



BULLETIN

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Implications of ASEAN-China Free Trade Agreement (ACFTA)

by Artur Gradziuk

1 January 2010 saw the going into effect of five free trade agreements concluded by ASEAN. The most important of these is the ASEAN–China agreement establishing one of the world's largest free trade zones. The liberalization of trade between ASEAN and China should lead to the growth of trade and of China's investment in the region; on the other hand, in some ASEAN members there are concerns about the adverse effects of an upsurge of imports from China. For China the ACFTA is an important part of its push for closer cooperation with Southeast Asian states and for bolstering its own role in the region.

On 1 January 2010 free trade agreements (FTAs) between the Association of Southeast Asian Nations (ASEAN)¹ and, respectively, Australia and New Zealand, China, Japan, the Republic of Korea and India, went into effect. These agreements can be seen as marking yet another step towards integration among the ASEAN member states, which for purposes of these agreements are deemed to be a single entity—a meaningful shift away from the more developed ASEAN members' (Singapore, Malaysia, Thailand) former practice of signing bilateral FTAs. Moreover, this series of free trade agreements is an important part of the deepening of integration among the East Asian states, which include the region's three major economies: Japan, China and the Republic of Korea. Now that these countries have acquired better access to the ASEAN markets, the European Union, which due to slow progress in March 2009 suspended region-to-region negotiations with ASEAN, is likely to be spurred into concluding free trade agreements soon with individual members of this grouping.

The agreement between ASEAN and China (ACFTA) is the most important of the five new FTAs. It creates the largest regional trade agreement by population (nearly 1.9 billion) and the third largest (after the EU and the NAFTA) by trade volume (US\$192bn in 2008). For China this is by no means the first free trade agreement. The PRC already has signed FTAs with Hong Kong, Macau, Chile, Peru, New Zealand, Singapore and Pakistan; it is negotiating FTAs with Australia, Norway, Iceland, Costa Rica, the Gulf Cooperation Council and the Southern African Customs Union, and agreements with India and the Republic of Korea are under consideration.

ACFTA Negotiations: Underlying Reasons and Results. By launching ACFTA the ASEAN and China achieved an aim they had adopted back in 2001, when the idea of establishing a common free trade area was first advanced. A year later, the Framework Agreement of Comprehensive Economic Cooperation was concluded, with the target of creating an ACFTA in 2010. The concept of an ASEAN–China free trade area stemmed partly from the intensification of regional economic integration in various parts of the world. The integration processes have spread across Europe, North America, South America and Africa; each major economy has several FTAs, with these processes least visible in East Asia. Although the 1997–1998 Asian crisis highlighted the need for tighter regional cooperation, the time was not yet ripe for setting up a free trade area comprising the ASEAN states, China, Japan and Korea.

¹ The ASEAN member states include: Brunei, the Philippines, Indonesia, Malaysia and Thailand (forming "ASEAN 6") and Cambodia, Laos, Myanmar and Vietnam, often referred to by the acronym CLMV.

The adoption of the 2002 Framework Agreement opened a negotiating process that resulted in successive agreements between the ASEAN and China: the 2002 Agreement on Trade in Goods; the 2007 Agreement on Trade in Services, and an Investment Agreement signed in 2009. As of 2010 the free trade area comprises six ASEAN members: Brunei, the Philippines, Indonesia, Malaysia, Singapore and Thailand, while the remaining four members: Cambodia, Laos, Myanmar and Vietnam are due to reduce their tariff rates by 2015. Tariff free trade under the ACFTA will comprise 90% (by value) of the total trade. Each member state may place up to 400 tariff lines on so called "sensitive track" for which reduction or elimination of tariff will be postponed to a later date. With regard to services, the agreement also provides for a number of exceptions restricting many sectors from the free trade in services.

Potential Implications for ASEAN. The ASEAN consists of states with different levels of development and different structures of the economy, so the implications of the free trade agreement with China will be different for individual members. The reduced trade barriers will give the ASEAN exporters more favorable access to the Chinese market than that enjoyed by exporters from countries with no FTA with China. Export expansion opportunities look particularly promising for countries producing goods in high demand in China: raw materials, some agricultural and intermediate goods. This makes Malaysia (a palm oil exporter) and food producers and exporters (notably Thailand, Vietnam and Cambodia) potential major beneficiaries of the ACTFA. Given the rising costs of labor in China, the tightening of economic cooperation could also boost China's investment in countries in the region—a trend that could benefit the poorest ASEAN members: Laos, Cambodia and Myanmar.

Yet in many ASEAN states there are concerns about potential downsides of the liberalization of trade with the PRC. Cheap, low-value-added manufactured goods exported by China also dominate in the structure of most ASEAN members' exports, so there is a risk that an increase in imports of these products (e.g. textiles, clothing, footwear) from China will hurt the local enterprises. Particularly vulnerable are Thailand, Vietnam, Cambodia and Indonesia (in the latter, workers staged rally demanding that the ACFTA's implementation would be postponed). These countries' apprehensions are validated by China's exchange rate policy. With the Chinese currency pegged to the U.S. dollar at an artificially low rate since July 2008, Chinese exports have had a price edge over those of the ASEAN countries. This puts the latter's domestic production at risk and for this reason China's exchange rate policy is likely to feature prominently in ASEAN–China relations in the coming months, much as has been the case in China's relations with the U.S. and the EU. The ACFTA, in which the countries of the region act as a group, theoretically offers them more leverage over China's policy, yet in this relationship the ASEAN is junior partner and this gap is likely to be widening in the years to come.

ACFTA Importance for China. The ACFTA has improved the Chinese exporters' access to the ASEAN markets, what is important in the context of the ASEAN's other free trade agreements. China seeks to expand exports to the region as part of its foreign markets diversification, what is especially needed after the last year's downturn in import demand in the U.S. and the EU. By maintaining an artificially low exchange rate of the renminbi (RMB) China has been able to compete with ASEAN local producers in their home markets, yet these countries will unavoidably pressure China to revise its current exchange rate policy. The resolution of this issue should be important for China, provided it is intent on increasing the scope for RMB-settled trade and, in a longer run, on enhancing the international role of its currency. Liberalized trade will make it easier for China to satisfy the domestic import requirement (agricultural products, raw materials), while the investment agreement, which is a part of the ACFTA, will facilitate Chinese companies' involvement in mining projects of strategic importance to the country's development needs. On the other hand, Chinese farmers in the provinces neighboring with Vietnam and Laos could feel the negative effects of the ACFTA.

For China the ACFTA has not only economic meaning, it is also an important element of furthering its foreign policy aims. Not only does the beefing up of economic cooperation contribute to strengthening regional security, which is high on the list of China's development priorities, but it is also meant to reduce the fear of "the Chinese threat" and highlight the concept of "peaceful development" promoted by the Chinese government. At the same time, the ACFTA serves the purpose of bolstering China's position in the region. In China's relations with Southeast Asian states, much like in its relations with many other states, economic diplomacy is an instrument to enhance political relations. By building up its position in the region China expects to reduce the U.S. influence and to win the ASEAN states' supportive and sympathetic attitude on important issues addressed at various international forums. This gradual strengthening of position has a strategic importance for the Chinese government, both because of the seemingly impending intensification of regional integration processes and because of the role to which China aspires in East Asia.