

# The ASEAN-China Free Trade Area: Opportunities and Challenges\*

Temario C. Rivera\*\*

## Introduction

On 1 January 2010, the ASEAN-China Free Trade Area (ACFTA) was fully established after the framework agreement on comprehensive economic cooperation was originally signed between these two parties in November 2002. In another landmark development, the ASEAN free trade agreement comes into full effect in 2015 in pursuit of the goal of regional economic integration among its ten member states through an ASEAN Economic Community (AEC).

The short and long-term impact of these two developments demand close attention. Founded in 1967, the ASEAN has been the “most durable and successful regional association in the developing world” (Hill and Menon 2010, p. 1) and a key player in the region’s multilateral economic and security groupings including the ASEAN Economic Forum (ARF), the ASEAN + 3 (China, Japan, and the Republic of Korea), and the East Asia Summit.

The ACTFA is now the world’s largest Free Trade Area (FTA) with a combined population of over 1.9 billion and the third largest FTA in terms of economic size. China, the world’s second largest economy, is now the ASEAN’s leading trade partner while the ASEAN is China’s third largest trade partner.

This paper briefly examines some trends and opportunities provided by the establishment of the ACTFA as well as the challenges faced by this free trade area. It ends with a discussion of some policy concerns related with the progress and sustainability of the ACTFA especially from the point of view of the weaker states, and its impact on the overall security in the region and the common people in the participating states.

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\*\* Chair of the Board of Directors of the Center for People Empowerment in Governance (CenPEG) in the Philippines and Professorial Lecturer in Politics and International Relations, University of the Philippines, Diliman, Quezon City.

## Why Regional Trade Agreements?

There are both political and economic reasons for entering into regional trade agreements. Ravenhill (2008, 183) provides a useful summary of these reasons. The political motivations typically include: “enhancing security; improving intentional bargaining

positions; signalling to potential investors the seriousness of their commitment to reforms; to satisfy domestic constituencies' demands for reciprocity; and states perceive regional agreements are easier to negotiate than those within the WTO."

Among the usual economic reasons are: "access to a larger 'domestic market'; possibilities for attracting additional foreign direct investment (FDI); the possibility of engaging in 'deeper integration'; and the opportunity afforded to continue to protect politically sensitive, globally uncompetitive industries." Ravenhill (2008, p. 183).

In the 1990s, about a decade before the signing of the original Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the PRC, a confluence of regional and global factors paved the way for the ACTFA. By the 1990s, the ASEAN had witnessed the emergence of the PRC as the region's fastest growing economy, its transformation as the world's manufacturing hub, and a destination of huge FDI inflows. In an attempt to transform ASEAN into a stronger trading and production base, the ASEAN 6 signed in 1992 the ASEAN Free Trade Agreement (AFTA) to progressively eliminate tariff and non-tariff barriers to trade and attract more foreign investment. This signalled an attempt to make the regional bloc a more competitive trading and production base. However, ASEAN's vulnerability as a regional bloc was dramatically exposed by the 1997 Asian financial crisis which severely hit major Southeast Asian countries, particularly Thailand, Indonesia, and Malaysia, while leaving China (and India) largely unscathed.

Moreover, regional groupings toward economic integration in the 1990s such as the creation of NAFTA (North American Free Trade Agreement) and the Maastricht Treaty establishing the European Union added pressures on the need for economic integration among the weaker Southeast Asian states. In light of all these developments, the ASEAN had to "struggle to define its rationale and identity against the backdrop of a fast-changing regional and global environment (Hill and Menon 2010, 7).

### **Defining Features of the ASEAN as a Regional Bloc**

To understand the dynamics of the implementation of the ACTFA, it is important to examine the key norms, both substantive and procedural, that have underpinned the development and functioning of the ASEAN as a regional grouping and its relations with the PRC in related regional groupings. Since its founding in 1967, the ASEAN has been driven by substantial norms anchored on "non-interference in internal affairs of states, the pacific settlement of disputes and the primacy of regional solutions" and by procedural norms characterized by "consensus, informalism, and voluntary compliance" (Acharya 2011, 2001). This is the so-called "ASEAN Way" which explains much of the durability of the bloc but also its weaknesses. This "ASEAN Way" has served as the glue that has enabled the ASEAN to maintain and expand its membership in spite of the extreme diversity of the member states and peoples and to serve as the driver of some of the region-wide organizations.

As further stressed by Acharya, Asian regional institutions including the ASEAN, the ARF, and APEC, have typically pursued the internalization of norms among its members in a " non-legalistic and consensual" mode and "moving at a pace in which everyone is comfortable, but there is no danger of backtracking." (2011, Abstract). Echoing this

assessment about the “ASEAN Way” and how it has significantly influenced the formation and conduct of Asian regional institutions, Haggard identifies its three core norms and procedures:

- “1) an overwhelming emphasis on inter-governmental as opposed to supranational bodies, with a weak Secretary General and Secretariat;
- 2) consensus-decision-making procedures; and
- 3) strong norms of non-intervention, or non-interference, which were typically interpreted to mean that compliance with joint initiatives was voluntary and non-binding.” (2011, 9)

Thus, for various historical and political reasons, ASEAN has played a crucial role in deepening regional institutions, “exercising political influence that far outstrips its economic weight.” (Haggard 2011, 2)

In the context of the ASEAN Way and how this might affect the ACFTA, the PRC shares with the ASEAN a strong regard for the principles of respecting state sovereign rights and non-interference in the internal affairs of others. These foreign policy principles go back all the way to China’s advocacy of the Five Principles of Co-Existence first formally codified in treaty form with India in 1954 and later incorporated in the declaration of principles of the Asian and African states that attended the Bandung conference in 1955. Affirming the continuing relevance of these five core principles, Pres. Xi Jinping hosted this year a formal celebration with Pres. Thein Sein of Myanmar and Vice-President Mohammad Hamid Ansari of India as guests to commemorate 60 years of the Five Principles of Coexistence.

A full dialogue partner of the ASEAN since 1996, the PRC is also a founding member of the ASEAN Regional Forum (ARF) in 1994, and a signatory in 2003 to the Treaty of Amity and Cooperation with the ASEAN. The PRC also agreed to multilateral talks with the ASEAN in 1995 on the South China Sea Dispute and to the signing of a Declaration on the Conduct of Parties in the South China Sea. However the PRC also opposes raising the South China Sea dispute in the ARF and wants this body to remain consultative rather than become a problem-solving forum (Acharya 2011, 18).

**Trends in Trade Relations in ASEAN and the ACTFA**

One surprising fact about ASEAN trade is that intra-trade among the member states has been relatively unchanged at an average rate of 24.5% for the period from 1995 to 2012. The available data show that the intra-ASEAN trade rate took off at 22.4 % in 1970 and peaked at 25% in 2011. (see Table 1). Not even the passage of the ASEAN Free Trade Agreement (AFTA) in 1992 by the first six members (Indonesia, Philippines, Malaysia, Thailand, Singapore and Brunei Darussalam) had any significant impact in improving intra-trade relations. What this means then is that about 75% of total ASEAN trade is with non-ASEAN members.

**Table 1. Changes in the share of intra-regional trade in the ASEAN/AFTA (percent)**

|  |      |      |      |      |      |      |      |      |      |      |
|--|------|------|------|------|------|------|------|------|------|------|
|  | 1970 | 1980 | 1985 | 1990 | 1995 | 2000 | 2005 | 2009 | 2011 | 2012 |
|--|------|------|------|------|------|------|------|------|------|------|

|                        |      |      |      |      |      |      |      |      |      |      |
|------------------------|------|------|------|------|------|------|------|------|------|------|
| <b>ASEAN/<br/>AFTA</b> | 22.4 | 17.4 | 18.6 | 19.0 | 22.0 | 23.8 | 24.6 | 24.5 | 25.0 | 24.3 |
|------------------------|------|------|------|------|------|------|------|------|------|------|

Source: Ravenhill 2008; ASEAN Merchandise Trade Statistics, 2009, 2011, and 2012. [www.asean.org/resources](http://www.asean.org/resources)

The two poorest countries in ASEAN, Laos and Myanmar, show the largest share of their country total trade with its ASEAN neighbors at 64% and 48.3% in 2011. In contrast, the richest countries, Singapore and Brunei, only had 26.5% and 19.6% of their total country trade with the ASEAN bloc. For Indonesia, Malaysia, Thailand, and the Philippines, trade with the ASEAN bloc averaged only 24.4% of their country total trade in 2011. (see Table 2)

**Table 2. Intra-ASEAN trade as percent of country total trade.**

|             | <b>2000</b> | <b>2005</b> | <b>2011</b> |
|-------------|-------------|-------------|-------------|
| Laos        | 65.1        | 65.2        | 64.0        |
| Myanmar     | 35.6        | 51.2        | 48.3        |
| Singapore   | 26.1        | 31.3        | 26.5        |
| Indonesia   | 18.2        | 22.9        | 26.1        |
| Malaysia    | 25.4        | 25.5        | 26.0        |
| Thailand    | 18.1        | 20.0        | 24.3        |
| Cambodia    | 24.8        | 15.8        | 23.4        |
| Philippines | 15.6        | 18.1        | 21.1        |
| Brunei      | 33.9        | 34.1        | 19.6        |
| Vietnam     | 23.5        | 21.2        | 17.2        |
| ASEAN 10    | 22.8        | 25.5        | 25.0        |

Source: ASEAN Merchandise Trade Statistics Data Base. [www.asean.org/resources](http://www.asean.org/resources)

What accounts for this relatively low and flat intra-ASEAN trade rates? The first factor concerns the relatively low level of complementarity in the export and import structures among the ASEAN states. The leading economies in ASEAN (Singapore, Malaysia, Thailand, Indonesia, and the Philippines) have export and import patterns oriented mainly to countries outside of the ASEAN such as those of China, Japan, the EU, the United States and South Korea. For instance, the leading exports of these major ASEAN economies typically include various electronic parts and components, computers, integrated circuits, and in the case of Malaysia and Indonesia, crude and refined petroleum, and petroleum gas most of which are destined for extra-ASEAN countries. In turn, their major imports include products such as machine parts, electronic products, integrated circuits, computers, cars and transport equipment, planes and helicopters, which are also mainly sourced from outside the ASEAN. This export-import pattern reflects the reality that the leading ASEAN economies have been

exporters of parts and components consistent with the fragmented production system that characterizes the East Asian economy. In this system, much of the parts and components end up in China where the finished products are manufactured or assembled and also exported to outside markets. For instance, “four ASEAN countries (Singapore, Malaysia, Thailand, and Indonesia) together account for more than 80% of either ASEAN’s exports or imports with the PRC in 1980 to 2009. In addition, the bulk of the trade (exports and imports) between Malaysia, Singapore, Thailand and the PRC are concentrated in two sectors; machinery and mechanical appliances and their parts and components, and electrical machinery and equipment and their parts and components”. (Yu et al. 2012, 3).

In contrast with the intra-ASEAN economy, there exists a relatively high degree of complementarity in the export and import patterns between the PRC and the ASEAN and this is a positive factor for enhancing trade between the two partners (Estrada et al., 2012). (see Table 3) <sup>1</sup>

**Table 3: Trade Complementarity Index, 2006-2008 (%)**

| Importing Region or Country | Exporting Region or Country |      |       |
|-----------------------------|-----------------------------|------|-------|
|                             | ASEAN                       | PRC  | Japan |
| ASEAN                       |                             | 79.5 | 72.1  |
| PRC                         | 83.9                        |      | 70.8  |
| Japan                       | 77.3                        | 65.1 |       |

Source: Adapted from Estrada G., Donghyun Park, Innwon Park and Soonchan Park, 2012.

A second factor that has impeded a more robust intra-ASEAN trade is the large income and development level disparities among member states. (See Table 4) Comparable income and development levels among FTA members is an important factor for successful integration. As stressed by one study, “countries with similar income levels tend to have similar consumption patterns suggesting some scope for intra-industry trade . . .” (Estrada et al., 2012, 5).

The impact of different consumption patterns as shaped by significant differences in income and poverty levels among the ASEAN members is reflected in trade through their shares in intra and extra-ASEAN trade. (See Table 5). Of the five ASEAN members with the largest GDP per capita in 2012 (Singapore, Brunei, Malaysia, Thailand, and Indonesia), none had intra-ASEAN trade larger than 30%, with Malaysia the biggest at 27.3% and Brunei, the lowest at 19.1%. Even among the poorer ASEAN members, only Myanmar and Laos showed relatively bigger intra-ASEAN trade at 40.7% and 37.9%, respectively. However, even for these two countries, only Thailand proved to be a significant ASEAN trade partner in 2012.

**Table 4: GDP per Capita (2013), PPP (current international \$); and Poverty Indicators**

<sup>1</sup> The trade complementarity index is a measure of the extent to which one of two countries exports what the other imports. If the index is 100, the export and import shares exactly match. If the index is zero, then no goods are exported by one country or imported by the other.

|                   | <b>GDP per Capita, (2013) PPP<br/>(current international \$)</b> | <b>Poverty Headcount Ratio at<br/>\$2 (PPP) a Day (%)</b> |
|-------------------|------------------------------------------------------------------|-----------------------------------------------------------|
| Myanmar           | 1,156*                                                           | N.A.                                                      |
| Cambodia          | 3,042                                                            | 53.2 (2007)                                               |
| Lao PDR           | 4,812                                                            | 66.0 (2008)                                               |
| Vietnam           | 5,293                                                            | 43.3 (2008)                                               |
| Philippines       | 6,533                                                            | 41.6 (2009)                                               |
| Indonesia         | 9,559                                                            | 46.1 (2010)                                               |
| Thailand          | 14,390                                                           | 4.60 (2009)                                               |
| Malaysia          | 23,298                                                           | 2.30 (2009)                                               |
| Brunei Darussalam | 50,199 (2008)                                                    | ...                                                       |
| Singapore         | 78,744                                                           | ...                                                       |
| CHINA             | 11,904                                                           | 29.8 (2008)                                               |

\*IMF, (World Economic Outlook Data Base, 2009)

Sources: The World Bank. World Development Indicators Online.  
<http://data.worldbank.org>

**Table 5: Intra- and extra-ASEAN Trade, 2012**

Value in US\$ million; share in percent

|              | <b>Intra-ASEAN Trade</b> |                      | <b>Extra-ASEAN Trade</b> |                      |
|--------------|--------------------------|----------------------|--------------------------|----------------------|
|              | Value                    | Share to total Trade | Value                    | Share to Total Trade |
| Brunei       | 3,340.1                  | 19.8                 | 13,516.2                 | 80.2                 |
| Cambodia     | 5,142.9                  | 27.6                 | 13,520.8                 | 72.4                 |
| Indonesia    | 95,654.5                 | 25.1                 | 286,066.8                | 74.9                 |
| Lao PDR      | 2,337.2                  | 37.9                 | 3,821.6                  | 62.1                 |
| Malaysia     | 115,812.7                | 27.3                 | 308,117.6                | 72.7                 |
| Myanmar      | 7,525.4                  | 40.7                 | 10,977.9                 | 59.3                 |
| Philippines  | 24,758.3                 | 21.1                 | 92,623.3                 | 78.9                 |
| Singapore    | 209,621.3                | 26.6                 | 578,495.6                | 73.4                 |
| Thailand     | 99,535.5                 | 20.9                 | 377,766.4                | 79.1                 |
| Vietnam      | 38,320.2                 | 16.8                 | 189,473.1                | 83.2                 |
| <b>ASEAN</b> | <b>602,048.2</b>         | <b>24.3</b>          | <b>1,874,379.2</b>       | <b>75.7</b>          |

Source: ASEAN Merchandise Trade Statistics Data Base. [www.asean.org/resources](http://www.asean.org/resources)

### ASEAN Trade with China

China is ASEAN's largest trade partner while the latter is China's third largest trade partner (See Table 6). "From 2002 to 2012, China-ASEAN bilateral trade climbed 23.6% annually to its current 400 billion US dollars." (*Xinhua*, 10 October 2013). Malaysia, Singapore,

Thailand, Indonesia, and Vietnam are China’s leading ASEAN trade partners (ASEAN-China Center 2014).

**Table 6: ASEAN’s Leading Trade Partners by Country/Region, 2012**

(Share to Total, %)

|             | Total Trade (in US\$ thousand) | Exports from ASEAN (%) | Imports from ASEAN (%) | Total Trade (%) |
|-------------|--------------------------------|------------------------|------------------------|-----------------|
| ASEAN       | 602,048,218.2                  | 25.8                   | 22.8                   | 24.3            |
| China       | 319,484,794.5                  | 11.3                   | 14.5                   | 12.9            |
| EU-28       | 242,598,935.4                  | 10.0                   | 9.6                    | 9.8             |
| U.S.A.      | 200,027,174.7                  | 8.6                    | 7.5                    | 8.1             |
| South Korea | 131,030,148.2                  | 4.4                    | 6.2                    | 5.3             |
| Taiwan      | 96,251,869.9                   | 2.8                    | 5.0                    | 3.9             |
| Hongkong    | 94,742,373.7                   | 6.4                    | 1.2                    | 3.8             |
| India       | 71,815,750.7                   | 3.5                    | 2.3                    | 2.9             |

Source: ASEAN Merchandise Trade Statistics Data Base. [www.asean.org/resources](http://www.asean.org/resources)

The trade agreement between the ASEAN and China has led to the substantial lowering of the tariff on traded goods between them. Thus, “the average tariff on ASEAN-origin exports to the PRC was lowered from 9.8% to 0.1% in 2010, while the average tariff on PRC-origin exports to the six original ASEAN members (Indonesia, Malaysia, Philippines, Thailand, Singapore, and Brunei) was reduced from 12.8% to 0.6%.” (Yu et al., 2012, 1). With the formal launch of the ASEAN Economic Community by 2015, the same tariff arrangements are expected to extend to the remaining four newest ASEAN members (Vietnam, Cambodia, Lao PDR and Myanmar).

The trade pattern between the ASEAN and PRC has been characterized by an increasing shift from primary goods to manufacturing goods. Yu et al. summarize these important changes thus:

“From 1978 when PRC initiated the open-door policy to the 1997 Asian financial crisis, inter-industry trade of commodity goods was the dominant feature of the bilateral trade. For instance in 1985, trade in agricultural and mineral goods accounted for more than half of total ASEAN exports to and imports from PRC at 55% and 83%, respectively. More recently, however, intra-industry trade in manufactured goods has grown in importance. This is most apparent in the rapid growth of the share of machinery and transport equipment in total ASEAN exports to PRC from 18% in 1980 to 49% in 2005 and its share in total imports from PRC from 8% to 57% in the same period.” (2012, 2-3).

The same study by Yu et al. provides an optimistic assessment on the future of the ACTFA, “since the higher the proportion of component trade in the bilateral trade between member countries, the larger is the increase in bilateral trade flows after the formation of the ACTFA. Finally, since trade in parts and components is usually complementary among member countries (driven by the international production linkages), trade creation may dominate trade diversion effects.” (Yu et al. 2012, 13).

Another study takes note of the PRC’s “rising role as a consumer of final goods” and not just that of “an assembler of parts and components from East and Southeast Asia for the production of final goods for export to the U.S. and other industrial economies”. (Estrada et al. 2012, 18) The authors argue that such a shift will benefit the region given the PRC’s “huge economic size and remarkable growth” and thus positioning it as an “engine of growth for the region”. Doing a study of the comparative benefits for the PRC of FTAs with the ASEAN, Japan and the Republic of Korea, the same authors argue that the PRC “should prioritize ACTFA since it has income levels closer to and a trade structure more complementary with ASEAN . . .” (Estrada et al. 2012, 18).

### **ASEAN-China Trade Relations: Challenges and Concerns**

Anticipating the deepening of economic integration through the ASEAN Economic Community in 2015, the International Labor Organization (ILO) and the Asian Development Bank (ADB) has issued a joint report in 2014 entitled “ASEAN Community 2015: Managing Integration for Better Jobs and Prosperity,” that examines the likely gains and challenges facing this major undertaking. The joint report’s main points and policy recommendations are relevant as well to the increasingly significant economic ties developing between the ASEAN and China in the aftermath of the ACFTA.

Stressing an overall concern, the report states that: “Ultimately, the success of ASEAN regional integration will depend on how it affects the labour market---and therefore on how it improves the quality of life of women and men in the region.” (*ASEAN Community 2015*, xiv) The report further notes that the AEC “could generate 14 million additional jobs but the gains will not be distributed evenly across countries or sectors, or between women and men” and that member states need to develop policies and institutions that support “more balanced and inclusive growth”. (*ASEAN Community 2015*, xii).

Similar concerns will be activated as trade and economic ties between the ASEAN and China escalate in light of the ACTFA. In varying degrees, the ACTFA will also ignite structural changes between the parties that will impact on trade competitiveness, income differentials, labour productivities, social security, and environmental issues, among others.



However, the ACTFA also provides an immense opportunity where potential gains could be shared by most countries and the widest sectors if common concerns on a wide range of issues could be addressed effectively by both ASEAN members and China. For instance, China could express its support for progressive ASEAN-wide declarations such as those on the Protection and Promotion of the Rights of Migrant Workers and the Declaration on Strengthening Social Protection. Moreover, both parties can also explore creative ways on how to include representatives of peoples' organizations in decision-making networks affecting trade and economic ties at various levels. Such a mechanism will greatly expand the legitimacy and consensus necessary to sustain economic structural changes whose wide-ranging impact oftentimes affect most immediately the common women and men of each country.

In the end, the ultimate challenge of the ACTFA lies in how it can translate economic gains among its participating members as opportunities for further building and deepening cooperation and understanding in the region.

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