

ASEAN-China Free Trade Area: Features and Implications for Cambodia

*Hing Vutha, research associate at CDRI, reviews salient features of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China with particular emphasis on the Early Harvest Programme (EHP), and explores opportunities, challenges and poverty implications of this agreement from the perspective of Cambodia.**

The Free Trade Area (FTA) between the Association of South-East Asian Nations (ASEAN) and China was proposed in the ASEAN Plus Three summit in November 2000. The ASEAN-China Expert Group on Economic Cooperation was then established to study the implications of China's accession to the WTO and the possibility of establishing a free trade area between the two regions. In the eighth ASEAN summit in November 2002 in Phnom Penh, the ASEAN countries and China signed the Framework Agreement on Comprehensive Economic Cooperation, aiming to strengthen and enhance economic trade and investment cooperation and to form a free trade area within 10 years. The framework covers cooperation in goods, services and investment and provides for the removal of trade barriers between ASEAN and China. These liberalisation measures are expected to lower costs, increase intra-regional trade, promote greater specialisation, increase economic efficiency and attract more investment to an integrated regional market. Cambodia, which joined ASEAN in April 1999, is automatically bound by this agreement, which is expected to provide Cambodia economic benefits and opportunities as well as challenges. Whether the net benefits of this FTA will be positive or negative remains uncertain. Little information and research are available about the implications of this ASEAN-China FTA for Cambodia.

This article is designed to fill this information gap by (1) examining the most salient features of the framework agreement between ASEAN and China and (2) exploring some of the economic opportunities, challenges and poverty implications for Cambodia. It is primarily based on CDRI's current research on "The Early Harvest Programme: Implications for Cambodian Agriculture", which is funded by Oxfam America's, East Asia Regional Office.

* This article is based on a report produced by the ASEAN-China Expert Group on Economic Cooperation in October 2001 entitled "Forging Closer ASEAN-China Economic Relations in the Twenty-First Century".

Features of Framework Agreement

The Framework Agreement on Comprehensive Economic Cooperation covers trade in goods, services and investment with four specific objectives: (1) strengthening and enhancing economic, trade and investment cooperation, (2) progressively liberalising and promoting trade in goods and services, as well as creating a transparent and facilitative investment regime, (3) exploring new areas and developing appropriate measures for closer economic cooperation and (4) facilitating a more effective economic integration of the newer ASEAN members and bridging the development gap among the member countries. The agreement on trade in goods, which was concluded in November 2004, allows for tariff reduction and elimination of two categories of products, referred to as normal and sensitive tracks. Normal track products should have mutually agreed upon reduced or eliminated tariffs over a period from 1 January 2005 to 2010 for the ASEAN Six¹ and China, and until 2015² for CLMV³ countries. Sensitive track⁴ products are those submitted by any party with final tariff ceilings and end dates different from the normal schedule, but must also be mutually agreed upon by individual ASEAN country and China. ASEAN and China have also agreed to negotiate to liberalise progressively trade in services with wider and substantial coverage in the service sector. The negotiations began in 2003 and aim to be concluded as expeditiously as possible. The agreement will aim at progressively eliminating all discrimination of trade in services between or among ASEAN and China, are expanding the depth and scope of liberalisation of trade in services. It also enhances further cooperation in services to improve efficiency and competitiveness and to diversify the supply and distribution of services.

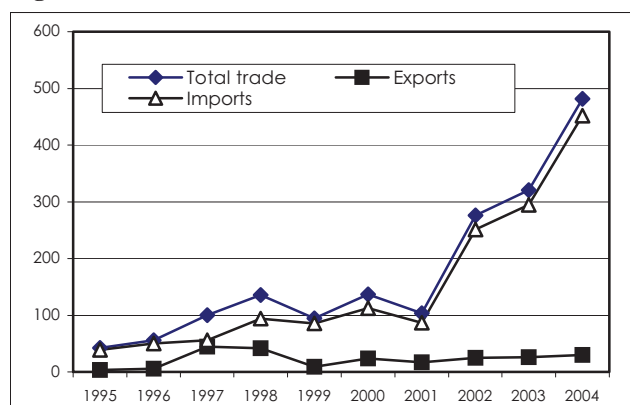
As for investment, both parties have agreed to: (1) negotiate to liberalise progressively the investment regime, (2) strengthen cooperation in investment, facilitate investment and improve transparency of investment rules and regulations and (3) provide for the protection of investments.

The Early Harvest Programme

To accelerate the reduction and elimination of tariffs on goods, the framework agreement provides for the Early Harvest Programme (EHP), which covers eight chapters of products in the Harmonized System: (1) live animals, (2) meat and edible meat offal, (3) fish, (4) dairy produce, (5) other animal products, (6) live trees, (7) edible vegetables and (8) edible fruits and nuts. In terms of tariff reduction and elimination, all products covered under the EHP are to be divided into three categories according to the Most Favoured Nation (MFN) tariff rate set by each country.

- Category 1: For the ASEAN Six and China, this refers to all products with applied MFN tariff rates higher than 15 percent. For the newer ASEAN countries, it

Figure 1: Cambodia's Trade with China



Source: Customs and Excise Department, TradeMap (ITC)

refers to all products with applied MFN tariff rates of 30 percent or higher.

- Category 2: For the ASEAN Six and China, this refers to all products with applied MFN tariff rates between 5 percent (inclusive) and 15 percent (inclusive). For the newer ASEAN countries, it refers to all products with applied MFN tariff rates between 15 percent (inclusive) and 30 percent (inclusive).
- Category 3: For the ASEAN Six and China, this refers to all products with applied MFN tariff rates lower than 5 percent. For the newer ASEAN countries, it refers to all products with applied MFN tariff rates lower than 15 percent.

The implementation of the EHP started in January 2004 with an ongoing schedule to reduce tariffs to levels as follows:

(1) For China and the ASEAN Six

Product Category	Not later than 1 Jan. 2004	Not later than 1 Jan. 2005	Not later than 1 Jan. 2006
Category 1	10%	5%	0%
Category 2	5%	0%	0%
Category 3	0	0	0

(2) For the newer ASEAN Countries

Country	No later than 1 Jan. 2004	No later than 1 Jan. 2005	No later than 1 Jan. 2006	No later than 1 Jan. 2007	No later than 1 Jan. 2008	No later than 1 Jan. 2009	No later than 1 Jan. 2010
<i>Product Category 1</i>							
Cambodia			20%	15%	10%	5%	0%
Lao PDR			20%	14%	8%	0%	0%
Myanmar			20%	14%	8%	0%	0%
Vietnam	20%	15%	10%	5%	0%	0%	0%
<i>Product Category 2</i>							
Cambodia			10%	10%	5%	5%	0%
Lao PDR			10%	10%	5%	0%	0%
Myanmar			10%	10%	5%	0%	0%
Vietnam	10%	10%	5%	5%	0%	0%	0%
<i>Product Category 3</i>							
Cambodia			5%	5%	0-5%	0-5%	0%
Lao PDR			5%	5%	0-5%	0%	0%
Myanmar			5%	5%	0-5%	0%	0%
Vietnam	5%	5%	0-5%	0-5%	0%	0%	0%

Economic Relationship between Cambodia and China

Economic relations between Cambodia and China have developed notably since the 1990s. Prior to the framework agreement between ASEAN and China signed in November 2002, Cambodia concluded an investment promotion and protection agreement with China in July 1996 and a bilateral trade agreement in July 1997. These agreements have stimulated an expansion in trade and investment between the two nations.

Cambodia-China Trade

Cambodia's total trade with China has been increasing gradually with an annual average growth rate of 50 percent during 1995–2004. China was Cambodia's seventh largest trade partner in 1995 and fourth largest in 2003. Cambodia's external trade with China grew at an annual rate of 23 percent during 1995–2001 and at 77 percent during 2001–04. Cambodia's exports to China increased from \$3.8 million in 1995 to \$30 million in 2004, and its imports from China increased from \$39 million in 1995 to \$452 million in 2004. During 1995–2004, Cambodia's exports to China increased by 41 percent, more slowly than its imports from China, which rose by 97 percent.

Cambodia exports natural-resource-based and agricultural products, and imports a wide range of manufactured products from China, such as textiles and apparel, iron and steel, ceramics, electrical and electronic equipment, foodstuffs and vehicles. The largest of Cambodia's exports to China are wood and wood articles, making up half of the total, and valued at \$15 million in 2004. Other major exports to China include cotton, rubber and fish. Textiles and apparel amount to around 63 percent of total imports from China, reaching \$286 million in 2004. The second largest import from China is machinery and electrical appliances, valued at \$37.59 million, or 8 percent of the total. Other major imports include meat, fish and seafood, iron and steel, iron and steel articles, ceramic products and vehicles.

Under the EHP, Cambodia exports to China live animals, live fish, shrimps and prawns and crustaceans. These exports amount to \$1.32 million, about 4 percent of Cambodia's total exports to China. Shrimps and prawns were the largest item in this category, valued at \$725,000 in 2004, followed by live fish, live animals and crustaceans. Cambodia imports from China products categorised in chapter 7 (edible vegetables) and chapter 8 (edible fruits and nut) amounting to \$1.48 million, or 0.3 percent of Cambodia's total imports from China. Garlic was the largest commodity in these categories, valued at \$720,000 in 2004. Other products include apples, dried mushrooms and truffles, pears and quinces, red beans and vegetables.

Investment

During 1995-2004, China was the fourth largest source of Cambodia's foreign direct investment (FDI), investing in more than 150 projects with a contractual sum worth \$395 million, or 9 percent of total FDI. The major investment areas are infrastructure construction, garments, textiles and agricultural development. Garments are the only sector that has absorbed a constant inflow of investment from China since 1995, totalling \$100 million during 1995-2004, or about 25 percent of total investment from China.

Implications for Cambodia

According to economic theory, an FTA offers advantages to all member countries, ranging from greater economic

efficiency to closer cooperation and partnership in non-economic areas, such as promoting peace and stability. The ASEAN-China FTA, which requires progressive reduction of tariffs and elimination of non-tariff barriers, is expected to lower costs, increase intra-regional trade and enhance competitiveness, productivity and efficiency. At the same time, there is no trade liberalisation scheme that provides economic benefits without costs and challenges.

Opportunities

For Cambodia, the most important opportunity associated with the free trade area will be easier and wider access to a huge and growing Chinese market. As noted earlier, Cambodia currently exports rubber, fish, livestock and shrimps to China. With the implementation of the EHP, most agricultural products have wide access to the Chinese market, and thus the sector has high potential for expansion and growth.

Second, the FTA may attract more FDI to Cambodia from both member countries and the rest of the world. The ASEAN Six and China are developing and upgrading their economies by switching from basic, labour-intensive manufacturing to more technological and knowledge-intensive industries. Basic and labour-intensive manufacturing sectors are expected to move to less developed countries like Cambodia. Given its resource endowment and level of development, Cambodia would be an appropriate destination for investment in low-tech and labour-intensive manufacturing. Garment manufacturing

Table 1: Cambodian Trade with China in Products Covered by EHP, 2002-04 (in US\$)

Product Code		2002	2003	2004
Exports				
030623	Shrimps & prawns, not frozen, in shell or not, including boiled in shell	176,000	373,000	725,000
030199	Live fish	1,063,000	683,000	520,000
010600	Live animal	317,000	64,000	40,000
030629	Crustaceans, not frozen, in shell or not, including boiled in shell	1,000	18,000	37,000
Imports				
070320	Garlic, fresh or chilled	79,000	526,000	720,000
080810	Apples, fresh	32,000	48,000	287,000
071230	Mushrooms and truffles dried but not further prepared	0	42,000	279,000
080820	Pears and quinces, fresh	29,000	5,000	130,000
071332	Beans, small red (Adzuki) dried, shelled, whether or not skinned or split	0	16,000	33,000
071290	Vegetables and mixtures dried, but not further prepared	222,000	81,000	3,000

Source: TradeMap (ITC)

Table 2: Cambodia Foreign Investment, 1995–2004 (US\$ million)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total Investment	2,243	767	744	854	448	218	205	238	250	210
FDI	1,910	619	578	556	196	160	140	145	65	134
Investment from China	3	38	36	105	46	28	5	24	33	77
of which: Garment sector	0.13	5	16	23	12	0.7	1.7	3	7	32

Source: Cambodia Investment Board, CDC

and agro-industry have high potential to attract FDI from China and ASEAN countries.

Third, the elimination of tariffs and non-tariff barriers is expected to facilitate trade flows and promote specialisation. In terms of trade structures and patterns of EHP products between Cambodia and China, there is a high potential for Cambodia to export to China many more goods that it can produce more efficiently (e.g. fish, shrimps and live animals). Cambodia could probably also diversify into agricultural exports such as soybeans, mung beans and cassava.

Fourth, the FTA will provide Cambodian consumers a wider range of product choices at competitive prices, thus increasing consumer welfare. Apart from economic opportunities, an ASEAN-China FTA may also create a number of non-economic opportunities. These could include a strengthening of relations and cooperation in other areas, deepening cooperation with China in the Greater Mekong Sub-region and receiving more special treatment and technical assistance from China.

Challenges

The framework agreement also creates some significant challenges for Cambodia in terms of how best to utilise this package and to mitigate possible negative impacts. One significant challenge for Cambodia is to build supply-side capacity to better compete in the regional market. This involves creating a domestic policy framework that supports the private sector, especially small and medium enterprises, by reducing the costs of conducting trade. It also relates to the quality and capacity of public institutions to coordinate and implement policies that promote the productive capacity of private enterprises.

Another concern for Cambodia is the potential negative impacts of trade liberalisation on domestic producers and the labour market. When barriers to trade are dismantled, some industries will expand and others will contract as a result of competition. This may cause uneven distribution of costs and benefits among different sectors and industries. In addition, when tariffs on traded goods are reduced or eliminated, there is likely to be intensified competition with goods imported from China. Domestic producers who are not sufficiently competitive, especially in terms of production costs and product quality, could be crowded out by such imports. The closure of ineffective domestic producers may trigger short-term

costs in terms of lost jobs, lost income and movement into poverty.

Other challenges associated with the framework agreement include concerns over the loss of government revenues and greater trade deficits with China as a result of tariff reduction. This might make government fiscal policy more volatile and less secure.

Some Poverty Implications

As one of the poorest ASEAN countries, Cambodia perceives the agreement as an opportunity to promote economic growth and poverty reduction. As already mentioned, trade liberalisation schemes under this agreement will create both economic opportunities and challenges and are expected to have both positive and negative impacts on the poor. The net benefits for the poor remain uncertain and depend on whether regional and domestic policy frameworks favour the poor. Trade liberalisation will benefit the poor if policy is structured to develop local markets that will eventually have the capacity to compete regionally and internationally. The extent of benefits for the poor also depends on the degree to which the poor, especially in the rural sector, participate in trade-oriented activities, such as supplying export goods or labouring in competitive sectors and associated jobs.

The Early Harvest Programme is certainly important to the Cambodian agricultural sector in general, and farmers in particular. Most Cambodian farmers are poor, produce on a small scale with relatively low productivity and earn their living by supplying products to the domestic market. Based on these characteristics, Cambodian negotiators have included 250 tariff lines for liberalisation, while excluding 30 sensitive agricultural products, such as tomatoes, onions, garlic, cauliflower, cabbages, lettuce, carrots, turnips, beans, coconuts, pineapples, guavas, mangoes, mangosteens, oranges, melons, watermelons and longans. With the above exclusions, it is likely that Cambodian farmers would avoid losses caused by imported goods. In addition to such a minimal threat to farmers, the EHP seems favourable to farmers in terms of opportunities for exports. Cambodia would gain from greater exports of such products as live fish, live animals, shrimps and prawns, soybeans and maize. Any government policy and intervention measures that aim to promote production of these products for export would significantly help the poor to improve their incomes.

continued on page 12