

China and Southeast Asia: Emerging Problems in an Economic Relationship

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The much publicized wooing of African countries by China exemplified by the China-Africa meeting that took place in Beijing in the first week of November brings up the question of how China is faring in its economic relations with its closest neighbors?

Southeast Asia, which is formally grouped into the Association of Southeast Asian Nations (ASEAN), is probably the region most courted by China, so its relations with the area would give some indication of the likely evolution of Beijing's economic diplomacy toward other parts of the global South.

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 dependent on domestic demand. Indeed, this was also the case for Korea and Japan. 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."

A More Complex Picture

Yet the picture was 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 feared, has 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 2001 and 2002, 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 was another, perhaps greater, area of concern. In the last few years, China has aggressively sought free trade agreements with the ASEAN governments. This push appears to have met with some success. Thailand and China concluded an “early harvest” free trade pact in 2003. And at the 10th ASEAN Summit held in Vientiane, Laos, in November 2004, the ASEAN countries issued a joint statement expressing agreement with the goal of removing all tariffs between ASEAN and China by the year 2010. At that meeting, a positive spin on the proposed China-ASEAN Free Trade Agreement was provided by Philippine President Gloria Macapagal-Arroyo, who hailed the emergence of a “formidable regional grouping” that would rival the United States and the European Union.

Yet, things have not proceeded as smoothly as Beijing would have wanted. In the experimental arrangement between Thailand and China, the two countries agreed that tariffs on more than 200 items of vegetables and fruits would be immediately eliminated. Under the agreement, 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 mid-September 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. People wondered if FTA’s with China would not simply legalize the dumping of Chinese goods, a great deal of which were already being smuggled across their land borders with China or, in the case, of the Philippines, across the South China Sea.

The Chinese View

For Chinese officials, the benefits to China of an FTA with ASEAN were clear. The aim of the strategy, according to Chinese economist Angang Hu, was 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 protectionist sentiment in the US and European Union, Southeast Asia, which absorbed only 8.2 percent of China’s exports, was seen as an important market with tremendous potential to absorb more Chinese goods. Also key, noted Hu, was the Chinese government’s plan to attract investment “into the western region of China from ASEAN nations, weaving the western region more thoroughly into the

fabric of regional and international trade.”

ASEAN: a Net Beneficiary?

Despite brave words from President Arroyo and other ASEAN leaders, it was much less clear how ASEAN would benefit from the ASEAN-China relationship. It was highly doubtful that China would depart from what Hu has characterized as China’s “half open model,” which is marked by “open or free trade on the export side and protectionism on the import side.”

Certainly, the benefits would not come in labor-intensive manufacturing, where China enjoyed 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 were scared of China’s remarkable ability to move very quickly into high tech industries even as it consolidates its edge in labor-intensive production. Certainly not in labor services, since China could produce engineers, nurses, and domestic workers that would perform the same work but at lower wages than their ASEAN counterparts. For instance, China’s recent deployment of seafarers has threatened the Philippines premier position as a source of seamen globally.

Would agriculture in ASEAN be a net beneficiary? But, as the early harvest experience with Thailand showed, China was 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 might not be many more products to add to the list.

What about raw materials? Yes, of course, Indonesia and Malaysia had oil that was in scarce supply in China, and Malaysia did have rubber and tin and the Philippines had palm oil and metals. But a second look made one wonder if the relationship with China was 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.

Hard Truths

Thus, drastic imbalance would likely be the result of free trade agreements between the ASEAN countries and China.

In the view of many, the problem lies largely with ASEAN, since despite the rhetoric of regional integration, ASEAN’s economies are still largely ten separate economies. The vision of creating an integrated market of 450 million consumers that was expressed by the original ASEAN plan for regional import substitution industrialization—one that would have been achieved via increasingly freer trade among member countries accompanied by high tariffs and quotas against third country product—was never implemented. The Southeast Asian nations had over 30 years to build an “ASEAN house,” and they had squandered the opportunity. Had ASEAN evolved along the lines envisioned by its founders, it would not have displayed the disarray with which its members confronted the rise of China.

Genuine ASEAN integration is long overdue. In undertaking this process, the ASEAN countries have a lot to learn not only from the European Union, but from Latin America as well. In contrast to stagnation in ASEAN, significant movements toward closer regional cooperation on non-free trade

lines are afoot in Latin America. These include the Peoples' Trade Agreement among Bolivia, Venezuela, and Cuba, and the Bolivarian Alternative for the Americas (ALBA) being promoted by Venezuelan President Hugo Chavez. In ALBA, 14 Caribbean countries receive a 40 per cent discount from the world price of oil from Venezuela, and Bolivia and Argentina have an innovative barter scheme with Venezuela whereby in return for oil Bolivia exchanges soybeans and Argentina exchanges heifers. Joint investment schemes in different capital-intensive projects are in different stages of design and implementation. (See Davis Harris and Diego Azzi, *ALBA: Venezuela's Answer to Free Trade* [PDF].)

To sum up, ASEAN remains a very weak economic entity. Moving quickly to conclude a free trade agreement with China is likely to lead to the same consequences as the early harvest agreement China had with Thailand. Even if China agreed to many ASEAN exemptions from steep tariff reductions, ASEAN would be locked into a process where the only direction that barriers to super-competitive Chinese industrial and agricultural goods would be downwards. At this juncture, an ASEAN-China FTA or, what is more likely, separate Chinese FTAs with different ASEAN countries, can only lead to de-industrialization and agricultural crisis in ASEAN.

The relationship between ASEAN and China is not a colonial relationship. It cannot even be said to be an exploitative one at this point. But unless considerations of equity are front and center in the negotiation of economic relationships between Beijing and its neighbors, the old structural patterns marking the relations between Southeast Asia and Europe, the United States, and Japan could easily be replicated.

P.S.

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