THE CHINA-ASEAN FREE TRADE AREA:
A MALAYSIAN PERSPECTIVE

Shankaran Nambiar

Shankaran Nambiar is a Research Fellow at the Malaysian Institute of Economic Research (MIER). He is attached to the Policy Studies Division. His research interests are in institutional economics and development economics. He has published a number of journal articles and book chapters on the development of technology policy in Malaysia, technology transfer, and the political economy of the state. Some of his recent projects have been on matters relating to the World Trade Organisation as well as the impact of China's growth on the Malaysian economy. He received his BA and MA in economics from the universities of Madras and Delhi, respectively.

INTRODUCTION

China has been growing rapidly as an economic power and concomitant with this growth there has been a change in the posturing that China has adopted in the regional and international global arena. Perhaps the most significant event in recent times has been China's accession into the World Trade Organization (WTO) in 2001. This move in itself suggests that China is ready to integrate itself more completely within the global economy and intends to play a more active role in international trade. Viewed differently, the entry is clear evidence of acceptance of China's significant contribution to the global economy that is only formalised by the accession.

The China-ASEAN initiative to embark on a Free Trade Area (FTA) marks a further advance, albeit at a regional level, that is indicative of China's intentions to play a greater economic role at the regional level. Logically, there are two approaches that China can take in terms of its economic relations within the ASEAN region. One is to adopt a strategy that is unashamedly competitive. The other is to adopt a role that is based on cooperation, not on confrontation or rivalry. The China-ASEAN FTA initiative seems to indicate that China wishes to adopt the latter strategy in its relations with the region's members.

As far as Malaysia is concerned its relations with China are complex and any analysis of the China-ASEAN FTA must recognise the undercurrents that influence the relations. Nevertheless, it must be admitted that there
are many positive features that mark this relationship. Firstly, China and Malaysia share extensive common interests that arise due to historical factors, shared cultural backgrounds (keeping in mind that Malaysia has a fair share of ethnic Chinese) and, most importantly, by virtue of both countries being developing countries. Secondly, as far as political objectives are concerned, China and Malaysia, broadly speaking, have an interest in preserving peace and in remaining non-aligned. The recent issue of the threat of an attack on Iraq by the United States is one such example. Although the rhetoric that has been employed has differed, one can safely say that both countries question the wisdom of such an attack. The history of such shared political views goes back to China’s support for the Non-Aligned Movement (NAM), and Malaysia’s continued interest in maintaining the integrity of NAM as a forum for developing countries. Thirdly, within the realm of economic relations both Malaysia and China share many positive features. Both countries attach importance to economic cooperation and are equally committed to the prosperity of both nations within the context of cooperation. A prime example of this position surfaced in respect to China’s entry into the WTO, when the political leadership of both countries chose to view the event as promising more economic opportunities for both countries on the basis of developing complementarities.

Clearly, the issue of the China-ASEAN FTA must be situated within the context of several dimensions. Perhaps the most important of these would be the rapid growth of the Chinese economy. A related phenomenon would be the post-WTO entry phase of China, which has an influential voice in international economic fora, especially the WTO. Thirdly, one has to take into account the changing dynamics of nations within East Asia vis-à-vis their effect on ASEAN. In view of these considerations, the following section will examine some aspects of China’s emergence as an economic power. The third section will discuss the impact of China’s rapid development on the Malaysian economy. This will be followed by an analysis of the implications of the China-ASEAN FTA. The fourth section will deal with issues related to regional integration in East Asia, with special emphasis on the role of Japan. The fifth section will offer some concluding remarks.

CHINA’S EMERGENCE AS AN ECONOMIC POWER

Many scholars have emerged with very optimistic scenarios of China’s position in the global economic arena. These studies share the common assumptions of low production costs and productive labour resources as holding the key to China’s anticipated success. These accounts perceive a winning combination of features. In addition to cheap and disciplined labour, if there exist good management practices, sound financial institutions and instruments, superior technology, and the participation of foreign investment, then there is little to stop the country from progressing rapidly.
On the basis of such optimistic perceptions, and barring any obstacles, one can expect China’s economy to grow beyond that of even the US. It is generally held that China will become the largest economy in the world by the first half of the 21st century. Madison, for instance, is of the opinion that China would reach the same level of GDP as that of the US by 2015.\(^1\) He expects China to account for 17 per cent of the world’s GDP by that time. Although he concedes that it will still not be as wealthy as the US, he reiterates that its influence in economic and political terms would have grown to be massive.

It has been pointed out that China’s production of agricultural commodities already makes it an important global supplier.\(^2\) By 1998, China accounted for about 22 per cent of cereals and 25 per cent of the world output in rapeseed, cotton lint and meat production. It had contributed more than 33 per cent of world production in tobacco leaves and groundnuts (in shell) and 40 per cent of fisheries by that time. Neither does China lag behind in the production of industrial products. In 1997 China was producing about 16 per cent of the world’s production of crude steel, 34 per cent of world production in cement, and 29 per cent of the global coal output. More than a quarter of the world’s production of television sets came from China in the same time period.

Agarwala compares the possible emergence of China as an economic power with that of the United States.\(^4\) He notes that the emergence of the United States as the largest economy in the world did “immense good not only for its own people, but also for the world”.\(^4\) In the same manner, he believes that China’s growth will help reverse the declining trend in commodity prices. He argues that this will boost the position of the producers of primary commodities in the world. Similarly, he contends that developing countries could gain from China’s anticipated growth because China could become a source of new investment. Finally, the developed countries would find more opportunities for investment in China. They would also be able to export technologically sophisticated goods to China. The growing market in China, and the growing development of its economy, would necessitate a modern services sector. This is another area that will present many opportunities for developed economies.

The United States has a large vested interest in China’s economic growth.\(^5\) China has been a big market for US goods and services in the 1990s. The WTO conditions, which demand that China liberalise its markets, will mean that the US will have growing access to its markets. More immediately, this means that the telecommunications, distribution and financial industries in the US will benefit from China’s accession to the WTO. The automobile and agricultural commodities markets in the US will also have access to markets in China.

The flip side of the situation is that China’s industries will have more access to markets in the US as well as in other global markets. Evidence
of this already available from the growth of the electrical and electronics exports from China. China is now among the world’s top producers in televisions, washing machines, air conditioners and photocopiers. The photocopiers produced in China account for half of the global production. Similarly, China contributes to 29 per cent of the world’s output in televisions and washing machines; and 32 per cent of the global output in air conditioners. It appears that China’s automotive industry is also growing very fast. Japanese automobile manufacturers are locating their plants in China. One such example is Toyota, which is assembling 30,000 cars in Shanghai. China is scheduled to enter into a bilateral agreement with the US on the automobile industry in 2006. This would further spur the growth of the automotive industry in China.

As China moves in the direction of integration within the global economy, and propels itself towards emerging as an economic power, the immediate outcomes seem favourable. Prior to China’s accession into the WTO it was claimed that China was, in essence, a ‘closed’ economy that was only interested in promoting its own exports while maintaining elements of a protectionist policy. Even before its entry into the WTO this complaint was dismissed. The foundation for the criticism that China was a ‘closed’ economy was based on the perception that China was keen to promote its exports while maintaining its protectionist policies. The WTO conditionality will see the gradual erosion of China’s protectionism. However, even before its entry into the WTO, China’s barriers to the import of goods had been significantly declining. In addition, China had become more open to FDI than any other country in East Asia, even prior to its WTO accession; and there has been a rapid growth in the sales of US goods to China, a phenomenon that continues.

Further, China’s integration will help keep prices of many commodities low in the US, specifically of those labour-intensive goods that are produced, or can be produced, in China. It has been argued that US trade with China, and the increasing scope for bilateral trade in the years to come will be a source of growth for the US. Lardy notes that China was the most rapidly growing foreign market for the US in the 1990s. He adds that trade expansion was “an important source of the record rates of growth of output and employment in the 1990s”, and implies that in some measure the robust trade that US enjoyed with China has contributed to the growth of the US economy. If this is true for the US, then the logic of the situation can be applied to other countries. Indeed, it is possible for developing countries to also establish their niche vis-à-vis China, and to boost their bilateral trade with China. There is a lesson that Malaysia can learn from the US experience in this respect, a matter that will be taken up in the next section.

At a broader level, China’s emergence as an economic power is likely to influence its relationship with other nations aside from the US. It is useful to speculate how China’s increasing dominance will influence other
countries. Taiwan, for instance, is one of the countries that will change with China’s economic growth. Economic and trade links between China and Taiwan have been on the rise since the late 1980s. In the 1990s Taiwanese corporations were locating their operations in Mainland China to a larger extent. By that time at least 40 per cent of Taiwanese FDI was in China; and this was before China’s entry into the WTO. By 1999, China was already almost as important as an export for Taiwan as the US, since almost 25 per cent of Taiwan’s exports went to China.

It is thought that the increased bilateral trade between Taiwan and China, as well as the increased allocation of Taiwanese FDI in China, may result in a peaceful resolution of political tensions between both countries. This is based on the assumption that the mutually beneficial economic relationship and economic interdependence between both nations, will forge closer economic cooperation. This will encourage a convergence of forces that emphasise trust and cooperation. At the same time, such a situation will discourage any attempt to induce military or political instability since it will be to the detriment of both countries. It is argued that the interplay of these forces will contribute to better relations between Taiwan and China.

India provides another instance of how China’s emergence can influence another country’s perceptions and economic actions. Three pivotal issues in China are catalysing change in India. First, the relatively low cost of labour in China, and the passive trade unions. Second, the government in China is receptive to the needs of foreign investors, and is less bureaucratic than India. Third, infrastructure facilities in China are much better developed than in India, and the cost of utilities is also much lower. The favourable characteristics of labour, an investor-friendly government and bureaucracy, plus well-developed and relatively inexpensive infrastructure facilities have made China attractive to Indian businesses. The outcome of this combination of factors has led to a relocation of Indian investment out of India into China.

Some of the industries in India that have found it profitable to base their production in China include the pharmaceutical, leather, electrical, and steel industries. The Chinese government has been particularly receptive to Indian software companies. The Shanghai Pudong Software Park is reported to be keen on attracting Indian investment. Software training companies have opened centres in China, and have established partnerships with major universities in China. It is not surprising then, that although bilateral trade between the two countries was marked at US$1.8 billion in 1998, it doubled in 2001. It is expected that this figure will rise to US$10 billion by 2005.

As much as there are positive consequences that India enjoys due to China’s rise to power, the negative consequences are no less significant. The average factory wages in India are 280 per cent lower than corresponding
rates in China. Einhorn and Kripalani estimate the average factory wages to be US$87.50 per month in China against US$31.25 per month in India. Yet, the lower wage rate does not serve to attract investment, in part because of the highly unionised labour environment and rigid labour laws. Other problems abound. The supply of electricity is unstable, and India's transportation system is inefficient. The outflow of investment from India, for all these reasons, will put pressure on the Indian government to speed up its economic reforms.

The reforms that India has to undertake must include opening up special economic zones, introducing greater flexibility to the labour market, and liberalising sectors such as telecommunications and agriculture. Reforms in these areas are worthy of being encouraged, and will encourage the growth of the Indian economy. The uneasy short-term part of China's rise to economic power is the displacement it would cause in many industries in India, as well as the destabilising effect on the labour market in the near-term. The location of Indian industries in China could result in the closing down of plants in India, or in reduced opportunities for employment in India. At the very least, developments in China will rob the Indian labour force of its edge to negotiate higher wages and better terms and conditions. Trade unions will be compelled to reorient themselves to the demands of the market.

It is obvious that China is a fast growing economy that is quickly emerging as a global economic power. Optimistic accounts foresee a China that will be a player in the international arena alongside the United States. Parallel with these developments it is expected that China will impact upon other nations in the region. We have adumbrated upon the influence that China could have upon countries India and Taiwan. It logically follows that China's weight will be felt upon ASEAN, and by extension upon Malaysia. There is little doubt that China, due to its rapid growth and accession into the WTO, will have consequences for Malaysia. The China-ASEAN FTA is a special case of the multifarious developments that demand an examination from the Malaysian perspective.

IMPACT OF CHINA'S DEVELOPMENT ON MALAYSIA

Trade Pattern

The volume of gross exports from Malaysia to China has been increasing tremendously from 1990 to 2000. In 1990 gross exports to China were valued at RM1.68 billion. It almost doubled in 1993 (RM3.09 billion). In 2000, Malaysia's gross exports to China amounted to RM11.51 billion. The performance of Malaysia's gross imports from China, in absolute terms, has been equally remarkable. In 1990, gross imports were worth RM1.51 billion, and they increased in value to RM12.31 billion in 2000.
Gross imports grew by 815 per cent over the ten-year period (1990-2000), and gross exports grew by 687 per cent over the same span of time.

Gross exports to China as a percentage of total gross exports have not been substantial. This figure has been as low at 1.9 per cent in 1991 and 1992. At its best it has been 3.3 per cent in 1994. Since 1998, the figure has been about 2.7 per cent. Just as China is not a significant destination for exports, China does not stand out as a major source of imports. Gross imports as a percentage of total gross imports were 1.9 per cent in 1990. Since 1998, the figure has been about 3.3 per cent.

There has been a slow increase in imports from China, but it is still not substantial. Consequently, the trade balance between Malaysia and China has been in Malaysia’s favour in these years. The trade balance was in China’s favour in 1991, 1992, 1997 and 2000. In 1997 and 2000, gross imports exceeded gross exports, leading to a negative trade balance of RM997 million and RM804 million, respectively.

The major products exported to China between 1998 to 2000, were electrical machinery and appliances; vegetable oils and fats; office machines and data processing equipment; cork and wood, and their manufactures; telecommunications and sound equipment; natural and manufactured gas; and petroleum, petroleum products and related materials. The first four items of the afore-mentioned list have consistently been significant export products to China.

Two product categories that have been important import products from China (from 1998 to 2000) have been electrical machinery, apparatus and appliances and telecommunications and sound apparatus and equipment. Cereals and cereal preparations have gained in importance as imports since 1997. Less important product categories include vegetables and fruits, and power generating machinery and equipment.

The ranking in importance of Malaysia’s exports to China seems to closely reflect the ranking in importance of Malaysia’s total exports. Electrical machinery and parts are the most important export products to China, and they are also Malaysia’s most important exports. Office machines and automatic data processing equipment are important exports to China, as they are when total exports are considered. The same can be said for agricultural products and other resource-based products, as they figure prominently in Malaysia’s exports to China.

Manufactured goods relating to the electrical and electronics industry, and office and other machines form a large portion of Malaysia’s total imports. However, Malaysia’s imports from China, aside from electrical machinery and appliances; telecommunications equipment and office machines, includes a large portion of textiles and agricultural products.
Changing Patterns of Demand

With China's rapid growth and its entry into the WTO, the pattern of exports to and the imports from China will change. Electrical machinery and related products have been a major export category to China. This category of products does not demand high technology. Rather its technology requirements are low, and a high level of labour is employed in the production of these products. The higher competitiveness of China in the area of labour will see a movement of foreign producers in this sector to China; it may also be cheaper for Malaysia to import these commodities from China. The net effect will be a reduction in the export of electrical machinery, apparatus and appliances to China.

Malaysia has a competitive advantage in natural resource-based goods such as rubber products, cork and wood products. China, however, is better equipped in sectors that demand labour-intensive production, which is characteristic of these products. Yet, because of the easy availability of raw material relating to rubber, cork and wood products in Malaysia, it is unlikely that China would want to compete in these areas. It can therefore be expected that the export of these commodities will increase in the years to come. Another category that is likely to see a bigger increase in the years to come is vegetable oils and fats. Palm oil being cheaper than oleo chemicals or soya oil, it will continue to be preferred by China. The increased demand in palm oil form China will also give Malaysia a margin of leverage over India, which, for long, has been the most important source of demand for the product.

On the import side, we can expect that electrical machinery and appliances will continue to be a major category of imports. Since it is anticipated that with the entry into the WTO China will seek to expand its manufacturing sector, we can expect that exports of products from this sector will increase, and this will include the export of electrical machinery. The import of textile yarn, fabrics and related products will figure more prominently than in previous years. This is because subsequent to its WTO entry, China's competitiveness in textiles and clothing will be improved due to the elimination of the Multi-fibre Agreement (MFA) quota. It has been estimated that this could lead to a 64 per cent increase in the export of textiles, whereas apparel exports would increase by more than 200 per cent.

In line with simulations, which project declines in output in the Chinese agricultural sector, we can expect imports of agriculture-based products from China to decrease. It has been estimated that China's imports of rice, wheat, other grain and non-grain crops as well as grain mill and vegetable oil will decline in terms of output and employment. The percentage increase in imports is expected to far exceed the percentage increase in exports, implying that there will be a net increase in imports over exports for these products. Unfortunately, Malaysia does not have a competitive
edge in many of these products. Malaysia will, thus, not be able to take advantage of this major aspect of change in the Chinese economy.

THE CHINA-ASEAN FTA AND ITS IMPLICATIONS

China-ASEAN Relations

The seeds of China-ASEAN relations, in an informal sense, have their roots in the 24th ASEAN Ministerial Meeting in 1991, which China’s Foreign Minister Qian Qichen attended at the invitation of the Malaysian government. This was followed by China’s participation in the 25th meeting in 1992 as the guest of the ASEAN Standing Committee. In 1994 China-ASEAN relations were formalised with the exchange of letters between the Secretary-General of ASEAN and China’s Vice Premier and Foreign Minister Qian. China’s keen interest in developing its relationship with ASEAN can be gauged even at that time from the joint committees that China initiated. One committee was on scientific and technological cooperation and the other on economic and trade cooperation.

ASEAN accorded full dialogue status to China at the 29th ministerial meeting in Jakarta in 1996. China took the move seriously, and subsequently agreed to the setting up of the ASEAN-China Cooperation Fund. China contributed US$5 million to the ASEAN-China Cooperation Fund. There was consensus that the cooperative arrangement should focus on agriculture, information technology, transport links, education and human resources development. China’s keen interest in cooperating with and participating in the economic development of ASEAN saw expression in its willingness to establish an Expert Group under the ASEAN-China Joint Cooperation Committee for the purposes of studying trade and economic cooperation between ASEAN and China. A specific item on the agenda of the study was to examine the implications of China’s entry into the WTO. Another issue that was to be investigated was the possibility of engaging in free-trade relations between ASEAN and China.

There has also been cooperation on political and security issues. ASEAN has valued China’s support in forums such as NAM and the Group of 77. The ASEAN-China Senior Officials Political Consultation convened its seventh meeting in Hainan in June, 2001. The underlying political philosophy that guides relations between China and ASEAN is the objective of preventing conflict and promoting peace in the region. ASEAN and China have also been known to work towards developing a code of conduct in the South China Sea.

It is obvious that China has planned a strategy that would serve the purposes of penetrating into the region on a cooperative basis. This cooperative involvement in ASEAN is clearly one that is multi-dimensional in so far as it covers all significant aspects of the region, ranging as it does from
technology to economic cooperation to human resource development and information technology. This wide-ranging involvement in the region offers a balanced strategy on ASEAN-China economic relations. This view is based on the understanding that although China will doubtlessly be a competitor to ASEAN in its post-accession era, it will also be a cooperative partner. The competitive element posed by China, as it emerges as a larger economic giant in this part of the world, will be balanced by its intention to work with the member states of ASEAN in areas of mutual benefit. It is in the context of stressing cooperation and complementarities that one can perceive the China-ASEAN FTA. The events leading to this proposal indicate that this offer is part of a larger strategy to participate in the economic development of the region that has been conceived well in advance and towards which China has been advancing gradually.

Framework for the China-ASEAN FTA

It is necessary to bear in mind that the plan of forming an ASEAN FTA (AFTA) precedes the China-ASEAN FTA. Consequently, there arises the question of sequencing or handling the overlap between the two FTAs. Following the timetable of the AFTA the older members of the ASEAN (i.e. Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) brought the tariff rates of many of their products down to 0-5 per cent. The newer member states (i.e. Cambodia, Laos, Myanmar and Vietnam) are expected to bring down their tariff rates in 2006. Further, it is planned that the old ASEAN member states will eliminate all tariffs and remove quantitative restrictions and non-tariff barriers in 2010. The newer member states will achieve similar goals in 2015. Although it was initially suggested by Premier Zhu Rongyi at the ASEAN-China Summit in 2001 that the China-ASEAN FTA be created within eight years, further negotiations resulted in the decision to set a ten-year time frame.

The China-ASEAN FTA, under the recommendations of the ASEAN-China Expert Group on Economic Cooperation, is expected to subscribe to the following five principle areas of mutual interest:

1. trade and investment facilitation
2. trade in services
3. capacity building and technical assistance
4. promotion measures
5. institutional measures.

In the matter of trade and investment facilitation tariff rates are an important issue. It has been suggested that the ASEAN states' common effective preferential tariff (CEPT) scheme be extended to China. In
reciprocity, China has proposed that it will reduce its tariff rates on Southeast Asian products and consider preferential tariff treatment for Cambodia, Laos and Myanmar, the newer ASEAN member states. In other words, China will accept ASEAN’s CEPT scheme and provide product lists that are consistent with it. This arrangement, where China accepts the reduction of tariff rates that are in line with AFTA’s provisions, is acceptable to Malaysia. A further element of the China-ASEAN framework, which will also work to the mutual benefit of Malaysia and China, is the removal of non-tariff barriers such as licensing requirements and quantitative restrictions. The removal of tariff and non-tariff barriers will jointly facilitate a free trading environment that will enable China to take advantage of opportunities in Malaysia, and equally, encourage Malaysian firms to locate themselves in China without the restrictive influence of any form of protectionism.

Other elements in the China-ASEAN FTA framework that would be to Malaysia’s advantage would include the liberalisation of trading and distribution rights in the importation of products and the simplification of customs procedures. Aside from the simplification of customs procedures it would also be useful to arrange for a convergence in procedures. If China and Malaysia were to adopt the same customs procedures, it would facilitate trade in goods for firms in both countries. At the level of businesses, it would be of great help for the business communities in China and Malaysia, if the framework avoided double taxation agreements and eased visa arrangements that would otherwise inconvenience businessmen.

Attempts should be made within the China-ASEAN FTA framework to promote trade in services. From the Malaysian point of view the services sector has been seen as an engine of economic growth. Malaysia has much experience in sectors such as tourism, education and construction. It also has a long established tradition of exposure to legal and accounting practices that are based on international standards. Needless to say Malaysia’s expertise in transportation is well recognised. In view of this record, both countries can mutually benefit from trade in services. A step towards achieving this goal would be to establish institutions that would promote the exchange of information on opportunities that would be to the advantage of both countries. At a more general and wider level, the exchange of information should encompass standards, laws, and regulations. A higher level of transparency on these issues would facilitate trade in goods, services and also encourage cross-border investments.

The position of the newer members of ASEAN is a matter of interest to China and Malaysia. In order to integrate these countries within the regional economy it is necessary to assist them in their development. For this to be possible, capacity building and technical assistance must be extended to countries like Cambodia, Myanmar and Laos. By improving the capacity of these countries not only will their respective states of development be enhanced, but they will then also be better able to do
business with Malaysia and other ASEAN nations. This process will therefore benefit the China-ASEAN FTA, and thus also benefit the gains that China can make by trading with these countries. To strengthen the capacities of the newer member states it is necessary to extend special consideration to those states that are non-WTO members. The purpose of extending such assistance is to help prepare them for eventual entry into the WTO. It must be remembered that Malaysia played a special role in fostering Myanmar’s transition towards what can be seen as its political liberalisation. It is for this purpose that promotion measures must be accommodated within the China-ASEAN FTA framework. These measures will, of course, fall within the larger ambit of creating institutional measures that are meant to improve cooperation within ASEAN and to strengthen linkages with China. In particular, the mechanics of cooperation between ASEAN member states and with China must be improved. For this to be done appropriate institutions have to be developed to promote intra-ASEAN trade and intra-ASEAN cooperation as well as to facilitate trade and cooperation between the ASEAN and China. Malaysia can play an active role in facilitating intra-ASEAN economic bonding and this will act as an appropriate foundation for linkages with China.

A feature of the suggested framework that deserves special mention is the so-called “early harvest.” The early harvest refers to the liberalisation of tariffs for priority sectors that would create immediate benefits to ASEAN and China. As part of the early harvest package, it has been suggested that measures be introduced to enhance market access opportunities for specific products or services of interest to ASEAN and China. Several sectors have been earmarked within this scheme; and they include:

1. agricultural and tropical products,
2. textiles and clothing,
3. machinery and electronic products,
4. footwear,
5. oils and fats,
6. foodstuff,
7. forestry and aquaculture products, and
8. energy.

It has been added that the list of products and services will be determined through the process of mutual agreement.

There are several products that will be of special interest to Malaysia. Within the agriculture sector, it is perhaps palm oil that comes to mind immediately as being of interest to Malaysia. Although there are reports
that China is concerned that the influx of crude palm oil is likely to have a dampening effect on its edible oil market, from Malaysia’s perspective the reaction is quite the opposite. As it stands China is Malaysia’s number one export destination for palm oil. Any market access measures easing the inflow of palm oil into China will be welcome for Malaysia. Other products that will open opportunities for Malaysian businesses would be those relating to office equipment, electronic products and forestry products. Malaysia will stand to gain if the markets in China are liberalised for the entry of Malaysian produce in these products. As such, if the early harvest includes the specified products, they will generate favourable outcomes for Malaysian companies.

**Implications for Malaysia**

It was not as if the idea of the China-ASEAN FTA was accepted readily and without question by Malaysia. At the Eight Summit of ASEAN when Premier Zhu proposed the notion of the China-ASEAN FTA, some of the leaders of ASEAN voiced their reservations. The Malaysian Prime Minister Mahathir Mohamad pointed out that due cognisance had to be made of the varying stages of development. He emphasised the need for greater flexibility and stressed that it was essential to afford a degree of protectionism for products and sectors that were not yet competitive. Mahathir also alerted the Summit to the threat of relocation of industries from Malaysia to China due to the lower costs of labour and production in China. He also added that the offer of a huge market was a pull factor that instigated the relocation of industries.

Objections were raised by Singapore’s Goh Chok Tong and President Arroyo, too. However, Premier Goh Chok Tong expressed reservations, but did not fail to add his thoughts on the appropriateness of the FTA. He mentioned that a viable and robust ASEAN had to be the precursor to the China-ASEAN FTA. Premier Goh argued that to devote attention to the China-ASEAN FTA before a cohesive ASEAN was realised would run the risk of having ASEAN overwhelmed by China. China and ASEAN would, then, not be able to negotiate as equal partners. Goh’s objection to the notion of the China-ASEAN FTA was blunted because he expressed the opinion that the FTA would benefit ASEAN more than it would China. He made the claim that ASEAN would eventually be able to match China’s competitiveness and that the FTA would offer an opportunity for foreign investors to spread their investments in ASEAN instead of locating them exclusively in China.

Premier Zhu capitalised on Goh’s line of argument and added that presently the balance of trade is in ASEAN’s favour. He pointed out that in 2002 ASEAN enjoyed a trade surplus of US$12 billion over China. This is in contrast to the trade surpluses that China had over its trade partners in the developed world, particularly the US and Europe. Zhu marshalled
another point to support his argument by drawing attention to the fact that the US attracts about US$250 billion in FDI per year. He claimed that the China-ASEAN FTA would be able to divert some of this FDI. Perhaps he clinched his proposal by acknowledging that he would be sensitive to the reservations raised by the Philippines and Malaysia. This gained the support of many ASEAN member states. Malaysia was, indeed, conscious of the implications of the China-ASEAN FTA and the manner in which it could negatively impact upon Malaysia; but China scored in its efforts at lobbying for support. It also reacted sympathetically to the reservations that were expressed, and by doing so gained the support it needed.

One reason for worry arises from the argument that the China-ASEAN FTA would result in foreign direct investment (FDI) shifting from Malaysia to China. The same argument was brought out by scholars who thought that China’s accession into the WTO would have the same effect. In response to this line of thinking it must be mentioned that this argument is posited on two assumptions. Firstly, it is thought that China’s low labour costs will act as an attractor. Secondly, entry into the WTO is believed to provide market access for China’s products in the United States. Both assumptions are mistaken in so far as low labour costs are only a part of the story behind production. In addition to labour, technology and the effects of path-dependence are important factors to the production process. Indeed, for industries that solely depend on low labour costs, China is likely to be a more attractive location. But in industries where the level of technology matters, and where a host of support industries and subcontracting activities have grown, relocation is not a rational decision. Thus, for those companies in the electrical and electronics industry in Malaysia that have a high level of technology and which have the support of local subcontracting activities, there is no incentive to relocate investment to China.

Much the same arguments can be used to defend the thesis that the China-ASEAN FTA will not, by itself, lead to the relocation of investment to China. In fact, the China-ASEAN FTA will probably encourage location of investment in Malaysia since the FTA will create an economic region with a population of 1.7 billion people. The combined GDP will amount to about US$2 billion and trade will amount to about US$1.2 billion. With such a huge market available in ASEAN, the FTA will encourage foreign investors to diversify their portfolio of investments. Rather than investing exclusively in China, foreign investors will attempt to reduce their risks and to locate their production closer to the ASEAN region by producing in Malaysia. The integration of the region with China and the liberalisation of the removal of tariff and non-tariff barriers within this FTA will attract investment. Of course, this will imply that those industries in which Malaysia has a comparative advantage over China will benefit.

Not only will foreign FDIs be encouraged to locate in Malaysia, but companies from China will also find it to their advantage to be based here.
There are several reasons why this is conceivable. First, China will want to take advantage of the industries in which Malaysia has a higher comparative advantage. As mentioned earlier, this includes timber, tropical commodities, tropical foods, fish, mineral resources, palm oil, and oil and gas. In addition, the financial services sector is also likely to benefit. This includes stockbroking, banking and insurance. Second, China will want to maintain an economic presence in this region for the production of those goods where the cost of labour is not a significant proportion of total production costs. This will be because it wants to take advantage of proximity to resources; to gain from the transfer of technology; and to benefit (or learn) from Malaysia in those areas where it has not developed its institutional capabilities. Third, China will want to set up joint ventures with Malaysian companies so as to penetrate the Malaysian market.

The China-ASEAN FTA will also have a positive influence on Malaysia’s negotiating position in the WTO. Malaysia and China are in broad agreement with WTO’s main objectives. The principle that an open economy promotes trade and investment is acceptable to Malaysia and China. Both countries accept that barriers to trade (whether they be in tariff or non-tariff form) are detrimental to encouraging trade. While they are concurrence on the goals and objectives of the WTO, both countries differ from the developed countries on the modalities and time frame that must be set for various issues. Both countries, again, feel that the stage of development of developing countries must be taken into account in negotiations. As such, Malaysia can expect to receive China’s support on a variety of issues.

Although Malaysia and China are in agreement on many issues at international fora, it would be realistic to expect Malaysia to be cautious about China’s political agenda within the region. Unlike Japan, China has political ambitions. It is a military power and has nuclear capabilities. Japan’s interest in the region was purely commercial and economic. China, on the other hand, has taken a tough position against the US on many matters. This, in itself, is not cause for concern. What is more reason for concern is the possibility that China may see itself as a countervailing power against the US in the years to come. Of course, this raises the question of how the US will manage such a scenario. Within the matrix of such a development in geopolitics, it is likely that Malaysia may be caught within the web of China’s domination. However, this is a scenario that will not actualise itself in the near future.

**REGIONAL INTEGRATION IN EAST ASIA**

As it stands the China-ASEAN FTA holds to possibility of disadvantaging the other major players in the East Asian region. The China-ASEAN FTA does not actively engage Japan, Taiwan and Korea. Taiwan poses a special problem because any initiative that is forwarded by China will exclude Taiwan from its calculus. Taiwan is presently an active economic
participant in the economic activity of ASEAN. The trade volume between Taiwan and the major member states of ASEAN (i.e. Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam) reached close to US$38 billion. Investment from Taiwan to the same states in 2000 totalled close to US$1.3 billion. It is hard to see how Taiwan can function within any FTA where China is a partner. It appears that Taiwan will have to initiate FTAs on its own accord.

Japan has, historically, had a great interest in the region. There have been suggestions that the China-ASEAN FTA be modelled after Japan’s agreement with Singapore. However, China’s FTA with the region cannot be on the same model as Japan’s FTA with Singapore. Singapore does not have any agricultural produce and it is at a different stage of development than Malaysia. The natural resources that Malaysia has at its disposal are not available to Singapore. Neither does Singapore have much access to land. Given these differences one cannot expect the Japan-Singapore FTA to be a model for the China-ASEAN FTA. Nevertheless, the initiative for the FTA shows Japan’s continued interest in the region.

In order to pursue its continued interests in the region, and as a counter-offer, the Japanese Prime Minister Junichiro Koizumi visited the Philippines, Malaysia, Thailand, Indonesia and Singapore. Koizumi’s offer was to devise a broader free trade zone that would cover ASEAN-10, Japan, China, Korea, Australia and New Zealand. He further waived the requirement for any time frame for concluding the proposed FTA. Koizumi’s strategy was to devise an FTA that would supersede that of China’s by being wider in scope than China’s and which would offer market access opportunities that were of a wider range and deeper. The reservation to this proposal from Malaysia arises mainly due to the inclusion of New Zealand and Australia as members. The other point of difference arises from the Japan-Singapore FTA, which, it is feared will dilute the AFTA arrangement.

There is a clear need for Japan to take a more aggressive approach in providing the leadership for economic integration. This is necessary for two reasons. Japan’s failure to do so will result in Japan losing its leadership over the region. This will hamper Japan’s development in the long run. Second, Japan’s failure to take the lead will result in China’s sole dominance over the region. Third, if Japan were to take a more active role in the regional integration of the region, ASEAN will be able to gain from a wider array of opportunities. There are gains both to Japan and ASEAN if Japan were to take a more aggressive role in providing the necessary leadership for the integration of the region.

Koizumi should pursue the package that he is in the process of devising. He will have to effectively lobby and counter the reservations expressed by Malaysia. Also, it is necessary to devise an arrangement that will suit the conditions that obtain in ASEAN and that can be seen to bring gains to the region, as well as to individual nations. Agriculture and natural
resources will have to figure prominently in any proposal that Japan seeks to bring forth since most of the ASEAN member states have economies that are highly dependent on agriculture and natural resources. Japan will also have to devise an arrangement that can give greater opportunities for the export of services and manufactured goods. China is able to offer this possibility as bait. Japan has to suggest an equally attractive reply for the region.

The Japan-ASEAN Comprehensive Economic Partnership (JACEP) is a meaningful step towards strengthening economic partnership between Japan and ASEAN. Koizumi proposed the initiative for JACEP in January 2002 in recognition of the progress that was made in various parts of the world in the area of regional economic integration, particularly in Europe and in North America. It was understood that a comprehensive economic partnership between Japan and ASEAN would provide greater market opportunities to both economies through the creation of a larger market. Such a partnership would cover a broad range of areas including liberalisation of trade and investment, facilitation measures, as well as cooperation in other areas, such as financial services, information and communications technology, science and technology, transport, energy and small and medium enterprises.

CONCLUSION

China’s rapid development has had an impact on trade with Malaysia. The volume of trade between Malaysia and China has been increasing rapidly. As a consequence of its own development and also because of its greater participation in global markets, which may have been induced by its entry into the WTO, it can be expected that China will be a destination for the growth in particular kinds of industries. Vis-à-vis the developments in China, industries in Malaysia are going to be affected. Broadly, the industries that will gain from China’s growth will include timber, tropical commodities and foods, fish, mineral resources, palm oil and oil and gas. The industries in Malaysia that are likely to suffer as a consequence of competition from China would include the electrical sector, garments and textiles, footwear, and toys.

In view of the impact from China, it would serve Malaysia to take advantage of the China-ASEAN FTA. The FTA is poised to bring benefits to Malaysia. It is likely to increase trade and to encourage investment in Malaysia. However, one must add a cautionary statement, as China will definitely affect labour-intensive industries in Malaysia. These industries will not be able to withstand competition from China on the basis of the cost of labour. Nevertheless, those industries that can work on a complimentary basis in view of developments in China and those industries
that have the advantage of high technology will gain from the proposed FTA. So too will agriculture-based industries and those that employ natural resources such as palm oil, timber, cork, wood, and, oil and gas.

It would be to Malaysia’s advantage, as it would be to ASEAN’s, if Japan would take the initiative to promote regional integration. Japan has to provide the leadership to be able to create an arrangement that will offer a wider range of opportunities to ASEAN, and for Malaysia, in particular. In this effort, Japan has to appeal to the requirements and aspirations of ASEAN countries.

NOTES


3 Ibid

4 Ibid., p.19


8 Ibid., p.4


12 Ibid.


REFERENCES


