeast Asia is still grappling with the aftermath of the 1997-8 Asian Financial Crisis." (Wang, 2007) With America distracted and Japan weakened by its long recession, China's pragmatic approach of increasing trade and investment has won much goodwill in the region (Kurlantzick, 2007). It may be added that by excluding Taiwan, CAFTA benefits China by isolating Taiwan, a bonus point for China's long-term project of reunification. This incidentally reveals the fact that economic and political matters are closely intertwined. This is true of CAFTA, as it is true of other free trade agreements. China needs the political goodwill of its Southeast Asian neighbours as much as the neighbours want to profit from strengthening economic ties with China.<sup>4</sup>

In August 2009, China and ASEAN ratified the China-ASEAN Investment Agreement during the 41st ASEAN Economic Ministers Meeting. This, together with the already-signed China-ASEAN agreements of trade in goods and services, completed the negotiation process of CAFTA. It paves the way for the implementation of CAFTA from January 2010 for China and the older ASEAN members (i.e. Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand). The FTA between China and the newer ASEAN

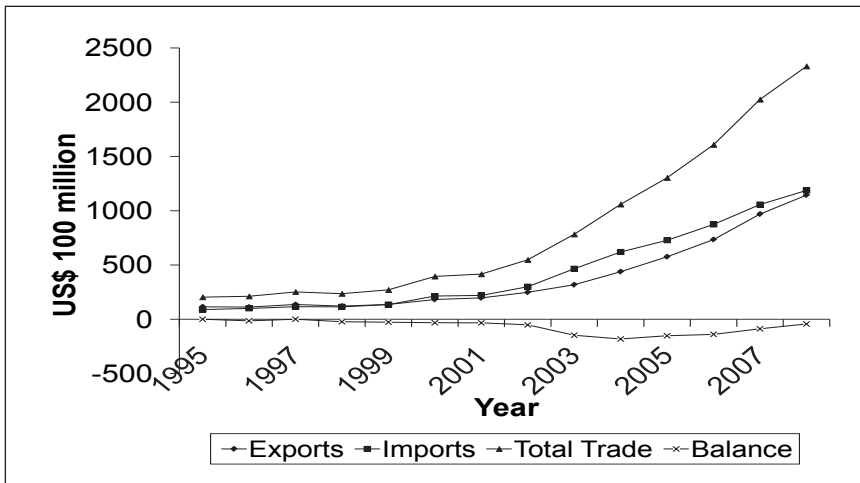
members (Cambodia, Laos, Myanmar and Vietnam) will only take effect from January 2015.

As a free trade agreement, CAFTA is pretty comprehensive as it covers trade in goods and services as well as investment. The new agreement has created the largest FTA in terms of population (1.9 billion), with a combined GDP of US\$5.6 trillion and total trade volume of US\$4.5 trillion. It is the third largest trading block after the European Union and North American Free Trade Agreement region in terms of GDP.<sup>5</sup> CAFTA is expected to boost China-ASEAN trade alongside expanding intra-industry trade and increase investment flow between the two sides.<sup>6</sup> Because of the enlarged market, it is likely to attract more FDI to the region.

Since 1991, China-ASEAN trade has experienced significant growth. From 1991 to 2000, China-ASEAN total trade volume grew at an annual rate of more than 15 per cent from US\$8 billion to US\$40 billion. After China joined the WTO in 2001, China-ASEAN total trade volume grew at an even faster pace. During the period from 2001 to 2008, China-ASEAN trade ballooned at an annual rate of over 20 per cent from US\$42 billion to over US\$230 billion (see Figure 1). China is now ASEAN’s third largest trading partner. To a certain extent, the rapid expansion of China-ASEAN trade since 2001 was contributed by the “early harvest” programme of CAFTA which liberalized China’s agricultural market to ASEAN countries.

While working towards CAFTA, ASEAN redoubled its efforts to create not only free trade amongst its members, but also an ASEAN Economic

Figure 1 China-ASEAN Trade, 1995-2008



Source: *China Statistical Yearbook 2009*.

Community by 2015 in which goods, skilled labour and capital can move freely. The 2008 financial crisis gave this another boost.<sup>7</sup>

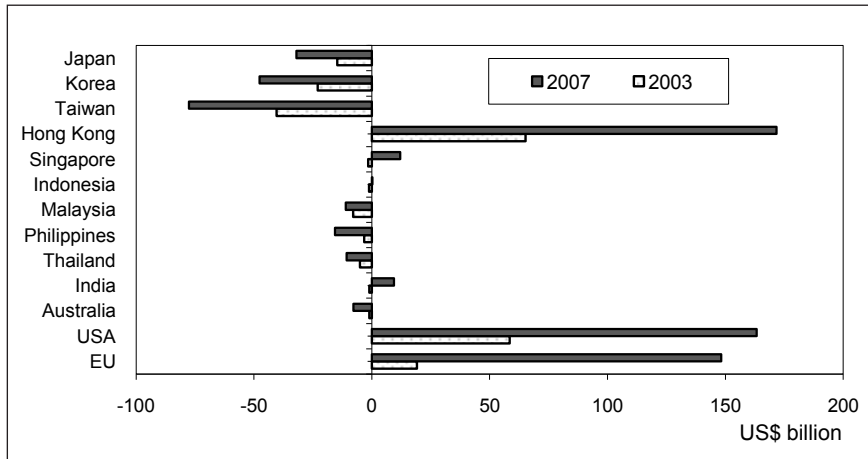
### **3. China-centric Regional Production Network**

A strong factor behind the growth of China-ASEAN trade was due to the integration of ASEAN economies into the China-centric regional production network. The China-centric regional production network was formed towards the end of the 1990s when China began to assume the region's traditional position of a manufacturing and assembly hub (mostly for labour-intensive and lower value-added products). Some of the conditions that allowed China to take on this role include its limited exposure to the Asian financial crisis of 1997, its ability to attract FDI away from the ASEAN region, and its large pool of cheap labour. To regain its competitiveness, ASEAN economies leveraged on China's new found role by aligning themselves more closely to the processing phase of China's production. This is illustrated by the composition of ASEAN exports to China from the late 1990s onwards. On the one hand, raw materials and intermediate manufacture products remain the top commodities in ASEAN's exports to China over the years. On the other hand, ASEAN countries have upgraded export structure based on its evolving comparative advantage by shifting focus to high value-added intermediate products. Indeed, the share of resource-based commodities decreased from two-thirds of the total export value of ASEAN to China in the early 1990s to only 22 per cent in 1999, and has remained almost at the same level ever since. Meanwhile, the relative share of intermediate manufacture goods (machinery and transport equipment in Figure 3) – electrical machinery, computer chips and automobile parts particularly – went up drastically from 12 per cent in 1990 to 52 per cent in 2008. This economic arrangement between China and ASEAN complemented the export-oriented strategy of both sides. ASEAN economies are to supply the raw materials and intermediate products for China's manufacturing, while China will export the finished product to third countries. Based on the economic performance of ASEAN and China in recent years, it seems that this production network was able to usher in a period of strong growth for both sides.

However, this changed after the financial meltdown in September 2008. The global financial crisis has cut back Western demand for Chinese exports, which in turn reduces ASEAN export of processing materials to China. This has immediate impact on the economic growth of both ASEAN and China.

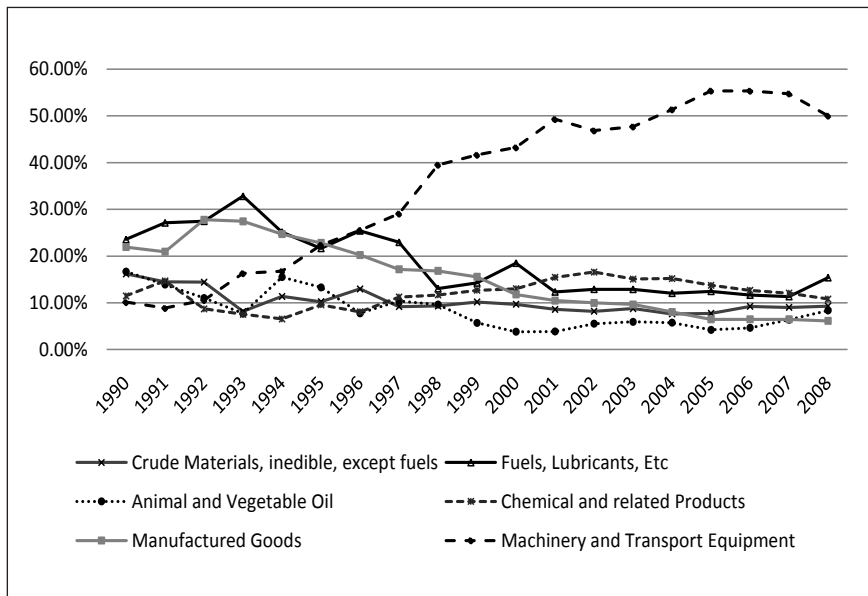
It is likely that global demand, especially from the Western economies, will remain weak despite improvement in the global economy. This is because the improvement was mainly due to aggressive government stimulus packages and a correction in private sector inventories. There has yet to be a firm or

Figure 2 China's Trade Balance with Selected Countries, 2003 and 2007



Source: *China Statistical Yearbook 2008*.

Figure 3 Percentage of Top 6 Commodities in ASEAN's Exports to China, 1995-2008



Source: The official website of the Association of Southeast Asian Nations.

sustainable rebound in private spending. This is not a surprising development as unemployment rate remains high and the credit market continues to remain tight in developed economies.

High spending consumers in the United States and developed European are now saving money and paying down debt, while banks are building reserves and hoarding cash. The change in consumer behaviour in the developed markets has in turn affected the global economy. Thriftiness on the part of western consumers has led to a collapse of the bottomless appetite for goods that are made from components and raw materials from Asian, African and Latin American countries and assembled in China. Facing this changing world order, it is necessary for China and ASEAN to revise its role in the global economy in order to ensure a continuation of their economic development.

The launching of CAFTA brought new hopes to this area. However, we could not neglect some challenges. On 21st April 2010 China's Vice-Minister of Commerce Yi Xiaozhun said China-ASEAN bilateral trade had grown rapidly in the first three months this year compared with the same period of last year. China's export to ASEAN went up 46.7 per cent while ASEAN's exports to China grew even higher to 76.6 per cent.<sup>8</sup> It does not mean that the high growth of two-side trade is totally due to the launching of CAFTA at the beginning of this year. To illustrate this point, let us look at China's trade figures with non-CAFTA countries. China's imports from Australia increases by 64 per cent, Japan by 56 per cent and South Korea by 61 per cent in the same period.<sup>9</sup> The numbers would have been smaller had it not been for the slump in previous trade due to the recent financial crisis. For example, ASEAN exported 8.8 per cent less to China in 2009.<sup>10</sup>

#### **4. Some Challenges**

Like any other FTA, CAFTA has its winners and losers, its opportunities and challenges. Success brings with it some problems, which need to be handled rationally and carefully. Concretely, CAFTA has revealed the following issues: trade deficits, pressures felt by some ASEAN industries, market size constrained by income, competition from other FTAs.

##### **4.1. Trade Deficits in Asian Countries**

From 2001 to 2006, at a time when the volume of ASEAN-China trade was booming, there was more or less trade balance, with ASEAN enjoying some surplus. The situation began to change in the last few years. Vietnam and Indonesia were showing trade deficits, and the gap seems to be increasing. According to data provided by ASEAN, the ASEAN side showed a trade



deficit of US\$21.5 billion in 2008. According to the Chinese Ministry of Commerce, China trade with ASEAN registered a decrease of deficits from more than US\$20 billion in 2004 to US\$2.8 billion in 2008. During the first three quarters of 2009, China had a surplus of US\$90 million in its trade with ASEAN.

As Figure 3 shows, almost half of ASEAN's export to China is resources and agricultural products. Compared to the manufacturing products ASEAN imports from China, its export to China has low value added content and less potential for future development.

Moreover, there is the issue of exchange rates. So far this year, the Malaysian Ringgit is up 7.5 per cent against the dollar and Indonesia Rupiah is up 4 per cent. As long as the yuan is pegged to the dollar, appreciation of ASEAN currencies makes their products more expensive for Chinese importers. Such exchange rate movements may accentuate the trade deficits. The dollar and yuan are now equally important in Asia. It could be expected that ASEAN countries would have more trade deficits with China if there is no drastic step taken to reverse the trend.

It must be added that most ASEAN countries do not have a big buffer of foreign reserves. Trade deficits, especially when they show sign of rapid increase, weaken their capacity to import. At the same time, it increases currency risks and lowers their ability to cope with the flow of hot money.

#### ***4.2. Pressures Experienced by Some ASEAN Industries***

The economic structures of ASEAN countries and China have both complementary as well as competitive aspects. Having a huge population of 1.3 billion, China has the task of providing employment for its vast pool of labour force. At its existing level of modernization, its labour intensive industries will remain a mainstay of employment provider in the foreseeable future. Unlike Japan and South Korea, China cannot afford to relocate all its labour intensive industries like home appliances manufacturing to ASEAN countries.

In early January, soon after CAFTA came into force, its impacts were covered by newspapers in Indonesia, the Philippines, Malaysia, Thailand and Singapore. While reporting on the positive aspects, they expressed concern that cheap Chinese products like textile products, footwears, headgears, and bags might drive such industries in ASEAN to the wall.

There are voices in Indonesia and the Philippines which championed the cause of such industries, especially textiles.<sup>11</sup> The association of textile industry in Indonesia said that the past two years had witnessed the closure of 271 textile factories due to competition from China. The spokesperson of the Indonesian Ministry of Industry revealed that the Indonesian government had written to ASEAN to ask for a postponement to 2011 of zero tariff for

textile, steel, and chemicals to give Indonesian enterprises more time to adjust. The Indonesian Minister of Trade, while assuring that Indonesia would abide by CAFTA, would set up a government agency to follow closely the impacts of the FTA on Indonesian industries. The hint is that Indonesia may resort to non-tariff measures to safeguard its enterprises, such as complicated and time-consuming import procedures and quality control. In fact, Indonesia has imposed the requirement that China's products can only be imported via ten specified ports.

### ***4.3. Market Size Constrained by Income***

Though ASEAN has a vast population, their purchasing power is relatively weak. The average annual income is slightly above US\$2,000. The older ASEAN-6 fares better with an average annual income of US\$4,000-5,000. During its best years of economic development from 2004 to 2008, the GDP registered an annual growth of 5.8 per cent while the level of consumption increased more slowly.

The low rate of consumption increase is due to low rate of income growth which in turn is due to low productivity and employment opportunities. The traditional approach to boost employment was through export oriented industrialization. However, with the current recession, technological advances and production overcapacity worldwide, it has become much more difficult for late comers to rely on export oriented and labour intensive industries to provide employment.

To raise productivity, it is necessary to develop basic infrastructure and to speed up the transfer of technology and skills to ASEAN, especially to the new members. This means FDI from the advanced countries. Take the case of Indonesia with its workforce of 110 million and population of 230 million. The unemployment rate is 8.1 per cent, which in itself is not high. But of this employment, only 30 per cent are in government and corporate firms. The remaining 70 per cent work in agricultural sector, as taxi drivers, or self-employed as small business people. From 1995 to 2008, labour supply increase exceeded employment increase by 2 per cent. It is estimated that 17 per cent of the people are in absolute poverty, surviving on less than US\$1.5 per day.

In the Philippines, the situation is worse. According to official statistics, the unemployment rate in July 2009 is 7.6 per cent, under-employment 19.8 per cent. The total number of unemployed and under-employed is 12 million. The country suffered from export slump, reduced remittance from Filipinos working abroad, and a drop in FDI. At the same time, its population of 90 million increases at 2.4 per cent per year, the top in Asia and higher than the government target of 1.9 per cent.

#### 4.4. Competition from Other FTAs

ASEAN has signed FTA with its various partners. All of them aim at tariff reduction. CAFTA is the first to come in force. The other FTAs are with Japan, South Korea, India, Australia and New Zealand. In its trade relations with ASEAN, China has to compete with these countries. In 2007 and 2008, China's trade volume with ASEAN exceeds Japan's with ASEAN but in 2009, Japan's trade volume with ASEAN overtakes China's. China's imports from Singapore, Malaysia, Indonesia and Vietnam are more than Japan's but its imports from the Philippines and Thailand are less than Japan's. The main items of both China's and Japan's exports to ASEAN are electronic/electrical goods and machineries, but Japanese goods are of higher quality. Japanese cars have captured a stable market in ASEAN region. Japanese corporations have a longer history of trade with and investment in ASEAN and enjoy much goodwill. Recently Japan initiated the Japan-Mekong Region Ministerial Meeting and convened the Japan-Mekong Summit. To counter China's influence in Southeast Asia, Japan proposed the ASEAN-Japan Comprehensive Economic Partnership. The agreement was signed by both sides in April 2008 and came into effect in December 2008.

While ASEAN countries want to gain from the rapid economic development in China and India, they are also cautious of the implications of rise of the new powers. They therefore see value in the institutions and mechanism of 10 + 8 ( the 10 ASEAN members, China, Japan, South Korea, India, Australia, New Zealand, Russia and the USA) as check and balance and to reduce the adverse impacts of a deepening cooperation among China, Japan and South Korea in northeast Asia.

As part of this trend, Brunei, Chile, New Zealand and Singapore set up the Trans-Pacific Strategic Economic Partnership (TPP) in 2005.<sup>12</sup> Since then it has expanded to include the United States, Australia, Peru and Vietnam. TPP is now one of Obama administration's main trade policies with its five-year goal of doubling US exports. At the same time, America is intensely aware of China's dominance in East Asian trade and TPP provides a platform for the USA to respond to it.<sup>13</sup>

### 5. Make Use of New Opportunities

CAFTA features in many discussions on how China and ASEAN should respond to the 2008 financial crisis. Much of these revolve around the reality of shrinking Western markets and the need to increase the intra-regional trade. CAFTA means a bigger market, as producers have a larger and more integrated market, leading to better economies of scale, higher efficiency and economic growth. Product differentiation and economies of scale are expected to grow over time and the role of the region as an integrated production base

for the global supply chain will also be strengthened. If history can act as a guide, CAFTA will stimulate trade growth, and this is confirmed by data so far. For example, in the first seven months of this year China's export to ASEAN went up by 43.2 per cent while ASEAN's exports to China grew to 56.1 per cent compared to the same period in the previous year. While CAFTA members are naturally expected to benefit from trade creation, trade with non-members might decline. CAFTA's impact on individual non-member economies could likely vary drastically, depending on how well a non-member is linked individually to signatory members in terms of trade, supply chains and other business arrangements.<sup>14</sup>

CAFTA opens up new avenues for ASEAN and China's business community to expand their business. Prior to the global financial crisis, economic growth and development in the ASEAN and China region have benefited the MNCs more than the business community of ASEAN. In fact, intra-ASEAN investment only accounts for a small percentage of ASEAN's total FDI. Of the US\$63 billion of FDI coming into ASEAN in 2007, intra-ASEAN FDI only amounts to US\$10 billion or about 15 per cent of ASEAN's total FDI inflow. China's investment to ASEAN is even smaller. In 2007, China's investment in ASEAN only made up of around 1 per cent of ASEAN's total FDI inflow, while ASEAN's investment to China was around 10 per cent of total FDI inflow into China in the same year. In 2008, China's investment in ASEAN was US\$2.2 billion. In the first half of 2010 the amount of China's FDI into Asean countries is US\$1.2 billion, an increase of 125.7 per cent over the same period of the previous year.<sup>15</sup>

There is a need for China and ASEAN to encourage their SMEs or even State-owned enterprises (SOEs) to take advantage of the investment mechanisms in CAFTA to increase their investment across borders. For instance, China should take advantage of its growing overseas investment brought about by its "going global" strategy to not only increase its investment in the ASEAN region, but also to diversify the investment areas. Currently, the areas where China's enterprises are investing are mostly on energy, resource gathering and infrastructure. Other than facilitating greater integration between China and ASEAN, an increase of intra-regional investment can lead to growth of the business community in the CAFTA region as well as a better distribution of development. This will in turn contribute to the emergence of a broader based middle-class and the maintenance of a sustainable regional market.

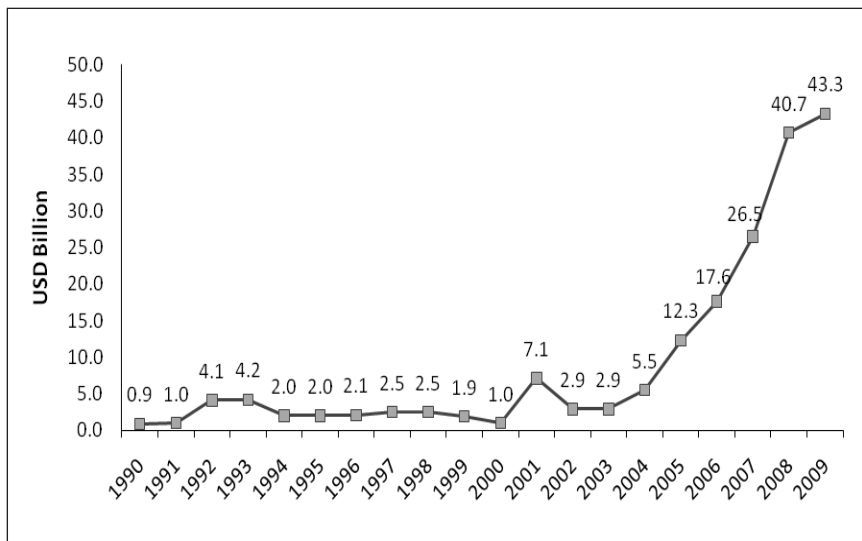
Between them China and ASEAN are a huge geographical area with a big economy with different levels of economic maturity, different resources and potentials as well as different infrastructure needs. They represent many opportunities for forward looking and bold cooperation. In most Asean countries, infrastructure is the first barrier to further development. There is

a huge demand for transportation facility for the Mekong River and other rivers, seaway, highway, railway, airway, bridges (such as Java-Sumatra bridge and others). It would cost US\$2 billion in 2007 prices to complete a railway across eight countries that will link Singapore to Kunming by 2015. An even bigger project is an initiative of the ADB, the GMS project which started in 1992. It involves China, Myanmar, Laos, Thailand, Cambodia and Vietnam. The total investment in GMS area is about 14 billion US dollars between 1992 and 2011. In the 81 construction projects involving transport, energy, economic corridor, tourism, communication, environment and trade facilities.

Another opportunity appears in the form of different labour costs in different regions or countries. For example, the average wage per month in Vietnam is about US\$60, less than two third of the wage level in China's coastline cities. In Cambodia, Laos and Myanmar the wage level is ever lower. The wage level, land cost and environment protection force the labour-intensive industries to move out from the Pearl River Delta, Yangtze River Delta and other coastline areas. Being attracted to such opportunities, companies have already relocated from China to the industrial parks set up in Vietnam, Cambodia, Lao and Myanmar.

The third opportunity comes from the differences in geographical conditions. The ASEAN nations are situated in tropical and sub-tropical

Figure 4 China's Outward FDI, 1999-2009



Sources: *China Statistical Yearbook 2009* and *China Statistical Abstract 2010*.

regions with an annual rainfall of 1500-2000mm, arable land of 153 million hectares but only 65 per cent of its resources utilized. Thailand, Vietnam and Myanmar are world-renowned rice-producing countries. ASEAN also produce tropical produce, fruits, timbers and sea products. Primary industry occupies 12 per cent of ASEAN's GDP, 13 per cent of its exports and 45 per cent of its labour. If efficient modern agriculture enterprises can be established, then productivity will be greatly increased and a portion of its labour can be transferred to manufacturing and service industries. China is rich with temperate produce and fruits but lack water resource (especially in the North) and arable land. China can help ASEAN establish stable markets by importing tropical produce while exporting temperate produce and fruits.

### ***5.1. Beneficial Nature of Trade***

Trade is by its very nature an economic activity that is voluntary and mutually beneficial. Where two sides have the same industries producing similar goods, then there is competition. Even though it may not be pleasant for the industries concerned, competition benefits consumers in terms of price and quality as well as choices. In the short term, governments are likely to be called upon to assist the weaker party to cope with the new situation.<sup>16</sup> Though there are concerns about the short term difficulties, it is heartening to note that the prevalent attitude in ASEAN is to face up to the challenges and to emerge stronger in the long term. "Southeast Asian governments and firms have increasingly viewed China and its companies as formidable competitors for markets – in Southeast Asia itself and elsewhere – and for foreign direct investment ... Competition is basically good for economies and companies. In the face of fair Chinese competition, ASEAN countries have to strengthen the competitiveness of their own economies as well as their companies." (Severino, 2008)

Competition is the market mechanism favoured by those who believe strongly in the workings of free market. But unbridled competition can also lead to unnecessary waste and in adverse economic conditions, it may lead to frictions. This can happen if one side chooses to use loopholes or resort to non-tariff measures to protect its own industries. This is certainly not a distant possibility as it has already been suggested by Indonesia. The situation can lead to disputes, and it can severely test the dispute mechanism signed in 2004. This is an issue that should engage the attention of both ASEAN and China at the ministerial level.

It is therefore important for China that CAFTA can demonstrate positive results for its ASEAN partners. For example, China unilaterally lowered the import tariff of agricultural products and let its trading partners benefit the "early harvest".

### **5.2. Investment in Production and Infrastructure**

It would be useful for the CAFTA members to identify areas of cooperation that will deliver benefits to all concerned. China must also address the concerns of trade deficits as experienced by some ASEAN members. It can increase imports of raw materials, agricultural produce (including seafood), increase its direct investment especially in the area of natural resources.

There are win-win situations in investment in critical infrastructures, value-adding activities based on local human and natural resources. If done well, these will lead to employment, income growth, export and import growth, and higher standard of living. One simple example is the Indonesia province of Gorontalo with its fertile soils, poor physical infrastructure, and potential fishery industries.<sup>17</sup> There are no canneries to process the catch from the sea and no stable power supply. Lack of infrastructure can also be found in landlocked Laos where China would provide a long-term loan of US\$4 billion to finance a railway network.<sup>18</sup>

There are challenges faced by China in investing in ASEAN region. Because of historical reasons, ASEAN countries still hold some reservations about Chinese investment.<sup>19</sup> Moreover, China has not accumulated vast experiences and built extensive business network there. As the service centre of Southeast Asia, Singapore can play a useful role. With more than a few centuries of experiences and accumulated skills of functioning as a financial centre and service centre, it can assist China with advice, networking and partnerships in creating win-win situations for all the parties involved.

Another point to note is that Chinese MNCs operating in ASEAN regions must not only abide by the best practices of their western counterparts, but must try to do even better. This is especially so in the area of exploitation of natural resources, which has negative impacts on the physical environment. The matter has to be handled well in order not to end up in a counter-productive situation. It has been observed that Chinese firms have been occasionally enmeshed in cases of corruption in some ASEAN countries (Severino, 2008).

### **5.3. Coordination in Industrial Policies, Fiscal and Monetary Policies**

Trade is the most natural solution of wealth creation for two parties which have complementary products. Complementary economic activity can be a direct consequence of natural endowment, e.g. Malaysia and Indonesia exporting rubber and palm oil. But it can be also a result of history, technological capability, indigenous market size and FDI. This suggests that there is a role for industrial policy formulation, so that different countries and sub-region can develop different areas of comparative prowess and competitive advantage. Here we can see clearly the benefits for ASEAN and

China to strive towards coordination and mutual consultation in formulating their industrial policies. It is a kind of regionalism based on mutually beneficial division of “labour” without creating a situation favourable for monopolistic control of the market. Long-term wise, economic growth is driven by productivity. This is an important factor that should be considered in formulating their industrial policies.

If we think beyond trade and consider the broader picture of economic relations, CAFTA members may do well to explore the issue of coordinating their fiscal and monetary policies. Of the two, monetary policies coordination is more important for the obvious reason that exchange rate is often implicated in trade disputes.

Currently, Asian financial markets are more closely bound to global market than to each other.<sup>20</sup> This has its historical reason but the increasing volume of trade amongst the CAFTA members may provide the imperatives for them to move towards closer integration of their financial sectors. Given the growing volume of trade and investment among the CAFTA members, especially between ASEAN nations and China, it does make sense to do business with the Chinese yuan as the currency. This lowers transaction cost in the form of uncertainty in exchange rate.

Before concluding, one last point may be added. Unlike Europe which has seen a retreat of nationalism, Asia must still cope with nationalism as a very powerful political force. And since nationalism is not going to fade away soon, regionalism has to bear this in mind. By its sheer size, CAFTA is a phenomenon worth studying, all the more so now that economic power is shifting from West to East. It is likely to yield interesting insights into FTA performance, regional cooperation and globalization.

## Notes

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