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ECON 370: Trade Policy Essay

China – ASEAN Free Trade Agreement (CAFTA)

Globalization, removal of tariffs and steps towards an inter-dependent world economy have caused many free trade agreements to be implemented between countries in the same region and a global trade organization, namely World Trade Organization. Considering the huge economic growth in labor abundant developing countries, where the labor force is cheaper compared to other countries, many more trade agreements have been implemented and a great deal of emphasis have been placed on trade policies. Due to China's vigorous economic growth, its connections with other world countries have expanded rapidly. One of the most important free trade agreements (FTA) in the last decade was China – ASEAN (Association of Southeast Asian Nations) Comprehensive Economic Cooperation Agreement, which was signed in 2002.

Although the agreement has been viewed as a purely economic agreement, it has helped both sides to cooperate in terms of environment, science and technology, non-traditional security areas and legal issues that members had amongst one another. Historically, according to Dr. Jing-dong Yuan, there has been a significant change in the relations of China with ASEAN countries in a sense that heavy militarism and protectionism has yielded its place to regional economic and geo-political beneficial process. Increasing importance on political negotiations on disputes, rather than threatening or using military power to solve issues, have also contributed to a better and stronger relationship between all Asian countries, and in the globalizing world as well. It is important to note that China's relations with other Asian countries was both "amity and animosity" at the same time (Yuan 3). Considering itself a communist state, China has been an interesting and powerful case in the Asian world. The first official contact between China and

ASEAN had happened in July 1991, which was continued with China becoming a full dialogue partner of ASEAN in 1997, as well as the issuance of the “Joint Declaration of the PRC and ASEAN State Leaders — A Strategic Partnership for Peace and Prosperity” which was endorsed in October 2003 (Yuan 5).

Historically there have been three main areas of dispute between China and ASEAN countries, which are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. The first one is managing territorial disputes amongst China and ASEAN countries, which was mainly about proclamations by each country regarding the territories between them, specifically islands in most known cases (e.g. the Spratly Islands which had caused a dispute in 1980). Defense and security cooperation has been another main controversial area for Asian countries (e.g. overdose spending to military and defense in order to be able to insure security). Lastly, economic relations between countries have been a very controversial arena for Asian countries in terms of being able to take advantage of a globalizing world and capital to develop their own nations amongst a very competitive environment of labor intensive countries in Asia. Moreover, China is a rising economic empire throughout the world; therefore, it has a great deal of influence on other countries, especially its neighbors. China’s developing economy and income levels has attracted many other countries, including ASEAN countries, and it is seen as an opportunity for other countries to benefit from.

Therefore, as said in the beginning, the China – ASEAN Free Trade Agreement is not only meant to be an economic agreement, but also is meant to be a peace treaty which shows the goodwill of all parties towards a better and united Asian world with less money going towards militarization and more money to create trade and relationships with surrounding countries. The agreement, called CAFTA – not to be confused with DR-CAFTA (Dominican Republic - Central

America Free Trade Agreement, which the U.S. has also played a major role in) – was intended to benefit both sides by reducing tariffs on products to create a free trade area.

Elaborating more on why any of the participating countries would want to sign such an agreement, it is clearly seen from data – Exhibit 1 – that ASEAN imports from China jumped from 39.6% in 1993 to 57.0% in 1999, which was only the beginning of Chinese success in the production environment. Decreasing tariffs would benefit both sides to increase the amount of trade and allow ASEAN population to consume more of cheap Chinese products. In addition to that, ASEAN countries have always harbored a suspicion towards China due to its communist regime and provincial executives. Therefore, having trade benefits and economic ties with the superpower, China, has been a very important issue in the whole region. As stated in Yuan's detailed report: "ASEAN's active engagement of China played a critical role in removing suspicions and encouraged Beijing [China] to full participation in the regional multilateral security arrangement" (24).

Summarizing ASEAN member countries' views and historical background with China, Malaysia has had a couple of issues regarding territorial and domestic politics; however, they have managed to maintain a better relationship as proven, showed by the maritime cooperation agreement that was signed in August 2006 between both parties. Considering Viet Nam, bilateral trade data, which had increased from \$32 million 1991 to \$3.6 billion in 2005 (Yuan 33), explains how much the relationship has improved in recent years between the two parties. Singapore, has been trying to stabilize its relationship with China, in that such an economic agreement would clearly benefit Singapore in order to insure its future relationship with China. However, at the same time, they are making an effort to maintain sound relations with the U.S as well. Myanmar has been one of the closest countries to China in its diplomatic history, and has

always been influenced by Chinese politics. Philippines on the other hand, has hand territorial disputes directly with China, which could affect the relationship; however, its relationship with China has been improving in the past two to three years. Thailand has had a relatively better relationship with China than any other ASEAN member country with the beginning of an arms dealership amongst one another, which led to the formation of strong political and economic ties with each other. On the other hand, the last ASEAN member, Indonesia has been the problematic member state concerning relationships with China. Indonesian citizens have protested against CAFTA and the country has had many political problems with China historically.

Following the analysis of historical relationships between China and ASEAN member countries, one should recognize the importance of politics in the agreement process. On the other hand, looking from the economics viewpoint:

Tariffs have been coming down for years, helping drive brisk growth in China-ASEAN trade. On January 1st [2010] the six richest ASEAN members eliminated remaining tariffs and barriers to investment on 90% of products. But the poorest four ASEAN members, Vietnam, Cambodia, Laos and Myanmar, will not need to cut tariffs to the same levels till 2015. Meanwhile, every country may list dozens of sensitive areas where tariffs can still apply, from ports to cars to popcorn. And with no rigorous mechanism for settling disputes, doubts remain about whether the deal will have real teeth.

The Economist

Although CAFTA has been viewed as similar to NAFTA and EU customs union, in a sense, it falls far beyond any of the examples given. CAFTA looks more like a preferential trade arrangement rather than a free trade area due to the fact that not all members are not happy with it, and there are many ambiguities involved.

However, the policy viewpoint explains other alternatives that could have been done in such a situation. The first one could have been to partially removal of tariffs; because, now that tariffs are removed on 90% of the goods, there has been a sudden impact on some countries.

They could also have engaged in applying tariff-rate quotas, which is a combined policy in which imports within the quota receive a lower tariff rate and imports beyond the quota receive a higher tariff rate. In both cases, the government revenues would not have decreased as much, considering the fact that CAFTA eliminates all tariff revenues that parties collect. Although the increasing level of connection with each other provides incentive to decrease military and security spending, this will not happen immediately. CAFTA has been in use, since January 1 2010, therefore causing parties to have a sudden decrease in government income. Yet, economics rationale itself has not been the only important thing in member nations' politics. Taking into consideration militaristic power and political influence in not just the Far East, but also the rest of the world, and the relative weaker economies of the ASEAN members provides rationale for CAFTA agreement.

One other important basis for CAFTA is the protective Asian culture that has affected the viewpoint of both parties. It is important to note that for those labor intensive countries to be able to hold the cheap labor force to continue their growth and open new markets for themselves is of great importance. The following declaration explains more about the subject:

“The elimination of tariffs by ASEAN -6 underscores ASEAN's commitment to dismantle tariffs and keep intra-ASEAN trade open. It will also serve as a catalyst for the development of the single market and production base projected by the ASEAN Economic Community (AEC) Blueprint,” the Jakarta-based ASEAN Secretariat said in a statement.

China Post

Despite the fact that China and ASEAN countries were thinking to form a free trade area – with the hopes of upgrading it to a customs union in the future – this does not seem to be the case any time soon. Some parties, especially Indonesia in particular, do not appear pleased with this agreement. Due to the fact that they have not readied themselves to the reduction process

beforehand, the firms who are in fear of Chinese domination in their domestic market, have protested against their own government. As a result, Indonesia submitted a request to renegotiate parts of CAFTA, and was rejected.

In conclusion, contrary to the economic standpoint which argues that CAFTA could be derogatory for the ASEAN members due to Chinese domination in the region, the agreement will establish and strengthen the bonds between all participating countries. Moreover, it will not only contribute to world peace and a decrease in military spending, but it will also increase total trade, decrease the deadweight loss that was occurring due to tariffs, and will increase the welfare of communities as well. At this point in time, it is very hard to conclude on the effects of CAFTA considering that it has been applied so recently and no progress data is currently available for analysis. However, projections of ASEAN are very optimistic that CAFTA will benefit the regular consumer in ASEAN member countries. As said before, even if CAFTA does not give desirable economic results, it will be very beneficial to member nations in terms of collaboration, diplomacy and security.

Exhibits

Exhibit 1:

1993			1999		
PRODUCT	IMPORTS (US \$ Billion)	SHARE	PRODUCT	IMPORTS (US \$ Billion)	SHARE
Electrical Equipment	0.48	11.1%	Electrical Equipment	3.24	26.6%
Computer/Machinery	0.42	9.7%	Computer/Machinery	2.44	20.0%
Lubricants/Fuels/Oil	0.39	9.0%	Cereals	0.52	4.3%
Cotton	0.24	5.6%	Lubricants/Fuels/Oil	0.43	3.6%
Tobacco	0.18	4.2%	Ships/Boats	0.30	2.5%
SUB-TOTAL	1.72	39.6%	SUB-TOTAL	6.9	57.0%

Source: ASEAN Secretariat.

Source: http://www.aseansec.org/newdata/asean_chi.pdf

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