The China Trade-off

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The China-Asean free trade deal is a milestone as Southeast Asian nations test the waters of economic competitiveness

Almost one-third of the world's population is covered in the China-Asean Free Trade Area (CAFTA), which came into being on Jan. 1. However, CAFTA is only the third largest free trade zone in the world, after the EU and the North American Free Trade Agreement zone (NAFTA). Association of Southeast Asian Nations (Asean) governments hope that their economies will benefit as businesses get easier access to Chinese markets.

Most of the optimism seems to be coming from China, however, as the long-negotiated deal becomes a reality. The Chinese news agency, Xinhua, ran numerous feel-good stories talking up the merits of the new agreement, quoting officials, business people and academics in Asean states in a series of reports outlining the possible benefits of freer trade. With Chinese exports to the US and Europe down and not likely to recover anytime soon, Asean countries offer China more economic opportunity, as the more developed member-states seek to boost domestic consumption. Indonesian shoppers browse among textile fabrics in a Jakarta store in January. a new regional trade pact with China is on track despite concerns from some Indonesian businesses. The agreement between China and Southeast Asia took full effect on Jan. 1, liberalizing billions of dollars in trade and investments in a market of 1.7 billion consumers.

However, Asean was immediately put on the defensive, with Secretary-General Surin Pitsuwan refuting claims that CAFTA would be detrimental to the bloc. In a press release marking the new agreement, he said, "Asean has the capacity to be the supply chain for China's booming economy, which has been very much propelled by the gradual trade liberalization under the China-Asean FTA (Free Trade Agreement)."

Opposition to the deal has been loudest in Indonesia, where the government has sought to placate industries, including textiles, food and electronics, that anticipate fierce competition with Chinese manufacturers. Industry lobby groups have been vocal. Ade Sudradjat, vice chairman of the Indonesian Textile Association, said that Jakarta should renegotiate the deal because the textile industry may see its domestic market share decline by 50 percent as cheaper Chinese goods enter the market.

Tariffs have been gradually reduced since 2005. In the meantime, counterfeit Chinese products have been eating into traders' margins. Indonesia's renowned batik, with its intricate patterns, has already seen competition from Chinese imitations, prompting public anger among batik makers.

Responding to such concerns, Beijing has taken to sweet-talking Asean. "Such worries are understandable," said Yi Ziaozhun, China's deputy minister for commerce, when speaking at CAFTA's opening ceremony. He added, "But the free trade agreement is mutually beneficial. Policy makers from both regions have reached a consensus that trade pressures would ultimately be transformed into an impetus that drives the economic development of the whole region."

While some Asean-based business sectors will struggle with increased Chinese competition, overall the agreement should offer others the opportunity to access the Chinese market. Arpitha Bykere, a senior analyst at Roubini Global Economics, focusing on Asia, told The Irrawaddy that “despite increased import competition for domestic producers, the Asean exporters will benefit by providing cheaper exports of intermediate goods and commodities to China and receiving [export-led] investment from China.”

The deal comes as Asian countries in general are coping better with the global economic downturn than counterparts in Europe and North America. Part of China’s strategy has been to pump money into its private sector as stimulus spending designed to offset the impact of the downturn. Often the lines between the state and private sectors are blurred, however, and China’s resources mean that Asean-based business rivals could be at a disadvantage to the economic giant.

Robert Sutter, a visiting professor of Asian studies at Georgetown University in the US, told The Irrawaddy: “Asean manufacturers were girding for more difficult competition with Chinese manufacturers as the latter were using stimulus funds and loans from state-controlled banks to create ever greater modern manufacturing capacity that will guarantee that China sustains and advances its share of exports to the slowly reviving US, European and other international markets.”

As is often the case with such agreements, CAFTA falls short of genuine free trade. Each country can register hundreds of sensitive goods on which tariffs will continue to apply, in many cases until at least 2020. Such sensitive products include various types of electronic equipment, motor vehicles and automotive parts, chemicals and miscellaneous items such as popcorn, snowboarding equipment and toilet paper.

And like many other FTAs, non-tariff barriers will remain. Razeen Sally, a director of the Brussels-based European Centre for International Political Economy, said: “Basically it [CAFTA] takes down the tariffs but does little on all the non-tariff barriers (NTBs) where you would have much bigger gains to trade.” Asean members see NTBs as a key hedge against Chinese competition.
Visi tors shop at the Burma exhibtion during the 4th China-Asean Expo (CAEXPO) in October, 2007, in Nanning, China. the CAEXPO is the only major internat ional economic and trading event co-sponsored by the governments of China and the 10 Asean members, which is aimed at promoting the China- asean Free trade area. (Photo: AFP)

CAFTA was negotiated when US and European demand for Asian exports was high. The trade in parts and components, often from Asean states to China, where final assembly and export of finished goods takes place, prior to export to the West, remains the “central artery” of China-Asean economic ties, according to Sally. He said that CAFTA will not make much difference here as most of those tariffs are already near zero.

However, CAFTA may help diminish reliance on the regional trade in parts and components and the Western-oriented export market. Bykere said “the FTA sets the foundation where Asian countries can increasingly trade amongst each other for final demand rather than exporting to the US and EU.” However, this will not happen overnight, as domestic markets and consumption are not sufficient to compensate for the reduced demand in the West.

CAFTA will not apply across the board in Asean, for now at least. Burma, Vietnam, Cambodia and Laos have been given until 2015 to cut tariffs, reflecting the disparities within Asean between member-states, and acknowledging that local industries could not compete with Chinese rivals. Wide economic disparity has hindered Asean’s internal efforts to form a single market, as the purchasing power of the group’s four richest countries was 10 times greater than that of the other members last year.

As for Burma, the agreement will not make much difference for now, according to Sean Turnell, who edits the Burma Economic Watch. “Formal tariff barriers are not the principal obstacles to trade or business with the country,” he said.

Burma will not benefit from CAFTA unless the country undergoes real political change that removes economic sanctions and presumably leads to the end of Burma’s current economic system, which is characterized by profound mismanagement and corruption. An exception could be the natural resource sector, where Asean member-states anticipate Chinese demand for energy and raw materials to increase under CAFTA. However, in Burma’s case, increased resource revenues would merely bolster the military regime and perpetuate its economically disastrous rule.

The background to CAFTA is a sixfold jump in trade between China and Asean since 2000, to US $193 billion last year, surpassing that of US trade with China.

China’s share of Southeast Asia’s total commerce has increased to 11.3 percent from 4 percent in that time, overtaking the US and becoming Asean’s third most important trading partner, after Japan and the European Union.

As trade grows, the coming years should see greater Chinese investment in transport and infrastructure in Asean member-states. Prior to CAFTA, China launched a $10 billion infrastructure investment fund to improve road, railway, airlines and information telecommunications links between China and Southeast Asia and is also providing a $15 billion credit facility to promote regional integration and connectivity.

At the same time, it is easy to overstate China’s economic influence in Southeast Asia. “China’s share of the net inflow of direct foreign investment to Asean in recent years was quite small, about 2 percent,” said Robert Sutter, the Georgetown professor.

With that in mind, the deal could prove to be a geopolitical milestone. China has at least partly overcome wariness among Asean states about its long-term intentions, while American policy toward the region remains in flux, despite claims that the US is “back” in Southeast Asia after years of alleged indifference under the Republican administration.

Just days after CAFTA was signed, China overtook Germany to become the world’s largest exporter. Beijing’s economic success is appealing to Asean’s member-states, all of which hope to boost their economic growth through interaction with the world’s most dynamic economy.

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