Afterthoughts

# The China-Asean Free Trade Area: Propaganda and Reality

Saturday 23 January 2010, by BELLO Walden (Date first published: 14 January 2010).

ON JAN. 1, 2010, the China-Asean Free Trade Area (Cafta) went into effect. Touted as the world's biggest Free Trade Area, CAFTA is billed as having 1.7 million consumers, with a combined gross domestic product of $ 2 trillion and total trade of $ 1.3 trillion.

Under the agreement, trade between China and six Asean countries including Brunei, Indonesia, Malaysia, the Philippines, Thailand and Singapore has become duty-free for more than 7,000 products.

By 2015, the newer Asean countries, Vietnam, Laos, Cambodia and Myanmar, will join the zero-tariff arrangement.

The propaganda mills, especially in Beijing, have been trumpeting the FTA as bringing "mutual benefits" to China and Asean.

A positive spin on Cafta has also come from President Gloria Macapagal-Arroyo, who hailed the emergence of a "formidable regional grouping" that would rival the United States and the European Union.

The reality, however, is that most of the advantages will probably flow to China.

At first glance, it seems like the China-Asean relationship has been positive. After all, demand from a Chinese economy growing at a breakneck pace was a key factor in Southeast Asian growth beginning around 2003, after a period of low growth following the Asian financial crisis of 1997 and 1998.

For Asia as a whole, in 2003 and the beginning of 2004, noted an Unctad report, "China was a major engine of growth for most of the economies in the region. The country's imports accelerated even more than its exports, with a large proportion of them coming from the rest of Asia."

During the current international recession, Asean governments are counting on China – which is expected to register growth of 7-8 per cent when the figures for 2009 are final – to pull them out of the doldrums.

### A More Complex Picture

Yet the picture is more complex than that of a Chinese locomotive pulling the rest of East Asia along with it on a fast track to economic nirvana.

There have been widespread fears that China's growth is, in fact taking place at Southeast Asia's expense.

Low wages, many in Southeast Asia fear, have encouraged local and foreign manufacturers to phase out their operations in relatively high wage Southeast Asia and moving them to China.

There appears to be some support for this. China's devaluation of the yuan in 1994 had the effect of diverting some foreign direct investment away from Southeast Asia.

The trend of Asean losing ground to China accelerated after the financial crisis of 1997.

In 2000, foreign direct investment in Asean shrank to 10 per cent of all foreign direct investment in developing Asia, down from 30 per cent in the mid-nineties.

The decline continued in the rest of the decade, with the United Nations World Investment Report attributing the trend partly to "increased competition from China."

Since the Japanese have been the most dynamic foreign investors in the region, much apprehension in the Asean capitals greeted a Japanese government survey that revealed that 57 per cent of Japanese manufacturing TNCs found China to be more attractive than the Asean-4 (Thailand, Malaysia, Indonesia, and the Philippines).

**Snags in a Trade Relationship**

Trade has been another, perhaps greater, area of concern.

Massive smuggling of goods from has disrupted practically all Asean economies.

For instance, with some 70-80 per cent of shoe shops in Vietnam selling smuggled Chinese shoes, the Vietnamese shoe industry has suffered badly.

In the case of the Philippines, a recent paper by Joseph Francia and Errol Ramos of the Free Trade Alliance claims that the local shoe industry, along with the vegetable industry, has also been hit badly by smuggling of Chinese goods.

Indeed the range of goods negatively affected is broad, including steel, paper, cement, petrochemicals, plastics, and ceramic tiles.

"Many Philippine companies, even those that are competitive globally, had to close shop or reduce production and employment, due to smuggling," they write.

It is owing to massive smuggling that few analysts take seriously official trade figures with China released by the Chinese Embassy in Manila that show the Philippines enjoying a positive trade balance.

Now there are fears that Cafta will simply legalize smuggling and worsen the already negative effects of Chinese imports on Asean industry and agriculture.

**The Thai "Early Harvest" Debacle**

Local vegetable producers complain that they have already been badly hit by Cafta's experimental "early harvest agreement" that went into effect in December 2005. A similar result has apparently emerged in Thailand, where the impact of the early harvest agreement with China has been better documented.

Under the agreement, Thailand and China agreed that tariffs on more than 200 items of vegetables and fruits would be immediately eliminated. Thailand would export tropical fruits to China while winter fruits from China would be eligible for the zero-tariff deal.

The expectations of mutual benefit evaporated after a few months, however, with most Thai commentaries admitting that Thailand got a bad deal.

As one assessment put it, "despite the limited scope of the Thailand-China early harvest agreement, it has had an appreciable impact in the sectors covered.

The “appreciable impact” has been to wipe out northern Thai producers of garlic and red onions and to cripple the sale of temperate fruit and vegetables from the Royal projects."

Thai newspapers pointed to officials in Southern China refusing to bring down tariffs as stipulated in the agreement while the Thai government brought down the barriers to Chinese products.

Resentment at the results of the China-Thai “early harvest” agreement among Thai fruit and vegetable growers was, in fact, one of the factors that contributed to widespread disillusionment with the broader free trade agenda of the Thaksin government; and opposition to free trade was a prominent feature of the popular mobilizations that culminated in the ouster of that regime in September 2006 by a military coup.

The Thai early harvest experience, in fact, created consternation not just in Thailand but throughout Southeast Asia. It stoked fears of Asean becoming a dumping ground for China’s extremely competitive industrial and agricultural sectors, which could drive down prices owing to cheap urban labor that was continually replenished by dirt cheap labor streaming from the countryside.

These fears at the grassroots have, however, fallen on deaf ears as Asean governments have been extremely reluctant to displease Beijing.

**The Chinese View**

For Chinese officials, the benefits to China of an FTA with Asean are clear. The aim of the strategy, according to Chinese economist Angang Hu, os to more fully integrate China into the global economy as the “center of the world’s manufacturing industry.”

A central part of the plan was to open up Asean markets to Chinese manufactured products. In light of growing popularity of protectionist sentiments in the US and European Union, Southeast Asia, which absorbs only around 8 percent of China’s exports, is seen as an important market with tremendous potential to absorb more Chinese goods.

China’s trade strategy is described by Hu as a “half open model,” that is, “open or free trade on the export side and protectionism on the import side.”

**Asean: A Net Beneficiary?**

Despite brave words from President Arroyo and other Asean leaders, it is much less clear how Asean will benefit from the Asean-China relationship.

Certainly, the benefits will not come in labor-intensive manufacturing, where China enjoys an unbeatable edge by the constant downward pressure on wages exerted by migrants from a seemingly inexhaustible rural work force that makes an average of $285 a year.

Certainly not in high tech, since even the US and Japan are scared of China’s remarkable ability to move very quickly into high tech industries even as it consolidates its edge in labor-intensive production.

Will agriculture in Asean be a net beneficiary? But, as the early harvest experience with the Philippines and Thailand has shown, China is clearly super-competitive in a vast array of agricultural products from temperate crops to semi-tropical produce, and in agricultural processing.

Vietnam and Thailand might be able to hold their own in rice production, Indonesia and Vietnam in coffee, and the Philippines in coconut and coconut products, but there may not be many more products to add to the list.

Moreover, even if under Cafta, Asean were to gain or retain competitiveness in some areas of manufacturing and trade, it is highly doubtful that China will depart from what Hu calls its “half open” model of international trade.

The Thai early harvest experience underlines the effectiveness of administrative obstacles that can act as non-tariff barriers in China.

What about raw materials? Yes, of course, Indonesia and Malaysia have oil that is in scarce supply in China, and Malaysia does have rubber and tin and the Philippines has palm oil and metals.

But a second look makes one wonder if the relationship with China is not reproducing the old colonial division of labor, whereby low-value-added natural resources and agricultural products were shipped to the center while the Southeast Asian economies absorbed high-value added manufactures from Europe and the United States.

**The Cafta-Afta Double Blow**

For the Philippines, in particular, Cafta will add to the erosion of manufacturing and agriculture triggered by its hasty incorporation into the ASEAN’s free trade scheme, AFTA-CEPT (ASEAN Free Trade Area Common Effective Preferential Tariffs Arrangement).

The country has consistently charted agricultural trade deficits with ASEAN, and as early as the first quarter of 2009, the country’s negative agricultural trade balance with Asean already reached US $ 410.15 million. In terms of total trade, imports from Asean in 2008, valued at US $ 21.47 billion, far exceeded the country’s total value of exports in the same year of US $ 7.09 billion.

These trends are likely to accelerate under Cafta, but with a difference: China will beat out the country’s Asean neighbors in achieving control of the domestic market.

**Conclusion**

To sum up, despite the official propaganda, the China-Asean trade agreement that came into effect on Jan. 1, 2009, is likely to disadvantage Asean.

Even with the temporary exemptions of certain from full trade liberalization, Asean would be locked into a process where the only direction that barriers to super-competitive Chinese industrial and agricultural goods will be downwards.

Being one of Asean’s weaker economies, the Philippines has already seen itself driven into a massive deficit in its relations with other Asean countries under the Asean-Cept free trade scheme.

Cafta is likely to accelerate this negative trend, but with China, instead of the Philippines’ Asean neighbors, being the eventual winner.

**By Walden Bello**

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