

FTA Changes ASEAN-China Trade

Japanese Trade Policy Think Tank ITI Analyzes Implementation of ACFTA

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The ASEAN-China Free Trade Agreement (ACFTA), intended to be a comprehensive and high-quality FTA between ASEAN and China, was put into effect in 2005. This FTA aimed at elimination of tariffs for 90% of items by 2010 in China and six ASEAN members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) and by 2015 in Cambodia, Laos, Myanmar and Vietnam.

Here, the Institute for Trade and Investment (ITI), explains how the agreements on the schedule of tariff eliminations and their exceptions in ACFTA have been implemented and outlines their most effective use.

Trade Flow between ASEAN & China

Looking into the trade flow between ASEAN and China, as shown in [Table 1](#), the proportion of intermediate goods in the total exports to China (including Hong Kong) from the 10 ASEAN members reached 70% in 2010. Looking further at the items among those goods, whereas the proportion of processed goods such as industrial materials was 19%, the percentage of parts and components such as machinery equipment and machinery for transportation was 41%, much higher than for other items.

Among the items other than intermediate goods, the share of final goods such as automobiles and apparel products was 20% and that of raw materials such as plastics and paints was 10%. From 2005 until 2010, among the export items from ASEAN to China, raw materials increased by around 140% and this rate of increase exceeded by far the rate of increase in exports of both intermediate goods and final goods.

Conversely, in exports from China to ASEAN, the share of intermediate goods reached 54% in 2010. Among these items, the share of processed goods was 28%, higher than the share of components, which was 21%. The proportion of final goods was also high at 45%. Surprisingly, the share of raw materials was only 1%.

While exports of final goods from China to ASEAN increased by three times from 2005 to 2010, those of intermediate goods doubled. Assuming a continuation of such a gap in the rate of increases between the two groups of products, the share of final goods will one day exceed that of intermediate goods.

In short, the distinction to be noted in the bilateral trade structure between ASEAN and China is that ASEAN has been exporting a higher share of materials or intermediate goods to China, while China has been exporting a higher share of final goods to ASEAN. In other words, the trade between the two sides in these different sectors is complementary.

Therefore, if horizontal trade within the same industry such as “electric appliances” or “autoparts” evolves further, trade between ASEAN and China will correspondingly expand.

Impact of ACFTA upon ASEAN-China Trade in 2010

The tariff reduction schedule of ACFTA lags behind the schedule of the ASEAN Free Trade Agreement (AFTA) in which the intra-regional tariffs among the six ASEAN members previously mentioned became nearly zero in 2010.

In ACFTA, the tariffs on Early Harvest Products (EHP) to be lowered in the earliest stage mainly consisting of agricultural and fishery products, including processed ones, were already zero in 2006 in China and the six ASEAN countries. The tariffs on Normal Track 1 (NT1) items to be lowered in accordance with the general schedule of tariff reduction became zero in 2010.

Besides these, there are Normal Track 2 (NT2) items (exceptions to NT1) and Sensitive Track (ST) items covering products to be liberalized later than those in the normal schedule. Tariffs on those items remained in 2011 and in each major member of ACFTA the number of such items totals 700-1,500. In each nation, the total number of trade items (EHP+NT1+NT2+ST) is around 8,000 and the share of NT1 items is more than 70%.

China and the six ASEAN countries are scheduled to eliminate tariffs on NT2 in 2012. In Cambodia, Laos,

TABLE 1

ASEAN-China trade by product (million \$, %)

	ASEAN → China (including Hong Kong)			China (including Hong Kong) → ASEAN		
	Export amount in 2010	2005-2010 Rate of increase	Share in 2010	Export amount in 2010	2005-2010 Rate of increase	Share in 2010
Materials	19,381	140.6	10.4	1,604	-7.3	1.0
Intermediate goods	130,443	97.0	70.3	90,375	100.8	53.7
Processed goods	35,052	113.4	18.9	47,394	140.7	28.2
Parts & components	75,157	93.6	40.5	35,066	58.5	20.8
Final goods	35,718	94.2	19.3	76,377	194.7	45.4
Capital goods	23,401	84.9	12.6	45,776	210.5	27.2
Consumer goods	12,317	114.8	6.6	30,601	173.8	18.2
Total	185,542	100.3	100.0	168,356	131.7	100.0

Source: ITI

Myanmar and Vietnam, the tariffs on EHP items were eliminated in 2010 and the tariffs on NT1 items are to be zero in 2015 and those on NT2 will be zero in 2018.

The elimination of tariffs on EHP and NT1 items in ACFTA was successful in encouraging trade between ASEAN and China in 2010. ASEAN's exports to China in 2010 increased by 44.8% over the previous year, according to Chinese statistics. ASEAN's imports also increased by 30.1% in 2010 over the previous year.

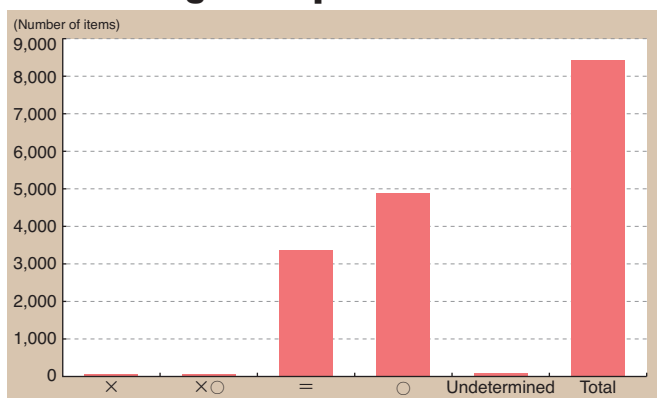
Proportion of Unachieved Tariff Lines Agreed in ACFTA Less than 2%

We have seen a notable increase of interest in ACFTA and firms are increasingly taking advantage of it. However, it is not clear yet how member countries are implementing the rules.

ITI has conducted research to find out whether the agreed tariff rates for each member country's individual items correspond in practice to the implemented tariff rate on the same item in the table of tariffs, in order to clarify whether member countries of ACFTA are putting the agreed tariff rates into practice exactly as in their commitment to tariff reduction in the agreement.

For example, in Indonesia, they considered "air conditioners for automobiles" as an NT2 item and decided to lower their tariff rate in the agreement to 5% (10% for imports from China). The tariff rate in practice for air conditioners for automobiles defined in the table of implemented tariffs corresponds to this agreed tariff rate. It is thus confirmed that Indonesia implements the tariff rate on air conditioners for automobiles in the agreement as committed.

CHART 1
Number of items by implementation of tariffs agreed upon in ACFTA



Note: In comparison between tariff committed to and tariff in practice:
 x: Tariff in practice higher than tariff committed to
 o: Tariff in practice lower than tariff committed to
 =: Tariff in practice equal to tariff committed to

Source: ITI, January 2012

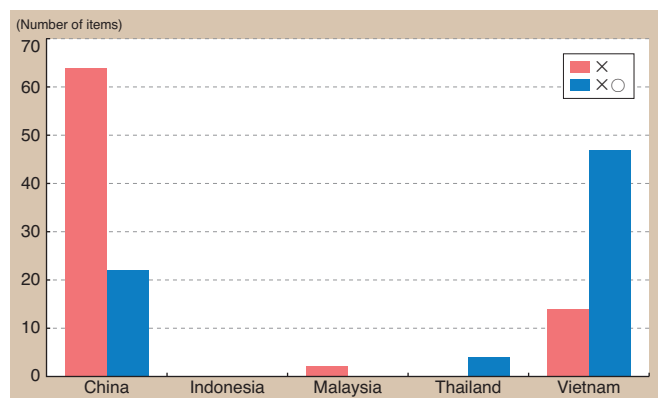
In conducting this research, we chose five countries – China, Indonesia, Malaysia, Thailand and Vietnam – as targets. *Chart 1* shows a summary of the implementation of the agreed tariffs in these five countries. In these countries, the number of items whose implemented tariff rate remains in practice above that stated in the agreement, meaning the tariff reduction commitment remains unachieved, is 80. Among them, as shown in *Chart 2*, it is to be noted that 64 items are in China, 14 items in Vietnam, and two items in Malaysia, with none in the other two countries. The percentage of items on which tariff reduction commitments remain unachieved is only 0.9% of the total items under study, some 8,434 in total in the five countries (excluding NT1 items).

The number of items on which tariffs are in practice lowered further than the agreed upon rate in ACFTA is 4,877 in the five countries, as shown in *Chart 1*, and the percentage of the total is 57.8%. These items are fewer in China than in the other countries. The number of items on which tariffs in practice correspond to the levels committed to in ACFTA is 3,376 in the five countries and its share is 40% of the total.

There are 73 items (x o), corresponding to 0.9% of all items covered by this research, on which each tariff line in the agreement corresponds to several different tariff lines (x o) in practice in terms of the table of implemented tariffs. For example, the tariff rate on polyester short fiber in China defined in ACFTA is 5%, but in the table of tariffs in practice a 4.5% tariff rate is applied to imports from Laos and a 5% tariff rate is applied to imports from the other countries.

As shown in *Chart 2*, among these 73 items, 22 were in China and 47 in Vietnam, and thus these two countries account for almost all

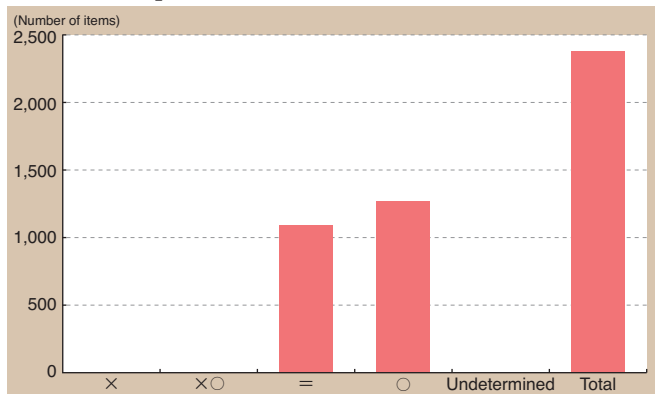
CHART 2
Number of items in which tariffs committed to are unachieved



Source: ITI, January 2012

CHART 3

Implementation of RTRs in case where China exports to the other 4 countries



Note: In comparison between RTRs and tariffs in practice:

- =: They are equal
- o: The latter is lower than the former (tariff reduction implemented as committed to)
- x: The latter is higher than the former (tariffs committed to unachieved)

Source: ITI, January 2012

these items. Therefore, adding these 73 items as ones failing to achieve the commitments in the agreement to the previously mentioned 80, the unachieved tariff lines total 153 and this is less than 2% of the total covered by our research. Thus for around 98% of the total items, tariff reduction is carried out either as committed to in the agreement or at an even more reduced level.

Among the five countries covered by our research, China has the highest percentage of unachieved tariff lines, followed by Vietnam.

Reciprocal Tariff Adopted for about Half of Traded Items in 4 ASEAN Countries

According to ACFTA, in a case where an exporting country assigns a certain product to ST items subject to a slower liberalization process, even though an importing country assigns it to EHP/NT items, the importing country will be allowed to postpone a tariff reduction on that product and impose a certain Reciprocal Tariff Rate (RTR) on it. It is also possible for the importing country to implement a tariff reduction as originally committed to without applying an RTR.

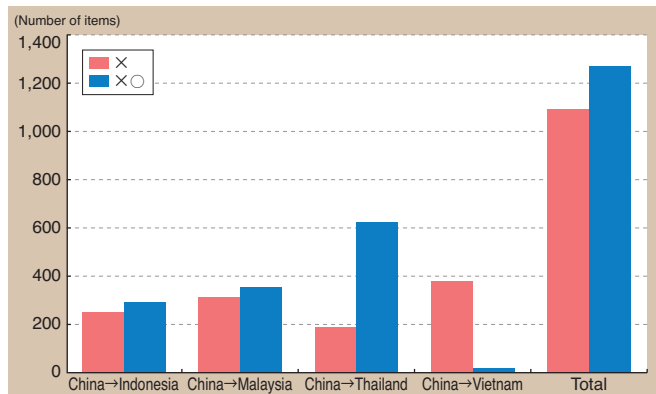
For example, in ACFTA, “windscreen wipers” are categorized as ST in China and subject to a 10% tariff, whereas in Indonesia they are considered an item in NT1 and thus subject to no tariff.

Under these rules, if China exports wipers to Indonesia, Indonesia can impose an RTR on them to be calculated by the difference in tariff rates between the exporting country and the importing one, in this case 5%. In practice, Indonesia’s tariff rate on wipers is zero, and thus no RTR is imposed on wipers imported from China.

In a case where China is the exporting country and the other four countries – Indonesia, Malaysia, Thailand and Vietnam – are the importers, we would have four cases of a combination of exporting country and importing country, as in [Chart 4](#). We devised a number of cases for an RTR to be applied item by item and calculated the RTR in each case, and then tried to find out whether the RTR was put

CHART 4

Implementation of RTRs by case (China exports to the other 4 countries)



Source: ITI, January 2012

into practice or not for each traded item by observing the difference between the calculated RTR and the tariff rate in practice ([Chart 3](#)).

According to this study, the number of items for which an importing country applies an RTR is 1,094 in the four cases mentioned. This corresponds to 46.1% of all items covered by our research (2,374 items) in cases where China is the exporting country and the other four countries are importers. Among the different cases, as seen in [Chart 4](#), the percentage of items subject to an RTR is the highest for Vietnamese imports from China, which is 95.4%.

The number of the items on which tariffs are reduced as committed to in accordance with ACFTA without an RTR being adopted is 1,272 in the four cases, corresponding to 53.6% of all items covered by our research. Among the four cases, the percentage of items being subject to tariff reduction as committed to without being subject to an RTR is the highest for Thai imports from China, namely 77.7%.

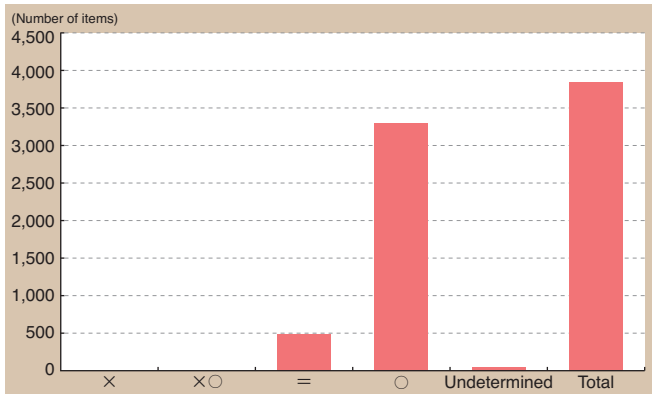
There are only two items, corresponding to 0.1% of the total, on which the adopted tariff is higher than an RTR and the agreed tariff rate remains unachieved.

Also, in China’s exports to the four ASEAN countries, the proportion of items for which an RTR was imposed by the importers is almost 50%. Therefore, if you tried to export from China to ASEAN through ACFTA, you would need to be careful about the application of an RTR by the importing nations. This is because ACFTA does not clarify which traded items could be covered by an RTR on a country basis, even though RTR is defined in the agreement. You would need to clarify on your own whether or not your goods would be subject to an RTR.

In the case where China is the exporting country and the four ASEAN members are importers, we would point out the following items as ones that could possibly be subject to the application of an RTR: agriculture and fishery products, food and alcohol, chemicals, plastics, rubber, wood and pulp, textiles, transportation machinery and components.

CHART 5

Implementation of RTRs in case where China imports from the other 4 countries



Source: ITI, January 2012

China Not Adopting RTR on Many Items & Largely Reducing Tariffs as Committed

In the case where China is the importing country and the four ASEAN countries are exporters, the percentage of items on which an RTR is adopted is 12.8% (Chart 5). (The number of items was 493 in the four cases and the total number of items covered by our research was 3,856.)

As seen in Chart 6, the rate of application of RTRs is the highest in the case of China's imports from Thailand and Vietnam.

The number of items on which tariffs are reduced in accordance with the original commitment was 3,306 in the four cases (Chart 5) and this corresponds to 85.7% of the covered items.

There are only nine items, about 0.3% of the total, on which tariffs are raised above RTR levels and on which the committed tariff rates remain unachieved.

This means that China is effectively implementing tariff reductions as committed to in the agreement without applying RTRs in most cases when it is an importing nation and the four ASEAN countries are exporters. China is promoting trade liberalization more than the other four countries in terms of RTRs, whereas in terms of application of the agreed tariffs it tends to adopt higher tariffs in practice.

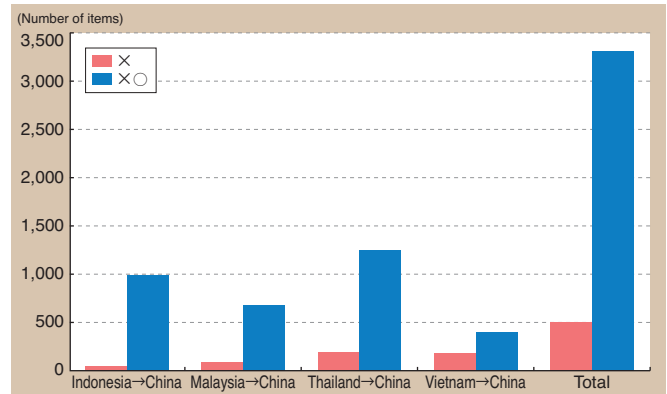
A business firm should be less worried about the possible application of an RTR in exporting goods to China from these four countries than in exporting goods to these four countries from China. In particular, RTRs are less likely to be applied in many cases in areas such as chemicals, textiles, steel and machinery.

Effective Use of ACFTA

Business firms which would like to take advantage of ACFTA would need first of all to get a detailed picture of the implementation of ACFTA articles or each member country's practices on agreed tariffs

CHART 6

Implementation of RTRs by case (China imports from the other 4 countries)



Source: ITI, January 2012

and check whether their products could gain any benefits in accordance with the tariff reductions defined in the agreement. It would also be important to confirm whether any RTR would be applied to their products in the light of the large number of the items to be covered by RTRs.

Further, one of our most important findings is that a business firm could avoid likely RTRs by exporting its goods to China from ASEAN rather than from China to ASEAN.

A business firm could refer to the large amount of data by country as well as by item gathered through our research on the implementation of the tariffs committed to in the agreement and RTRs. With this, they would need to clarify how they could reduce tariffs most effectively by choosing a product and a destination which would provide them with the cheapest way to export.

It would be also very important to be aware of the future schedule of tariff reductions.

In 2012, China and six ASEAN countries are scheduled to eliminate tariffs on NT2 items and also reduce tariffs on some ST items. That will give firms seeking to export to ASEAN and Chinese markets a good business opportunity, since this tariff reduction and elimination will cover more than 3,000 items overall.

In thinking about the future of trade in Asia, assuming that it will take at least another few years before a consensus is reached on the TPP (Trans-Pacific Partnership) or a China-Japan-South Korea FTA and put into effect, effective use of ACFTA, a rainbow bridge towards free trade between ASEAN and China, will be indispensable for firms pursuing immediate expansion of business in Asia.

ITI is responding to such an increasing need for effective use of ACFTA by business firms with a wide range of relevant data. Those who are interested in our detailed analysis and data should contact us at the following email address: toshiki_takahashi@iti.or.jp JS

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