

Chapter 3

The Dynamics of ASEAN–China Economic Relations

Ratna Shofi Inayati

Abstract ASEAN and China made a breakthrough step by establishing a free trade area called ASEAN–China Free Trade Agreement (ACFTA). Despite optimism that the FTA will be fruitful in the long term, it turned out that some industrial products have been negatively impacted in the short term. There are also some concerns that the ACFTA may slow down the process of ASEAN Free Trade Agreement (AFTA). All these facts raised questions on whether China’s motivation is towards economic domination or integration. This concern became more apparent when China, on the one hand, demonstrated a clear strategic goal, while ASEAN, on the other hand, did not yet have a clear picture on how to situate itself against the rising China. This chapter focuses on the dynamics of ASEAN–China relations in economy, especially in the context of ACFTA. Although ACFTA scheme contains the word ASEAN, bilateral agreements are given more emphasis in its relations-building efforts, such as agreements between China and Indonesia, China and Malaysia, China and Singapore and so forth. Furthermore, although the ACFTA is an inter-regional phenomenon, this is still an FTA whose characteristics are like other regionalism and the analysis, therefore, should use a regional approach. Whether or not the impacts of the ACFTA are well-anticipated is another question and, therefore, it is interesting to answer, especially in the context of Indonesia which tends to have comparative advantages.

Keywords ASEAN–China economic relations · Free trade agreement · ACFTA

1 Introduction

ASEAN and China made a breakthrough step by establishing a free trade area called ASEAN–China Free Trade Agreement (ACFTA). Despite optimism that this FTA will be fruitful in the long term, it turned out that some industrial products such as textiles, toys and motorcycles have been negatively impacted in the short term. Although China is a relatively new member of the World Trade Organization (WTO),

R. S. Inayati (✉)

Center for Political Studies, Indonesian Institute of Sciences (P2P-LIPI), Jakarta, Indonesia
e-mail: inayati.rs@gmail.com

it already became a dominant player in global market. As the quota system was annulled in January 2005, China's textile and garment products were flooding the world market. The Indonesian market was no exception. Chinese products, which are much cheaper, soon overwhelmed the Indonesian market. Indonesian textile industry, which was not yet recovered from the devastative economic crisis in 1997, now had to deal with the onslaught of Chinese products.

There are also some concerns that the ACFTA may slow down the process of ASEAN Free Trade Agreement (AFTA). There was fear that the free trade agreement offered by China could possibly disrupt the AFTA's core business. All these facts raised questions on whether China's motivation is towards economic domination or integration. To let China's really attractive economy distract, the process of AFTA means to render ASEAN with obstacles in achieving its economic integration. This concern became more apparent when China, on the one hand, demonstrated a clear strategic goal, while ASEAN, on the other hand, did not yet have a clear picture on how to situate itself against the rising China.

Although ACFTA scheme contains the word ASEAN, bilateral agreements are given more emphasis in its relations-building efforts, such as agreements between China and Indonesia, China and Malaysia, China and Singapore and so forth. This chapter focuses on the dynamics of ASEAN-China relations in economy. Furthermore, although the ACFTA is an inter-regional phenomenon (namely China and ASEAN are situated in different geographical areas), this is still an FTA whose characteristics are like other regionalism and the analysis, therefore, should use a regional approach. Whether or not the impacts of the ACFTA are well-anticipated is another question and, therefore, it is interesting to answer, especially in the context of Indonesia which tends to have comparative advantages. In the context of ACFTA, investment into and out of the country provides promises and detriment which are the two sides of the same coin. Indonesia with all its potentials is challenged to survive and strengthen its position in the world trade and investment. However, there are still pros and cons among Indonesian societies on whether investment laws in Indonesia are mature enough and capable of facing this ACFTA's version of free trade era.

2 Preparedness Towards Facing Free Trade Era

Developed countries failed to explore new sources of growth in the near future; however, China emerged as a new locomotive of the world economy.¹ For both parties, ACFTA is an important vehicle to strengthen their economic ties in order to accelerate the flows of their trade, investment, and goods and services. Nonetheless, while China is well-prepared towards liberalization, particularly in agriculture, ASEAN still needs to synchronize and coordinate their steps towards the ACFTA.

From 1993 to 2003, trading activities between ASEAN and China reached an average growth rate of 20.8%. Similarly, mutual investments between the two par-

¹ISEAS (2004, p. 26).

ties were also increasing. From 1991 to 2000, ASEAN investments in China grew at a yearly average rate of 28% and in 2001 reached 6.6% out of the total foreign investment in China. On the other hand, Chinese investments in ASEAN increased sharply, although still relatively small, in 2001, i.e. 7.7% out of the whole investments outside China.² It has been estimated that the ACFTA would increase ASEAN exports to China and vice versa, i.e. 48 and 55%, respectively.³ Although this model of estimation does not expose both export prices to the world market, there is a belief that the ACFTA would also accelerate ASEAN and China's exports to the world market. Economists are optimistic that with the support from the Chinese Government and the ACFTA, Chinese companies' investments in ASEAN will also increase. Some Chinese companies may prefer to establish Research and Development (R&D) centres in some ASEAN countries with advanced technology and some others to invest in natural resource development projects in ASEAN countries with abundant natural resources.

With its investment-driven economic growth and domestic consumption strength, a major challenge that Chinese economy should tackle in the future will be an urgent need to build institutions that are practical, transparent, effective and capable of establishing and implementing rules necessary for a well-functioning market economy. On the other hand, China's increasingly appealing economy would seemingly degenerate ASEAN position. Therefore, despite optimism described above, there is also an opinion that it is too early to ensure substantial achievements out of the free trade agreements. It is not always true to say that ASEAN countries accepted wholeheartedly Chinese approaches and offers to further improve cooperation, regardless of approvals at the leadership level. China's economic initiatives cannot ignore the fact that China and almost all ASEAN countries are, in fact, competing to each other in the world export markets.

Furthermore, ASEAN knows well its rivalry with China in attracting foreign investments. The problem is that there is a widespread belief that many investors turned from ASEAN to China. Although reports on declining foreign investments in ASEAN are somewhat exaggerated, the flows of foreign investments into China have been perceived to have negative impacts on the nearby areas in Southeast Asia. This negative perception stimulated a sense of threats in nearly all Southeast Asia's regions. Even though it is believed that ACFTA will scale up trading, a huge range of free trade areas could be costly in regard to rules of origin of goods, supervision and procedural administration. Furthermore, it could possibly create complexity when some members of ASEAN are engaged with China in a number of separate and overlapping free trade agreements. Thus, commitments to improve cooperation should, in fact, come along with awareness of challenges that may arise from the establishment of a free trade area between ASEAN and China. Given that the two share a similar industrial structure, each domestic market will be more competitive as well. The removal of trade barriers, which is the creative mechanism of a free trade area, also resulted in a loss of tariff revenues and endangered domestic industries.

²Ibid., p. 27.

³ASEAN–China Expert Group on Economic Cooperation (2001, p. 31).

3 ASEAN's Strategic Positioning Towards China

Relations between ASEAN and China have been well-established since the 1990s or since China's recognition of ASEAN as an economically promising community. Although their relations were built merely upon bilateral agreements between China and ASEAN's individual countries, China has successfully laid a strong foundation for its economic activities. China was quite often invited to attend or to be a consultant in ASEAN's economic activities. This strategy helped China's existence of being an active participant in the development of ASEAN's international trade. Because of its trading experience in Southeast Asia as well as ASEAN's warm welcome, it is reasonable if China encouraged a free trade with ASEAN countries for easier investments.⁴

Stirred by determination to strengthen its economy, China showed a greater interest in building closer relations with ASEAN. China's gross domestic product (GDP) in 2000 was US\$1.08 trillion, far less from Japan's and the USA, which were US\$4.14 billion (2001) and US\$8.35 billion (1999), respectively. However, China was passionately targeting to match Japan's GDP within the next 20 years, i.e. US\$5 billion. China's GDP growth of 8–9% per year showed its persistence and determination in achieving the desired GDP target. To make its target come true, China made various policies and took any necessary measures to anticipate both internal and external factors, one of which was to maintain good relations with other countries. As Tan Weiwen pointed out,⁵

China's foreign policy is built upon five principles of a peaceful coexistence as contained in the Asia Africa Conference in 1955. China's international diplomatic relations always belong to this principle. Actually, China and Indonesia share a common principle of foreign relations, which is free and active, and peace-oriented.

China became a partner of the ARF in 1994 and a dialogue partner of ASEAN since 1996. In 2001, China put forward a proposal on the establishment of a free trade area between China and ASEAN under an ASEAN–China Free Trade Agreement (ACFTA), which was targeted to be realized in 2010. The ACFTA agreement was jointly signed at the ASEAN Summit in Vientiane, Laos, in 2001.

During the whole process of the agreement, from the drafting to the signing process, it seemed that China was more enthusiastic and hoping for benefits from the ASEAN–China agreement. This implies that ASEAN is more strategic for China and not vice versa. In fact, China was the first country outside ASEAN that signed the Treaty of Amity and Cooperation (TAC) in 2003, after which Japan and South Korea then followed. This impression was confirmed by China's decision to soften its stance on the matter of the South China Sea by signing the Declaration on the Conduct (DoC) of Parties in the South China Sea in Cambodia in 2002.⁶ Previously,

⁴Forging Closer ASEAN–China Economic Relations in the twenty-first century, a report submitted by the ASEAN–China Expert Group on Economic Cooperation, October 2001, pp. 5–7.

⁵Interviews with Tan Weiwen, Counsellor for Trade and Commerce, The Embassy of the People's Republic of China, Jakarta, 2006.

⁶Yong (2005, p. 21).

China took a firm, rigid stand when dealing with other countries on the matter of the South China Sea in order to avoid a direct conflict with the USA.

On the other hand, an internal factor was that Chinese leaders successfully transformed its modalities into opportunities by encouraging the country's elites and communities to be productive and stick to international standards in their ways of doing things. Therefore, China hosted a various number of international events, such as the Asian Games in 2003, the Olympic Games in 2008 and the World's Fair in 2010. Chinese people are hard-workers, making this country of one billion people look like a giant factory where everyone is industriously and diligently producing goods. China is now the world's most productive country as shown in the world market. Besides, Chinese products are attractively designed and priced goods and, therefore, they can compete with other countries' products. Chinese products are flooding all the countries around the world, including Indonesia. Lower priced Chinese products, such as motorbikes, air conditioners, textiles, are challenging their competitors in every corner of the Indonesian market. The invasion of Chinese goods is adversely threatening local business.

However, there is no doubt that China's current demand for supplies of energy and raw materials will not end in the near future due to its huge production. It is obvious that China needs more markets for selling their products as well as getting more supplies of energy and raw materials. This is why ASEAN is a strategic partner that can accommodate China's interests.

China's rapid development is valuable to ASEAN as it demands for supplies of raw materials and energy from ASEAN countries. Similarly, China is also a potential market for the products of ASEAN. However, ASEAN's real demands for supporting economic integration and free trade are seemingly not as evident and powerful as China's. ASEAN countries take advantage from being the suppliers of raw materials and energy, while China being the producers of manufactured goods.

China's rapid growth attracted much attention of many countries whose analysts (especially in East Asia and Southeast Asia) are constantly studying the long-term impacts of the new rising power. Business communities are also making proper adjustments with this change in the hope of benefiting from the establishment of the ASEAN–China FTA. Despite its predicted negative impacts, the main focus nowadays is on great opportunities brought about by the China's economic growth. Anyhow, China's rising economic power is undeniable phenomenon. Together, China and ASEAN expect to mutually benefit from their relations.⁷

4 ASEAN Welcoming Partnership with China

There were China's economic conditions that, in general, attracted ASEAN's interests to accept China's proposal on FTA. Firstly, with an area twice bigger than ASEAN and a population of 1.3 billion, China was a potential market for ASEAN. China's

⁷Ibid, p. 277.

stronger purchasing power and freer market provided good opportunities for ASEAN exports to get rid of difficulties that it has been facing due to the low level of intra-ASEAN trades. Secondly, ASEAN economy is more complementary to Chinese economy rather than with inter-ASEAN one. In fact, China's industrial system is almost perfect. China's participation in the global economic community will enable ASEAN to play a part in the Chinese supply chain. In return, the China's rising economy demanded for more energy and minerals that ASEAN countries, which are rich in both, can fulfil. Thirdly, ASEAN could benefit from the China's rising economy in which its domestic market performance is matching its export growth. China is now an increasingly significant trading partner for Asian countries. For instance, China replaced the USA to become Japan's major trading partner. China's growing economic power was expected to stimulate ASEAN's economic awakening, in the same way as Japan's economic growth did a few years ago.

"The Plus Three Countries" (Japan, South Korea and China) have indeed studied the possibility of having a FTA with ASEAN. Since China was considered well-prepared than the other two, ASEAN decided immediately to go with China. There are two reasons why ASEAN left Japan and South Korea. Firstly, Japan was indeed qualified enough to tighten its economic ties with ASEAN. Although the Japanese economy was in an unfavourable situation in the last ten years, Japan's gross domestic product (GDP) still ranked the second highest in the world and some of its industries were still leading in the global market. The 1997 economic crisis, nevertheless, slumped Japan's economic conditions resulted in withdrawal of its investments in some Asian countries and also devaluation of its currency in order to overcome the dilemma in its domestic economy. In such a situation, Japan was gradually losing its leadership in leading and boosting Asian economies. People became more realized that Japan is no longer capable of bearing a big responsibility to integrate Asian economies. Secondly, it is true that when the financial crisis hit, South Korea was recovered faster than any other countries. South Korea was also gradually overcoming the problems related to its economic structure, banking system and corruption. However, this is still not enough for South Korea to be able to lead the integration of Asian economy due to its relatively small economic scale.

In addition to economically motivated considerations above, changing policies among the Southeast Asian countries towards China were also driven by political factors. They were: (1) China's engagement was of importance in coping with possible intraregional conflicts; (2) balance of power was necessary to counterbalance two current dominant powers in the region, i.e. the USA and Japan; and (3) stronger voting rights were needed in international forums, especially when ASEAN and China share a common view.

In the context of the ACFTA, one important question to address is whether or not complementarities will outperform competitions between them. The free trade area was created to make the best use of the existing complementarities. While it takes a long time to come with any definite answers on the question, for the time being, at least we can see that trades between ASEAN and China are leading to an indication of the significance of FTA. Trades between ASEAN and China are growing rapidly nowadays, even though they are not as big and important as those between

ASEAN and the USA or Japan. The 1997 economic crisis did not even dampen the trades between the two.⁸ As Chinese diplomacy was successfully building a good relationship with Southeast Asia, ASEAN countries became more welcome with the presence of China. Moreover, China was able to quickly survive in the global arena despite its more challenging atmosphere.

Following the declaration of ACFTA as an integral part of the ASEAN–China economic relations in the future, the next question is to what extent this initiative is beneficial. How ASEAN will cope with China’s economic dominance as well as the fact that China’s population rate, GDP and trade are higher? The FTA will be the world’s largest free trade area in terms of the total population and differently developing countries that are involved. In principle, FTA implies that the removal of tariff barriers would increase the trades because of lower costs and greater economic efficacy.

5 A Mutually Beneficial Relationship

As the financial crisis hit Asia in 1997, ASEAN countries were striving to recover from the crisis by restoring their domestic economies and strengthening their regional economic integration. However, ASEAN economic integration was hard to achieve alone from within considering the burdensome impacts that each country should bear from the crisis; therefore, a leverage from outside was necessary. In addition, ASEAN is still struggling with its own various limitations, such as its growth rate which is lower than that of NAFTA (North America Free Trade Arrangement) and the European Union. In 2000, ASEAN’s GDP was US\$581.58 billion, while NAFTA and the European Union were US\$11,059.93 billion and US\$7,894.52 billion, respectively.⁹ Singapore, the leading economy in ASEAN, was not able to leverage the economic growth of ASEAN as a whole. It is not to mention also intra-ASEAN’s small markets and low trades. For comparison, in 2000, intra-ASEAN trade rate reached only 24.1%, lower than NAFTA’s and the EU’s which touched the levels of 47 and 60.4%, respectively.¹⁰ Another disadvantaged factor was low complementarities in the ASEAN’s economic profile. Lack of industrial diversification among the ASEAN countries made it hard to benefit from regional economic complementarities. Internally, similar economic structures and resources disabled ASEAN countries to develop mutually profitable trades and investments. For example, the fact that ASEAN countries have common dependence on agricultural sector discouraged demands for agricultural products among them. Rather, they have to compete with each other in seizing foreign markets. All these economic barriers showed us that ASEAN countries (or ASEAN) as a whole are hardly to become a driving force for regional economic recovery. Therefore, ASEAN has no choice but to integrate

⁸Yong 2004.

⁹The World Bank World Development Indicators (2000).

¹⁰WTO International Trade Statistics (2001).

with regionally wider and economically stronger countries in East Asia. In this case, China, who is actively approaching ASEAN and proposing an FTA, is on the top list, followed then by Japan and South Korea.

Moreover, China's domestic conditions have certain advantages. The Asian financial had little impacts on China instead of corruption and crony capitalism that deeply infected the country. What was China's potent recipe then?

While other Asian countries had no choice but to raise their interest rates during the crisis, China without any hesitation cut its interest rates. By doing so, China would not worry about currency devaluation because it relied much on a fixed exchange rate system being implemented in the country. Accordingly, the Chinese Yuan was not convertible against the US dollar. The fact that applying a procedure of exchange rate control would possibly open a lot of room for corruption did not preclude China to launch policy manoeuvres that were absent in other Asian countries when dealing with the crisis. Meanwhile, the ability to freely manoeuvre policies was indeed a prerequisite to rebuild the Asian economy at that time.

Apparently, China's economic reform is running smoothly and quite successfully so far. It is interesting to note how China's economic reform does not necessarily alter the country's political system. As China is becoming more open, investments are coming from all over the world. Companies like Oracle, Microsoft, IBM and Intel established their research centres in China and recruited Chinese technicians to work on their long-term product developments. In terms of technology, it is well known also that China is ahead of other Asian countries. China also claims to be leading in other particular fields, such as digital media, voice-recognition and voice-synthetic technology.

China's stronger magnet for foreign investors concerned much ASEAN countries in their competitions to attract capital. China responded to it positively by proposing a free trade zone between China and ASEAN. Finally, in 2001, ASEAN and China agreed to establish a free trade plan of action within the next ten years.

To follow up the agreement, an ASEAN-China summit was held in Nusa Dua, Bali, in October 2003, the result of which was a Joint Declaration on Strategic Partnership for Peace and Prosperity signed by Chinese Prime Minister Wen Jiabao and all the ASEAN's ten member countries.¹¹ The declaration says that politically the two parties are committed to deepen understanding and friendship between the peoples of ASEAN and China and to promote dialogues and consultation mechanisms at various levels. Economically, both agreed to strengthen their markets and maintain the rapidly growing momentum in the ASEAN-China economic and trade relations. Furthermore, ASEAN-China Free Trade Zone became a key pillar for economic cooperation towards its establishment by 2010 as agreed in Vientiane, Laos, in 2004.

Indonesia should be well prepared in order to be competitive in and benefit from the ASEAN-China cooperation. Despite all the advantages enjoyed by China, there must be shortcomings that can be possibly transformed into opportunities by Indonesia in order to create a balanced, rather than a China-dominated cooperation. Moreover,

¹¹ Swee-Hock (2005, pp. 1–30).

the current dynamic environment makes it impossible for a single country to stand strong without interdependencies.

The idea to establish the ASEAN–China Free Trade Agreement (ACFTA) was first launched during the ASEAN+3 informal summits in Singapore in 2000. All the leaders of ASEAN countries were concerned at that time about the impacts of China’s entry into WTO. They thought that China will be more competitive in attracting foreign investments, and ASEAN should compete head-to-head with China for export markets. The Prime Minister, Zhu Rongji, was the first leader who expressed such a concern and at the same time proposed a collaborative study on the impacts of China’s entry into WTO.¹² Zhu Rongji even further proposed a feasibility study on the possibility of establishing a free trade between ASEAN and China. His proposal was based on the consideration that by becoming a member of WTO, the Chinese market will be more open. Meanwhile, it is not impossible for ASEAN, who is currently implementing the AFTA, to conduct trade arrangements between the two sides. On the one hand, ASEAN can benefit from China’s liberalization and high growth. On the other hand, China can expand the scope of its relationship with ASEAN by employing AFTA mechanisms for future market expansion and investments. Hence, Zhu Rongji’s official proposal on the ASEAN–China FTA at the ASEAN+1 Summit in 2001 received a positive response from ASEAN.

China’s rapidly and sustainably growing economy demands for sufficiently available supplies of energy and raw materials for which ASEAN countries, which are rich in natural resources, are considered the key suppliers. Both ASEAN and China are under pressure from the deeper and more expansive economic integration in Europe and America. The EU’s economic integration seems to become stronger as it receives an increasing number of new members from time to time. The same applies to America who persistently strives to extend its continental integration into the North America and South America under the NAFTA framework. These endeavours by the two regions towards deeper and wider economic integration, if successful, would possibly bring discrimination against non-participating countries and regions. Therefore, it is possible that China will experience a discriminatory export. Moreover, foreign investments will flow into the two regions and enjoy the advantages of special tariffs and economic scales for a wider and integrated market of production.

In addition to the economic motivation, political and security considerations were also part of China’s strategy in building a stronger relationship with ASEAN. Knowing that there is a certain suspicion from many neighbouring countries of the China’s rise and the ups and downs in the US–China relations, Chinese leaders launched a policy of maintaining good and friendly relations with neighbouring countries. They realized that however strong China is, any aggressive strategies would have a counter-productive impact, namely a risk of being excluded by its neighbours. Therefore, China preferred to launch friendly strategies towards the neighbouring countries in the region due to which it then enjoyed a safe and strategic regional environment.

¹²Panitchpakdi and Clifford (2002, p. 25).

Table 1 ASEAN–China trade balance

	2006	2007	2008	2009
ASEAN	926.5	4,028.4	1,855.7	4,536.6
China	31.5	28.9	139.6	65.5

Source The Ministry of Commerce of the Republic of Indonesia, 2009

In practice, China’s exports often encounter non-tariff barriers in the USA and the EU’s markets regardless China’s new membership in the WTO. Thus, China reduced the risk by, through its strong manufactures, expanding its export markets where ASEAN became its increasingly important target. In 1993, China was the fifth largest import origin of ASEAN with 1.9% of the ASEAN’s total imports. In 2000, China was the fourth by taking 5.2% of ASEAN’s share of imports.¹³ ASEAN–China trade balance was increasing in 2009 as illustrated in Table 1.¹⁴

On 1 January 2010, China and ASEAN constituted as “the world’s biggest free trade area” with a total GDP of US\$6.6 trillion. The intraregional trade in the region grew by 20% annually. ASEAN–China trade with the rest of the world has reached US\$4.3 trillion, which is equal to 13.3% of the world trade. The total market was 1.9 billion of consumers, and the per capita income was US\$2000–5000 on average. The changing trend was because of the growing middle class in the “emerging markets” (i.e. an income category between US\$6,000–30,000). China was the ASEAN’s first largest trading partner, ahead of the USA. Within three to five years, China will likely become the first largest one, beating Japan and Europe.

6 Indonesia Facing ACFTA

Since ACFTA was officially going into effect on 1 January 2010, ASEAN–China trades were growing. However, the ACFTA agreement gave an asymmetric impact on the trade balances in ASEAN countries, particularly the ASEAN-5 which consisted of Indonesia, Malaysia, Thailand, Singapore and Philippines. Indonesia was the only country that experienced a trade deficit with China.

ACFTA was established to fulfil several objectives: (1) strengthening and improving economic cooperation, trade and investment among the member countries; (2) progressively liberalizing and promoting trade in goods and services, creating a transparent system, and facilitating investment; (3) exploring new areas of cooperation and developing proper policies within the framework of economic cooperation among the member countries; (4) facilitating a more effective economic integration among ASEAN’s new members (Cambodia, Laos, Myanmar and Vietnam-CLMV)

¹³ASEAN Statistical Yearbook (2001).

¹⁴The Ministry of Trade, 2009.

and bridging the economic development gaps among the member countries.¹⁵ In addition, the ACFTA provides market access as wide as possible so as to give more/ less equal benefits to both sides through a request-and-offer-based negotiation process. Before making a deal, both sides certainly wanted to make sure that their interests are fairly accommodated during the negotiation process. Therefore, when the ASEAN countries began to negotiate with China, in-depth studies have been conducted to answer questions such as to what extent the benefits would be, in what areas gains and loss would be, and to which ASEAN countries the greatest gains or losses would be. It is not enough to see China as a huge potential market but most importantly also the possibility to move forward exports in it. An analysis of Revealed Comparative Advantage (RCA)¹⁶ is also inadequate because of two reasons. Firstly, this kind of analysis is static and, therefore, enables us only to observe a certain position in a certain year or in a comparative static at best. Secondly, although Indonesia, for example, could export oil palm to China, it does not mean that it has a comparative advantage over China. China does not grow oil palm due to its unsuitable climate for the plants. Moreover, exporting only raw materials would give Indonesia fewer profits because of its low value-added activity. Rather, Indonesia should strive to export its high value-added products of industry. Imports of raw materials that are nationally unavailable are not subject to tariff (i.e. zero tariffs). A free trade agreement, therefore, is fruitless for a lower or zero tariff goods. Also, an integral part of this agreement is The Agreement on the Early Harvest Program in the agricultural sector, which has been implemented since 1 July 2003.

The ACFTA's asymmetric impact also impinged on Indonesia wherein some regions in the country suffered losses, especially those industrial areas in Java that are producing China substitute goods. Meanwhile, some areas outside Java enjoyed the benefits from the ACFTA for being a centre of primary products for mining, agriculture, fisheries, forestry and others. In general, Indonesian products are unable to compete with imported products from China; as China and Indonesia have relatively similar industrial structures, both countries produce similar goods. Besides, Indonesia's export dependence on lower value-added primary commodities, such as cocoa, coffee, seaweed, is relatively high compared to imported goods from China which are dominated by high value-added products such as electronics, machinery and textiles.

Currently, the proportion of imported fruits from China to Indonesia tends to increase, i.e. 51% of the total fruit imports from all countries. The main goods that Indonesia imports from China include machine applications (20% of the total imports from all countries), electronics (40% of the total imports from all countries) and textile products (10–60% of the total imports from all countries). Meanwhile, major imports from ASEAN include application (22%), motor vehicles (38%) and textile products (5–50%). Many agricultural products have been free of import duties since 2004 and almost all agricultural products were subject to no import duties in

¹⁵ASEAN–China Document: Plan of Action to Implement the Joint Declaration on ASEAN–China Strategic Partnership for Peace and Prosperity. Article 5.

¹⁶Ibid.

2010. Textile products, machineries and electronics will be free of duties gradually from 2010 to 2018.¹⁷

Chinese products, which have been flooding the world market for almost 20 years, are no match for those of other developed or developing countries, particularly due to their far cheaper prices. China, who was previously hidden from view behind “the Bamboo Curtain”, now turns into a country with a more open economy. It is hardly possible to answer thoroughly what made Chinese products so inexpensive, phenomena that no any other country in the world can fight for.¹⁸ Chinese products, which are often referred to as a threat to the local products of the ASEAN’s countries, such as textiles, fruits and vegetables, are not in fact produced by large enterprises in China. Textile products, for instance, which are overflowing most of ASEAN countries, including Indonesia, are imported by traders with no long-term business commitment. These traders’ business approach certainly will injure the credibility of Chinese products.

When first entering into the Indonesian market, products of Chinese origin such as electronics, motorcycles, and even cars immediately win the hearts of consumers. However, the consumers soon realized that those products are very low in quality. In addition, no after-sales service networks are provided by the traders who are more interested in making big profits in a short time. Consequently, Chinese products are no longer able to compete with Japanese products whose after-sales service networks have been working effectively.

It should be noted that any attempts to establish a distribution system of exported goods require knowledge of any possible challenges. There are two channels through which a country can export its products to another country. The one is official (also known as “honest distributors”), and the other one is unofficial (known also as “dishonest distributors”). In the Indonesian market of information and technology (IT), for example, there is what the so-called a parallel import (PI), which refers to high-tech products purchased overseas and brought into the Indonesian market with free taxes. This PI is different from those products imported through official logistics transportations and large enterprises. An official importing channel would automatically increase the selling prices of the imported products because they are inclusive of value-added tax (VAT) and after-sales service.

Most of Chinese products, both high-tech and labour-intensive ones, including fruits, are imported through unofficial channels. This is why their selling prices in the market are reasonably low and, therefore, are endangering the local products. In short, trades between Indonesia and China in the ACFTA framework are characteristically occupied by intermediary traders, i.e. those who are trading products from one country to another, rather than the manufacturers (Fig. 1).

Although China has been able to produce a various kind of manufactured goods, they are still behind those of other developed countries in terms of quality, sophistication and precision. China is not necessarily superior in all areas as well; some of its products are even powerless in the Indonesian market. When the monetary crisis hit

¹⁷The Ministry of Commerce of the Republic of Indonesia (2009).

¹⁸Tarmidi (2010).

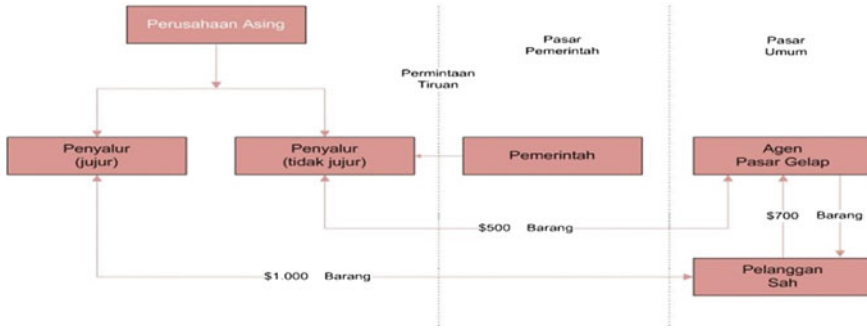


Fig. 1 A distribution system of exported goods. Source KPMG, data processed

Indonesia, for instance, China’s enormously cheaper motorcycle was invading the Indonesia market. There were more than 100 motorcycle brands that assemble and distribute their products in Indonesia; now, there is only a few of them that survive though in a very small production. Since a few years ago, there were local companies that assemble Chinese cars such as Geely, Cherry, Great Wall and Foton trucks but their production is still small. It is also somewhat difficult for televisions, refrigerators and air conditioners made in China to enter the Indonesian market through official channels.¹⁹

Another problem that Indonesia should encounter in being ready for the ACFTA is to provide orderly investment regulations. As the ACFTA had opened the door to a free trade, it is hoped that Indonesia will smoothen the path for investments in Indonesia. It would become a clear-cut parameter given that Indonesia has been long known by the investors as, regardless of the country’s potentiality, applying inhibitive investment regulations, especially its very strict requirements that are highly vulnerable to corruptions.

Among the Indonesia’s common investment barriers are inefficient permit procedures, bureaucrats’ negative behaviours, business restrictions, and unfavourable infrastructures for investments, absence of legal certainty and law enforcement and poor tax facilities. Taken as a means of investment enhancement, the ACFTA provides fuel for Indonesia to reform its investment regulations and, whenever possible, make necessary changes that are friendly with the interests of investments in the country.

Since the ACFTA agreement was signed, Indonesia’s domestic industries, i.e. those would be most likely affected by the agreement, had not yet done any necessary preparations in order to be competitive. Likewise, the government’s policies also failed to provide optimal supports for the domestic industries to be ready in the ACFTA’s competitive trade era. Up to now, in spite of significant changes as the result of economic development process, the contribution of non-primary sectors, especially the manufacturing industry, to the Indonesia’s GDP and diversification of

¹⁹Tarmidi and Gammeltoft (2008).

production in the manufacturing industry is still relatively small compared to that of other ASEAN countries. Looking at the industries that are vulnerably affected by ACFTA, such as steel, textiles and footwear, we can say that no significant progress has been made since the initial development of manufacturing industry in Indonesia. Thus, it is quite urgent now to prioritize the domestic industries, especially manufacturing, so that they are strongly competitive.

7 Conclusion

When ASEAN and China started talking their plan to establish a free trade area, they were aware of a fully uncontrollable global system that they would encounter. A rapidly growing advanced technology could also put pressure on the system of values, and accordingly, endanger the social stability, in each region. Thus, ASEAN and China felt an urgent need to integrate their social, political and economic goals and to reduce as best as possible any political differences that could ruin their cooperation. There are, of course, challenges that need to be resolved and anticipated during the process of ACFTA, including homogeneous export products, rationalized industry and enterprise, adjustments for small and medium enterprises, possible trade diversion, economic costs and lower tariff revenues.

There are possible steps to be taken if Indonesia wants to improve its position in the already signed agreement, regardless of its seemingly lesser impacts, such as improving the Indonesian products' efficiency and competitiveness by more infrastructures. Such efforts will take longer time, while fierce competition has begun. Indonesia needs to reduce its interest rates or increase efficiency and competitiveness that are necessary to face its competitors. This recipe will work also when Indonesia is going to implement FTA with India, Europe, Japan, America, South Africa and any other countries. Nevertheless, competition with China is an exception because far cheaper goods from China will remain unchallenged by any other countries, including Indonesia. The important question is whether it is a short- or a long-term domination of Chinese products. Whatever the answer is, it seems that Chinese products will likely continue their domination over the medium term, i.e. between five to ten years. While ASEAN countries will be able to enjoy the fruits of FTA on the long run, many of their domestic companies are already collapsed. Thus, ACFTA is a real threat to Indonesia. To be more competitive in attracting foreign investments, including from China, Indonesia should seriously improve its bureaucracy (one-roof service) and investment regulation, labour regulation, law enforcement and provide proper infrastructures. Therefore, an effective government and an efficient private sector and businessman are needed.

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Author Biography

Ratna Shofi Inayati is currently a researcher on the development of international politics at the Centre for Political Studies, LIPI, with a focus on Southeast Asia and Indonesia's Foreign Policy. She received her master's degree in International Management from the Southeastern University, Washington, D.C., USA. Her research focus includes the dynamics of ASEAN partnership and Indonesia's role at the regional, international and global levels.