

**ST-NUS ECONOMICS DEPARTMENT SERIES ON  
THE IMPACT OF CHINA'S ECONOMIC GROWTH**

# *How Asean can fully benefit from trade pact with China*



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**T**HE China-Asean Free Trade Area (Cafta) is one of the world's largest FTAs, with a combined gross domestic product of US\$6.6 trillion (S\$9.3 trillion), 1.9 billion people and a total trade of US\$4.3 trillion.

Its Framework Agreement was signed in November 2002. The Trade in Goods Agreement was concluded in November 2004 and entered into force in July 2005. And the Trade in Services Agreement was

signed in January 2007 and entered into force in July 2007. This year, the full implementation of zero tariffs for most goods in the FTA is expected for China and the Asean 6 - Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. Cambodia, Laos, Myanmar and Vietnam will do the same in 2015.

Cafta's key benefit for Asean is the access it provides to China's market. In 2008, China accounted for nearly 12 per cent of Asean's total exports and 10 per cent of its total imports. Some see Cafta as a potential platform for the creation of a larger free trade area, consisting of Asean+3 (China, Japan and South Korea) or Asean+6 (China, India, Japan, South Korea, Australia and New Zealand).

However, the potential benefits of Cafta for Asean are still not very clear.

The Chinese economy is a low-cost production base, endowed with a large pool of unskilled workers. It has also recently emerged as an important source of foreign direct investments overseas.

There could be short-term displacements in labour-intensive industries such as textile, garment, footwear and toy manufacturing in Asean, as well as in large capital-intensive industries such as steel and machinery serving domestic markets in Asean. The short-term impact might be more significant for small and medium-sized enterprises (SMEs) in the region. In particular, the competitive impact of Chinese exports of machinery and equipment is expected to affect SMEs in more advanced Asean countries, such as Singapore, Malaysia and Thailand. Overall, the impact of Chinese exports will

probably be more significant in Cambodia, Laos, Myanmar and Vietnam, as well as in emerging countries like Indonesia and the Philippines, which are still dominated by labour-intensive industries.

Furthermore, Cafta could diminish the importance of the Asean Free Trade Area and perhaps delay the formation of the Asean Economic Community (AEC). The dominance of the Chinese market might shift the focus away from Asean, even within the region. But despite the short-term adjustment costs of Cafta, the potential gains for Asean and China in the medium and long term are significant. To fully benefit from Cafta, however, Asean needs to address several key issues.

First, Asean needs to maintain the momentum for the formation of the AEC. The integration of Asean into an economic community consisting of a "single market and production base" will be crucial if Cafta is to evolve into a larger free trade grouping encompassing more countries.

Second, there are large disparities among Asean countries and greater focus should be directed towards reducing income disparities within the region. In particular, Asean could focus on capacity building in Cambodia, Laos, Myanmar and Vietnam, and develop stronger infrastructure to facilitate trade.

Third, Asean should focus on human capital development to facilitate the movement of workers from displaced in-

dustries to growing industries as a result of Cafta.

Fourth, the development of strong SMEs within Asean will enable the region to take full advantage of the growing Chinese market. Asean SMEs should focus on developing their research and development capabilities. The development of strong local industries will be crucial for Asean to fully benefit from Cafta.

Fifth, recent studies indicate the utilisation rate among businesses of Asean FTAs is very low. Asean needs to improve the utilisation rate by adopting concrete facilitation measures, such as designing a unified regime of Rules of Origin.

Finally, Asean needs to focus on issues such as technical regulations and standards and harmonisation with international standards. These will be crucial in establishing and maintaining high product standards and in differentiating domestic products from poor-quality imports.

Such product quality differential will enable domestic companies to maintain their domestic market share and also capture global market share. Furthermore, the development and harmonisation of product standards will be a key factor in developing a global production value chain in the region and in reaping the full benefits of Asean FTAs.

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