



Worth Noting

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Worth Noting is the weekly management journal of research and conferences company L21. It is focused on management strategy issues of relevance to senior executives.

In what was regarded as a milestone in Sino cooperation with the rest of Asia, Chinese Premier Zhu and the ASEAN nations' leaders have signed the '*Framework Agreement on China-ASEAN Comprehensive Economic Cooperation*'.

What this means essentially is that China and the 10 ASEAN nations (Malaysia, Indonesia, Singapore, Thailand, Cambodia, Laos, Philippines, Viet Nam, Brunei, Myanmar) have signed a pact to establish a free trade zone by 2010.

Many of us have become skeptical about 'free trade' pacts, many pacts containing almost more exceptions than agreements where genuine free trade will operate. In this edition of *Worth Noting*, we look at what this Sino-ASEAN agreement might mean for Australia.

The Free Trade Pact

As is usual after the conclusion of any international agreement for cooperation, it didn't take long for leaders from all sides to pat each other on the back and point to a sea-change era of good relations. Officials from both sides were upbeat in their statements: "a new era for Asia"; "a natural outcome of growing political relations"; "a new page in Sino relations" etc – all statements made by 'unnamed officials'.

According to the agreement, the free trade zone covers trade in goods and services, investment and economic cooperation, with the trade of goods being the core of the free trade. Tariffs and trade limits on most goods and products will be abolished gradually.

China and the ASEAN countries singled out agriculture, IT technology, human resources and investment promotion and the exploration of the Mekong River valley as the priorities for economic cooperation.

What about the numbers? Chinese and ASEAN experts have predicted that the China-ASEAN free trade zone, once established, will create an economic area of 1.7 billion consumers, about \$2 Trillion US worth of GDP and a trade volume of \$1.200 Trillion US.

With the free trade zone in operation, China's exports to ASEAN will increase by 10.6 billion US dollars, or 55 percent, and its imports from ASEAN will rise by 13 billion US dollars, or 48 percent. Two-way investment will also surge, experts say.

As far as the 'Framework Agreement' signed in Phnom Penh is concerned, the document lays a legal foundation for the free trade zone. It makes clear the relevant goals, ranges, measures, time span, early schedules, detailed arrangements concerning economic and technological cooperation, promises on offering Vietnam, Laos and Cambodia most-favored-nation treatment, and future negotiation arrangements on cargo, service and investment.

Currently, ASEAN is China's fifth largest trade partner and China is the sixth largest trade partner of ASEAN. In the first nine months this year, bilateral trade rose 27 percent to \$38B US. (China Daily)

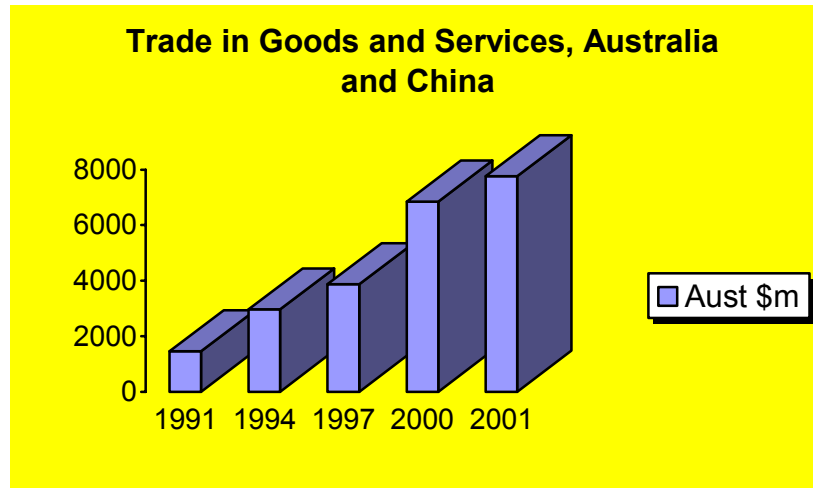
Analysts here say ASEAN countries now wish to gain the maximum benefit from China's booming economy, and both sides realise the necessity of strengthening economic ties in the face of regional economic integration.

Experts, who predict the China-ASEAN free trade zone would be a successful model for cooperation among developing countries, believe the latest development in China-ASEAN relations would enable the two sides to make joint efforts to reduce the risks brought about by economic globalisation and strengthen the position of Asian countries in international trade and economic affairs.

Australia & ASEAN Trade with China – The Facts

What does a free trade zone between China and ASEAN really mean for Australia?

It is important not to be caught up too much with the rhetoric of any agreement. What matters here are the facts and the implications for Australia.

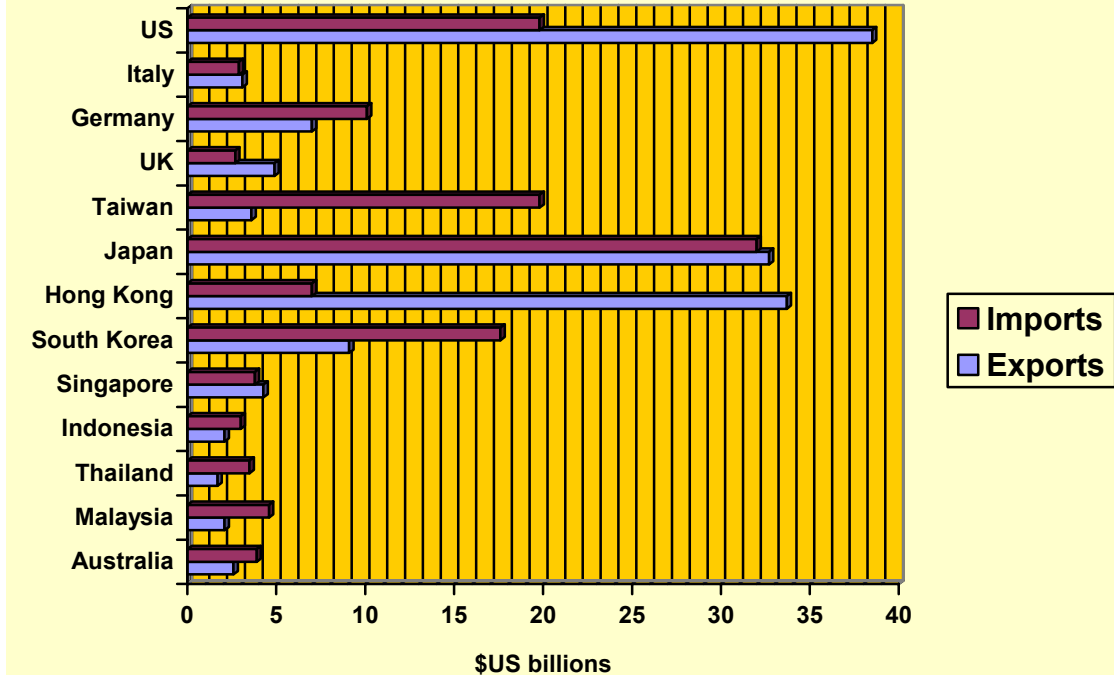


Source: ABS

The chart shows that trade with China has been steadily increasing over the past decade. China is now our 5th-6th largest trading partner.

What is more interesting, however, is a comparison of Australian trade with China with China's main trading partners, and in particular with the main economies within ASEAN.

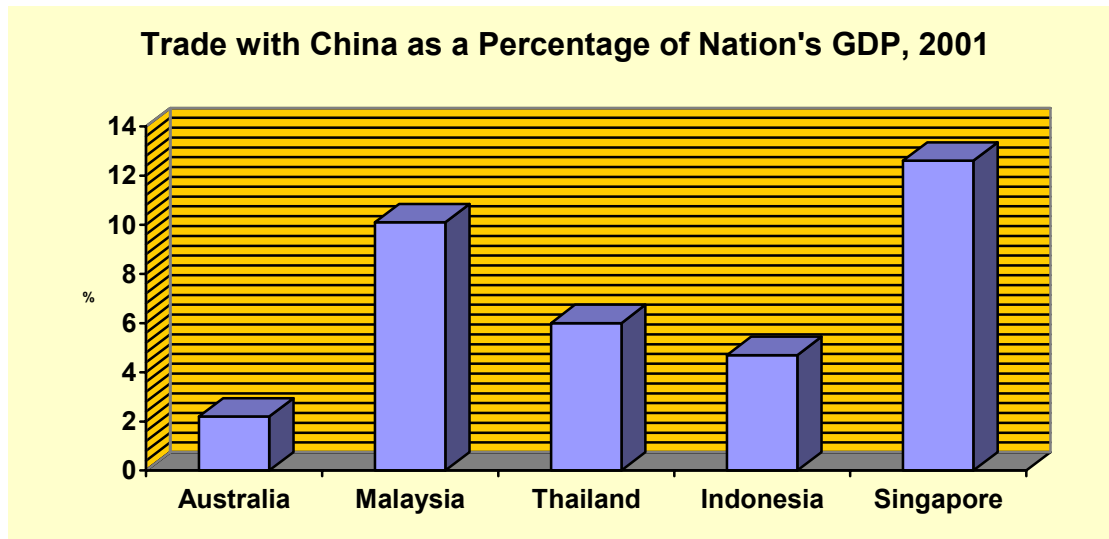
Chinese Export & Import Partners (Jan - Sep 2001)



Source: General Administration of Customs, China

We can see that the US, Japan and South Korea dominate. What is significant to note though, is that Australia is in a group of nations, including ASEAN members Malaysia, Singapore, Thailand and Indonesia, that all compete as the second tier partners with China. This means that the leading ASEAN nations are our natural competitors in the sense that we share a similar market presence in trade with China.

The following chart takes the perspective of China's trading partners, and looks at the relative importance of trade with China as a proportion of each country's GDP.



Source: ABS; ASEAN Statistics Unit; L21 Analysis

From Chart 3, it is clear that in the current situation trade with China is relatively more important to the major ASEAN countries than it is for Australia. Moreover, when we look at our exports to China, our research suggests that Australian exports are growing at about 5.9% compared to 13.3% for Malaysia and 9.9% for Thailand. In other words, even prior to any free trade agreement, Australia is already facing tough competition in gaining access to Chinese markets from the main ASEAN economies.

Implications of Free Trade Agreement

This now places us in a better position to understand the implications of the figures being brandished around of a US\$13 billion increase in imports from ASEAN to China after the implementation of the free trade zone. Experts believe that the free trade pact will increase China's GDP by about 1% and ASEAN member states' by about 0.3%.

In 2001, imports to China from ASEAN were about US\$26 billion compared to about US\$5 billion from Australia. (General Administration of Customs) Importantly, China's imports from ASEAN have been increasing at about 10-12% for the past few years while China's imports from Australia have been increasing at about 3-6% over the past three years.

On the face of it, the free trade pact will help ASEAN countries accelerate their trade with China with negative consequences for Australia.

However, the significance of the Sino-ASEAN free trade zone for Australia must be understood within the context of broader political factors and prior economic agreements.

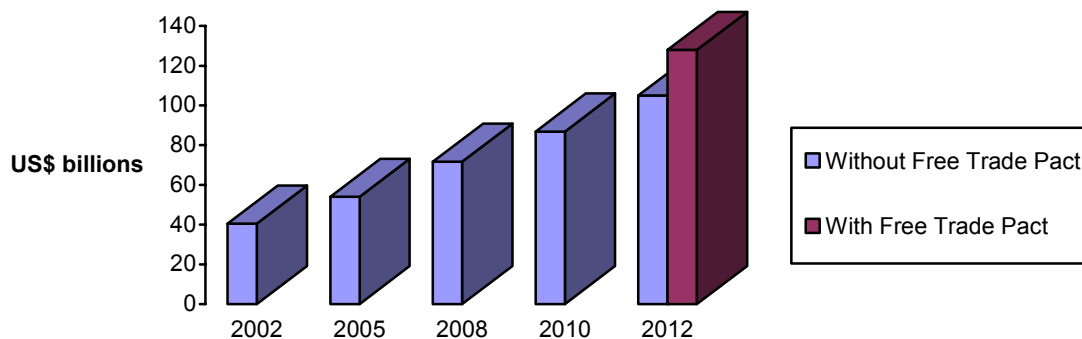
Preceding the Sino-ASEAN agreement was the ASEAN Free Trade Agreement (AFTA). Because ASEAN has its own plan of forming a regional free trade area, the proposed Sino-ASEAN agreement, from the point of view of ASEAN, must lag behind the AFTA timetable. AFTA agreements got underway when Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand brought tariff rates of many SE Asian products down to 0-5% in January this year. The other four member states (Cambodia, Laos, Myanmar and Vietnam) will begin to do so by 2006 which will then be followed by the removal of all tariff barriers for member states by 2010 by the initial six states.

What is worth noting is that although the Chinese have publicly stated a desire to implement the Sino-ASEAN agreement by 2006-8, the ASEAN states cannot envisage the free trade zone with China being in operation until at least 2010 given their AFTA priorities. At least, this will be the case unless China offers massive concessions to ASEAN.

It is also important to understand why ASEAN and China chose an exclusive agreement rather than proposed joint agreements with ASEAN and China, Japan and South Korea. Trade volume between China and ASEAN in 2001 was around US\$46 billion in 2001 compared with US\$86.3 billion between China and Japan. On the figures alone, neither China nor ASEAN are dominant trading partners of each other. Moreover, our analysis suggests that Chinese trade with ASEAN over the past 10 years has grown at about the same rate as China's GDP: the point being that ASEAN has not become proportionally more important to China than other trading partners.

This is also backed by a look at the proposed benefits to China from the free trade agreement.

Trade between China and ASEAN



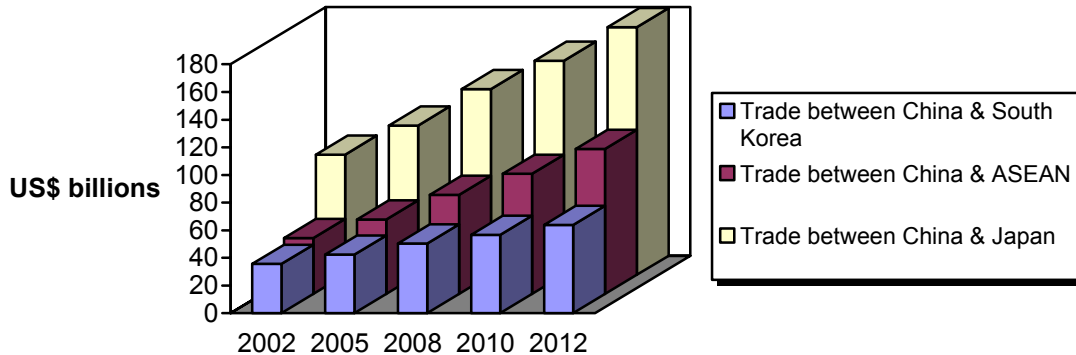
Source: Oxford Analytica; L21 Analysis

Assuming the free trade zone begins in 2012 which is the most likely scenario presently, the increases in trade as a result of the free trade pact is estimated at about US\$ 23 billion. This represents an increase of about 20% on the current projections.

This might seem like a significant increase but when we look at the importance of trade relations with individual countries like Japan and South Korea, clearly the benefits of the so-called ASEAN+3 agreement (ASEAN +China, Japan, Korea) would have exceeded the ASEAN+1 agreement (Sino-ASEAN agreement).

For example, the expected US\$23 billion increase in trade as a result of the China-ASEAN pact is only a little over 10% of the projected trade level with its main individual trading partner, Japan. This is also curious given Korea and Japan's proximity to China as well as the fact that Japan has been ASEAN's traditional partner in the Far East region.

Projected Trade between China & Selected Partners

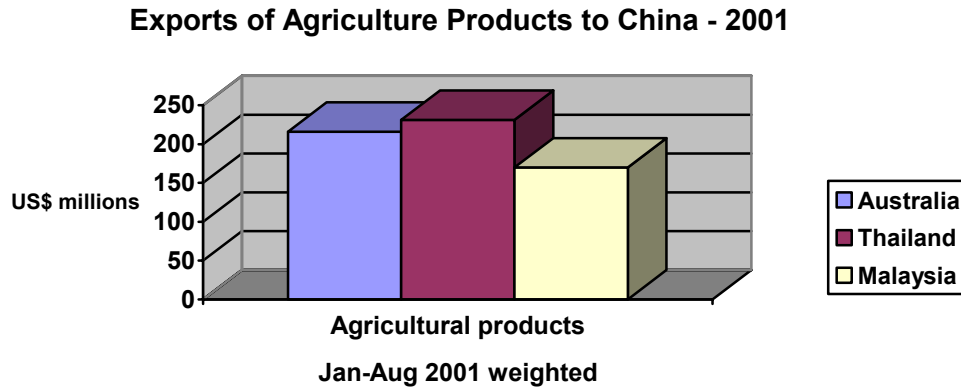


Source: Oxford Analytica; L21 Analysis

China's rationale in not pursuing a free trade agreement with Japan is generally accepted to be its perception of itself as Japan's competitor in the region. The very different cultural and political systems of China and South Korea also make cooperation difficult.

Implications for Australia

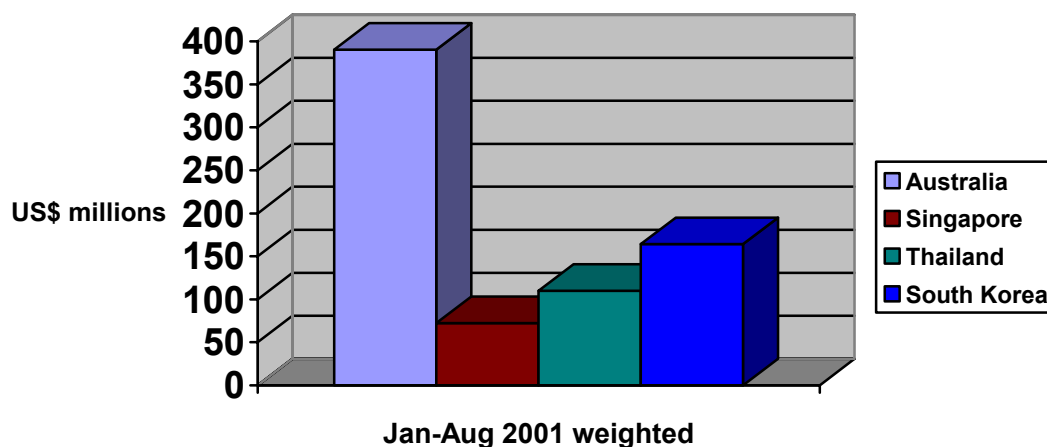
China and the ASEAN countries singled out amongst other things agriculture as one of the priorities for economic cooperation. As the chart below shows, Australian companies in this industry will face difficulties given the free trade advantages for our major ASEAN competitors.



Source: General Administration of Customs, China

What is also worth noting is that little has yet been said about the other main industries that make up Australia's exports to China. For example, we also face competition from ASEAN countries in one of our most important industries – base metals.

Export of Base Metals & Products to China



Source: General Administration of Customs, China

The point is that the significance of the Sino-ASEAN free trade pact must be examined industry by industry – what is important in this context is not the mere existence of a free trade pact but the goods and services that come under it.

Moreover, if Australia retains a competitive advantage in certain goods and services that are important to our trading partners, it is unlikely that Australia will be frozen out of an export market notwithstanding any exclusionary free trade agreements given the flexibility of free trade agreements.

The dramatic announcement of the general agreement is therefore less important than the negotiators who hammer out the details over the next decade.

Regardless of the individual agreements that might be concluded over the next few years between China and ASEAN, the political implications of the Sino-ASEAN free trade pact are perhaps much more important for Australia.

Japan and to a lesser extent South Korea has in the past argued for a general free trade region encompassing ASEAN countries, Japan, South Korea, China, Australia and New Zealand. The inclusion of Australia and New Zealand has been opposed by Indonesia and Malaysia – the two influential members of ASEAN.

The fact that China has now turned towards ASEAN rather than Japan leads to two important points.

First, China is gradually issuing a challenge to Japan as the dominant player in Asia. If China does indeed become the dominant economy, then on current political trends, things become alarming for Australian businesses.

This is the case because an 'Asian' trading zone led by ASEAN (which does not generally consider Australia part of Asia) and China (which is publicly uncommitted to the issue of whether Australia should be included or not) means that Australia is left without a powerful economic supporter in the region (i.e., Japan). On this analysis, the key to much of Australia's economic role in the region depends on Malaysia, ASEAN's emerging leader following Indonesia's meltdown – not a comforting thought for our politicians.

Second, the implications of the Sino-ASEAN agreement for Australia will hinge largely on changes in China and Japan's economic power, changes in Malaysia and Indonesia's political stance towards Australia, and resulting political strategies over the next decade.

If Japan remains as the economic leader, then on current policies, Australia is much more likely to benefit from any agreements in the region. If China emerges as the leader, then China will naturally be keen to remain the leader by increasingly isolating Japan (i.e., making the Sino-ASEAN free trade agreement comprehensive). In this scenario, Australia will then run the greatest risk of being frozen out of any mutually beneficial agreements.

It is an early stage and China is still feeling its way around the international stage. Business leaders in Australia would do well to watch closely the manoeuvres of China's, ASEAN's and our own political leaders.