

# Economic and Social Impact of Liberalization

A Study on Early Harvest Program under  
**China-ASEAN FTA**

Edited by Zhang Yunling

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**图书在版编目 (CIP) 数据**

市场开放的经济与社会影响：对落实中国—东盟自贸区框架下早期收获计划的专项研究 = Economic and Social Impact of Liberalization: A Study on Early Harvest Program under China-ASEAN FTA: 英文/张蕴岭主编. —北京：社会科学文献出版社，2009. 1

ISBN 978 - 7 - 5097 - 0566 - 7

I. 市... II. 张... III. 自由贸易区 - 研究 - 东南亚、中国 - 文集 - 英文 IV. F752.733 - 53

中国版本图书馆 CIP 数据核字 (2008) 第 205217 号

**Cataloguing in Publication Data**

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*Economic and Social Impact of Liberalization*

Edited by Zhang Yunling

—January 2009

ISBN 978 - 7 - 5097 - 0566 - 7

Published by Social Sciences Academic Press (China)

No. 10, Xianxiao Bystreet, Dongcheng District

Beijing, China

Postcode: 100005

© 2009 by Social Sciences Academic Press (China)

Editor: Hu Yali

Cover designer: Cai Changhai

Printed in Beijing, China

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# About the Editor

Zhang Yunling, born in May 1945, now the Professor, Academy Member, Director of Academic Division for International Studies, Chinese Academy of Social Sciences. He was the Director of Institute of Asia-Pacific Studies (1993–2007), Director of Institute of Japanese Studies (1995–2001) and Deputy Director of Institute of European Studies (1988–1992), Chinese Academy of Social Sciences. Currently he is also the President of Chinese Society for Asia-Pacific Studies, Vice-president of PECC, China Committee. He is a well-known scholar on international studies. His major books include *Interdependence in the World Economic Development*, *Study on the Changing World*, *East Asian Regionalism and China*.

# Introduction

*Zhang Yunling\**

Many questions have been raised on China-ASEAN agreement of the free trade area (FTA). The special concern was put forward as why China initiated the China-ASEAN FTA (CAFTA) first. I argued that just because it is easier to do.

## I. RTA as a Strategy

After joining WTO, China started to make its RTA(regional trade agreement) strategy. WTO membership is crucial for China since WTO provides China with the best global market access. However, China also understands that RTA can play a special role in developing the comprehensive cooperation with the regional partners. RTA can serve as both a market access strategy and a foreign policy strategy. This reflects the strategic choice for China in selecting its partners for RTA.

ASEAN is China's close neighbor and becomes an integrated market through the implementation of AFTA. Importantly, China and ASEAN share increasing interests in their trade and economic relations. This is why ASEAN was so eager to accept China's initiative for a FTA.

From China side, a FTA with ASEAN can make it as an experiment in participating in and promoting regional integration and cooperation after joining WTO. China is more confident in making a FTA with ASEAN partners since it shares great similarity with ASEAN countries. Political gains are also important for China since a closer economic relationship helps to smooth

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the comprehensive relations between the two sides, which has significant dimensions in creating a peaceful environment surrounding China.

China has emerged as a major trading economy in the world. The strengths supporting this significant progress are the reform and opening-up policies. Chinese economy has become more and more liberalized and integrated with the world market. Due to the opening-up of the Chinese economy, and with advantage of cheap labor cost and great potential of the market, foreign direct investment (FDI)<sup>①</sup> flowing into China has increased noticeably. China becomes one of the largest FDI recipient countries in the world. FDI plays a very important role in the Chinese economy. The dynamic growth of foreign invested enterprises (FIEs) becomes an important factor supporting Chinese economic dynamism. FIEs do not just bring in capital, but also the management and technology. As a matter of fact, FIEs, both as investors and competitors, become important factors in changing the economic structures and in pressing local enterprises, especially state-owned enterprises (SOEs) to make change.

The WTO entry is an important turning point for China. In the accession negotiations, China has committed a very comprehensive package of market liberalization. The entry into WTO represents a new stage of China's economic reform and opening-up to the outside world, i.e., from a kind of selective liberalization to comprehensive liberalization, from experimental liberalization to institution-based and accountable liberalization, from unilateral liberalization to WTO rule-based liberalization. It will make China's economy really integrated with the international system.

Liberalization, thus open competition of the economy will enhance Chinese economic efficiency and promote industrial progress. Competition will force Chinese enterprises to improve technology and management, which will be beneficial significantly to the Chinese economy in transferring from the quantitative growth to the qualitative growth.

## II. China-ASEAN Initiative

ASEAN raised great concern about China's entry into WTO since it is

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① FDI includes that from Hong Kong, Macao and Taiwan.

considered that China would become more competitive and attractive to foreign investors. At the same time, ASEAN also manages to grasp the opportunities in a more liberalized and prosperous Chinese market through integrating with China. During the “10+3” summit in Singapore in 2000, leaders from China and ASEAN agreed on a joint study for a long term China-ASEAN close economic arrangement, including a FTA.

The official joint study group proposed that it was beneficial to both by making a comprehensive economic partnership and a FTA between China and ASEAN. According to the study, the establishment of a free trade area (FTA) between ASEAN and China “will create the largest FTA, made up of developing countries, in terms of population, GDP and trade. The removal of trade barriers between ASEAN and China will lower costs, increase intra-regional trade economic efficiency”. “The FTA will lead to greater specialization in production based on comparative advantage. Trade creation occurs when some domestic production in one FTA member is replaced by lower-cost imports from another member. This would boost real income in both regions as resources flow to sectors where they can be more efficiently and productively utilized. The simulations conducted by the ASEAN Secretariat using the Global Trade Analysis Project (GTAP) suggest that an ASEAN-China FTA would increase ASEAN’s exports to China by 48 percent and China’s exports to ASEAN by 55.1 percent. The FTA increases ASEAN’s GDP by 0.9 percent or by US\$ 5.4 billion while China’s real GDP expands by 0.3 percent or by US\$ 2.2 billion in absolute terms.”

According to the study, the formation of an ASEAN-China FTA should also attract more investments into the region. The integration of ASEAN with China can entice more foreign corporations, which each market alone cannot otherwise attract. With a larger market, more intense competition, increased investment and economies of scale, enterprises will invest more in research and development, hence promoting technological innovation.

The significance of a FTA between China and ASEAN will go beyond economic gain. “ It will help to create the community between ASEAN members and China. Their geographic closeness, long historical ties and shared culture lays a good foundation for further cooperation. The sense of

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community engendered by an ASEAN-China FTA will contribute immensely to peace and stability in the Asia Pacific region.”<sup>①</sup> This positive conclusion encouraged the leaders of China and ASEAN to agree on a strategy to establish a FTA between the two sides within 10 years in 2001 and to sign the framework document for a comprehensive close economic partnership in 2002.

### III. The Framework Agreement

The signed framework agreement set up important principles for China-ASEAN FTA process. As stated, the aim of China-ASEAN FTA is “to minimize barriers and deepen economic linkages between the Parties; lower costs; increase intra-regional trade and investment; increase economic efficiency; create a larger market with greater opportunities and larger economies of scale for the businesses of the Parties; and enhance the attractiveness of the Parties to capital and talent;” and “to create a partnership between the Parties, and provide an important mechanism for strengthening cooperation and supporting economic stability in East Asia”.<sup>②</sup> The coverage of liberalization through FTA is comprehensive, including goods, services and also investments. According to the framework agreement, FTA will be realized through “progressive elimination of tariffs and non-tariff barriers in substantially all trade in goods; progressive liberalization of trade in services with substantial sectoral coverage; establishment of an open and competitive investment regime that facilitates and promotes investment within the ASEAN-China FTA”.<sup>③</sup>

The timing of establishing the FTA is 10 years. However, considering the internal differences of ASEAN, liberalization will be done by different tracks and different timetables. As for the trade in goods, the normal track will be implemented with specified schedules and rates over a period from 1 January 2005 to 2010 for ASEAN 6 and China, and in the case of the

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① A report submitted to the ASEAN-China Expert Group on Economic Cooperation, by Joint Research Team, Sep.27, 2001.

② Framework Agreement, Nov.4, 2002, p.2.

③ Framework Agreement, Nov.4, 2002, p.3.



newer ASEAN member states, the period shall be from 1 January 2005 to 2015 with higher starting tariff rates and different staging. The sensitive track will be in accordance with the mutually agreed end rates and end dates, and “where applicable, have their respective applied MFN tariff rates progressively eliminated within timeframes to be mutually agreed between the Parties”<sup>①</sup>.

As for liberalization of trade in services, it will have substantial sectoral coverage and aim at “progressive elimination of substantially all discrimination between or among the Parties and/or prohibition of new or more discriminatory measures with respect to trade in services between the Parties”. This liberalization intends to “expand the depth and scope of liberalisation of trade in services beyond those undertaken by ASEAN member states and China under the GATS, and enhance co-operation in services between the Parties in order to improve efficiency and competitiveness, as well as to diversify the supply and distribution of services of the respective service suppliers of the Parties.”

Investment liberalization is “to promote investments and to create a liberal, facilitative, transparent and competitive investment regime”, “to strengthen cooperation in investment, facilitate investment and improve transparency of investment rules and regulations and to provide for the protection of investments”<sup>②</sup>.

The framework agreement set the specific timetables for the negotiations of the FTA. Until now, China and ASEAN have signed FTA agreement for trade in goods and for service and will complete the agreement for investment soon.

FTA is just one core part of the framework agreement. It also listed up the other areas for broad cooperation. Five areas are listed as priority sectors for cooperation: agriculture; information and communications technology; human resources development; investment; and Mekong River basin development. The cooperation will be extended to other areas, including banking, finance, tourism, industrial cooperation, transport, telecommunications, intellectual

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① Framework Agreement, Nov.4, 2002, p.6.

② Framework Agreement, Nov.4, 2002, p.8.

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property rights, small and medium enterprises (SMEs), environment, biotechnology, fishery, forestry and forestry products, mining, energy and sub-regional development. Measures to strengthen cooperation shall include:

- (a) Promotion and facilitation of trade in goods and services, and investment, such as standards and conformity assessment, technical barriers to trade/non-tariff measures, and customs cooperation;
- (b) Increasing the competitiveness of SMEs;
- (c) Promotion of electronic commerce;
- (d) Capacity building;
- (e) Technology transfer.

In order to adjust their economic structure and expand their trade and investment with China, the capacity building programmes and technical assistance, particularly for the newer ASEAN member states will be implemented.

Other areas for economic cooperation also include: (a) Acceleration of the implementation of the Singapore-Kunming Rail Link and Bangkok-Kunming Highway projects under the framework of ASEAN Mekong Basin Development Cooperation (AMBDC) and the Greater Mekong Sub-region (GMS) Programme respectively; (b) Implementation of the mid-term and long-term plans for the all-round development of the Greater Mekong Sub-region (GMS); (c) To facilitate and promote, through specific procedures and mechanisms to be developed, trade and investment between the two sides; (d) To develop the mutual recognition arrangements in areas of mutual interests, such as agricultural products, electronic and electrical equipment, and complete within agreed timeframes; (e) Establishment of cooperation mechanism between standards and conformity authorities to enhance trade facilitation and cooperation in other areas; (f) Cooperation in information and communications technology sector; (g) Development of specific programmes for cooperation in human resources development; (h) Establishment of specific technical programmes to assist the newer ASEAN member states to build their capacity for regional integration and facilitation of the WTO accession process of the non-WTO ASEAN member states; (i) Establishment of cooperation mechanism between customs authorities to enhance trade facilitation; (j) Establishment of cooperation mechanism in the field of intellectual property rights protection.

Considering the special importance of agricultural cooperation between China and ASEAN, a memorandum of understanding on agricultural cooperation was signed separately at the same time. Some specific areas for cooperation were identified, such as training on hybrid rice, cultivation skills, fertilizer and water management, aquaculture specialists, bio-technology application in agriculture, farm machinery, agro-industry, agricultural extension, livestock, as well as technology in agriculture, forestry, post-harvest technology, and food security.<sup>①</sup>

## IV. Early Harvest Program

An important part of the framework agreement is the early harvest program (EHP). It was considered as a first step experiment toward the FTA. EHP shows a good will of the two sides since it was mutually agreed by consultations, rather than negotiations. EHP started to be implemented from January 1, 2004 and fully realized in 2006. This is unique in any FTA negotiation.

EHP covers the products in the chapters from 01 to 08 by HS code. It provides the preferential treatment for some ASEAN members (i.e., Cambodia, Laos, Philippines and Vietnam) with taking some products on the exclusion list. Considering the special interests of some ASEAN members, i.e., Indonesia, Malaysia and Thailand, China agreed to include some special products beyond chapters 01–08 based on the negotiation. For China and ASEAN 6, i.e., Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, the tariff rates shall be reduced to zero no later than January 1, 2006, and for China and the new ASEAN members, i.e., Vietnam, Laos, Myanmar and Cambodia, the tariff rates shall be reduced to zero no later than January 1, 2010.

Besides, in June 2003, China and Thailand signed the agreement on accelerating the implementation of EHP, mainly covering vegetables and fruits. According to the agreement, they would eliminate tariffs on all vegetable and fruit products subject to HS Chapters 07 and 08 no later than 1 October 2003. This agreement is open for any ASEAN member that has the interest to sign it.

EHP intended to provide the incentives for ASEAN countries to join the

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① Memorandum of Understanding on Agriculture Cooperation, Nov. 4, 2002.

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FTA process by early implementing the liberalization and increase the trade between China and ASEAN. This study will provide the fact and analysis on the results of the implementation.

### V. China-ASEAN Relations in Progress

China and ASEAN have moved ahead in forging FTA and comprehensive economic cooperation. China-ASEAN FTA has helped to create a large market based on gradual liberalization of trade goods, services and investments. More than that, by opening the markets, from a longer round, it will help to develop an integrated economic region based on the rational economic division of labor and economic efficiency. One interesting phenomenon in China-ASEAN trade relations is that the export of high tech products from ASEAN to China has increased rapidly in recent years. The story behind is that FDI production network in China and ASEAN has developed and manufacturing parts have circulated in the liberalized market easily, and the two markets have become increasingly integrated.

China and ASEAN have become important trade partners. Since signing the framework agreement, the bilateral trade has increased rapidly. Currently, ASEAN is China's the 4<sup>th</sup> largest import market and 5<sup>th</sup> largest export market and China is ASEAN's the 4<sup>th</sup> largest export market and 5<sup>th</sup> largest import market. For some ASEAN members, the importance of Chinese market is even more evident, especially for many products. For example, in the category of EHP products, China is the largest importer of many products.

Market liberalization is not the full story. China and ASEAN have developed their economic cooperation in many areas, from technology, capacity building, infrastructure (highway, railway, waterway and airway), to sub-regional development projects (aside from GMS, also Beibu Bay Economic zone) and economic assistance. A pioneer cooperation project is Nanning Expo which is located in Nanning City, China, but is jointly operated by China and ASEAN. It has played a positive role in promoting the economic ties not just between

China and ASEAN, but also China-ASEAN and the other parts of the world, since it serves as a window for business of China and ASEAN and the rest of the world.

## VI. Effects of the Implementation

The effects of China and ASEAN FTA, and EHP in particular, seem impressive and positive. As the other side of a coin, although liberalization is good, competition also brings about the pressure and even pain. Especially, when the regional production network is dominated by multinational companies, the benefits from the liberalization are not evenly distributed within local small and medium enterprises (SMEs), as well as small farmers as losers. In the sectoral analysis, the import and export may be unevenly distributed between China and ASEAN countries.

From Chinese case studies, they have made the following conclusion points: (1) The implementation of EHP will promote the export growth of Chinese products with comparative advantages, speed up the development of these industries, and thus promote the optimization of China's agricultural export structure. For example, in the Yunnan case study, the authors found that Yunnan Province and Thailand have great complementary structure in fruit and vegetable trade which benefits both significantly. (2) The implementation has also negative effects on the income of farmers in southern and southwestern China. For example, the longan production in Guangxi has been reduced due to the competition from ASEAN. The author argued that from a longer period, farmers may feel more competition from ASEAN if there are no further measures to support the local production and improve the quality of both fruits and vegetables.

In the Indonesian case study, the author argued that by implementing EHP, China gains more benefits than Indonesia does since for most commodities included in EHP, the actual production level in China is much higher than that in Indonesia. The author suggested that Indonesian government and farmers themselves should make more active response in enhancing the capacity for competition.

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In the Philippine case study, while generally the country has many advantages in developing the market potential provided by EHP, but it is the small farmers and producers that bear the brunt of agreement because they lack access to fallback mechanisms such as credit and insurance. The author suggested that the plight of the small farmers should be considered and proper support and social safety nets should be put in place.

In the Lao PDR case study, the authors found that EHP has not been implemented effectively, having early harvest, but without early preparation. Even with preferential tariff, import prices of some products from Laos are still high due to high cost of land transportation by tracks. The authors warned that ensuring EHP implementation will not cause more negative impacts on environmental and social sectors.

In the Vietnam case study, the authors argued that for the products that are not competitive, there is a positive impact for consumers who now pay lower price or are able to buy the products that are not produced in Vietnam, such as beef, dairy products, temperate fruits and vegetable. The local producers have to improve resource allocation efficiency, and in the long run, the net impact should be positive, but the government may have to adopt relevant policy measures to cushion for the short-term shock.

In the Cambodia case study, the author argued that EHP is an opportunity for Cambodia to develop agriculture as a new source of economic growth and poverty reduction through promotion of agricultural exports. However, EHP will benefit the poor if policy is structured to develop agricultural production and marketing systems that will assist small farmers to supply agricultural products in a cost effective and competitive manner. Farmers would also benefit from policy that helps establishing local enterprises, especially small and medium enterprises, to gain the capacity to compete in regional and international markets. The author has found that Cambodian traders have not been well aware and they are not well prepared to reap the benefit from EHP.

The aim of this project is to study the result of the implementation of EHP under the CAFTA framework. We understand that the implementation is still in its early process. Due to the structural differences among ASEAN members and also between China and ASEAN, the results and effects of the implementation

are various. The results that our studies have found would be useful for policy makers and business community of China and ASEAN to evaluate the policies and make the future strategies though they are not necessary representing the long term future trend.

EADN (East Asia Development Network) is an academic NGO that has played an important role in coordinating the research work on economic development in East Asia. As the project leader, I would like to pay my gratitude to EADN for supporting this project and express my sincere thanks to all project participants and paper contributors for their hard work in conducting their studies.

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