

THE IMPACT OF ASEAN - CHINA FREE TRADE AGREEMENT ON EUROPEAN ECONOMY

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Abstract. *ASEAN members initiated ASEAN Free Trade Area (AFTA) both to increase trade among them and to create an integrated market, thus exploiting the comparative advantage that may come from producing and exporting products like palm oil and biodiesel. Following the rise of China and its increasing trading opportunities, ASEAN members and China itself acknowledged that the best way to develop and promote growth in their countries was through a Free Trade Agreement (FTA). Through the ASEAN-China FTA (ACFTA), not only tariffs and barriers considerably reduced, but a higher level of economic integration was achieved. This was expected to boost the economies of the countries involved and attract foreign investments into the area. Of particular interest for the present study is the case of Indonesia, the largest economy of ASEAN, and an attractive destination for investors from China due to its richness in raw material resources. However, China and Indonesia (together with Vietnam) recently experienced the attempt by the EU to limit trade through the imposition of antidumping duties. Specific case studies that will be treated in this paper are related to: Chinese and Vietnamese shoe production; Chinese solar panel; Indonesia biodiesel. In all these cases, the EU imposed anti-dumping duties that raised much criticism and provoked serious trade retaliation (e.g. China imposed similar duties on the entrance of Bordeaux wine). The lack of political cohesion has so far reduced the effectiveness of the counter measures adopted by Asian countries. This paper suggests that things may rapidly change, as the higher level of economic integration reached through the ACFTA will progressively reinforce the ability of both ASEAN countries and China to respond to the protectionist policies adopted by the EU. To this regard, this paper evaluates the impact of trade retaliation on some specific European industries. In particular, it focuses on the solar panel industry and on the biodiesel industry and highlight their connection to the 20-20-20 plan (20% increase in energy efficiency, 20% reduction of CO2 emissions, and 20% increases in renewables by 2020) set by the EU. It argues that, in order to achieve its ambitious environmental goals, the European government should avoid unnecessary protectionist measures and collaborate more extensively with ASEAN nations and China.*

Keywords: *ASEAN Free Trade Area; China; European Union; trade retaliation; 20-20-20 Climate and Energy Package.*

Introduction

The Association of South East Asian Nations (ASEAN) was established in 1967 with the aim to strengthen the economic, social and cultural development of Southeast Asia. ASEAN members initiated ASEAN Free Trade Area (AFTA) in order to increase trade among themselves and to create an economic community. Member countries made significant progress in lowering intra-regional tariffs. Furthermore, following the European example, they pursued further economic integration and the creation of a proper common market (Plummer, 2006). The emergence of China as a global player contributed to changing the scenario. As a result, increased negotiations between ASEAN and China led to the formation of the ASEAN-China Free Trade Agreement (ACFTA), a free trade area among the ten member states of the ASEAN and the People's Republic of China.

Even though China had already established economic trade with individual South East Asia countries throughout the course of history, it did not pursue official relations until the 1990s. In 1991, at the 24th ASEAN Ministerial Meeting, China officially initiated to build relationships with ASEAN. The ASEAN members welcomed China's interest. Soon afterwards subsequent formation of committees on different areas such as science, technology, security, and trade followed. A major breakthrough was the signing of the Framework Agreement on a Comprehensive Economic Cooperation in 2002,

which laid the foundation for ACFTA. Further developments on this agreement occurred in 2004 with the signing of the Framework Agreement on Trade in Goods by ASEAN and China. The six original ASEAN countries (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) agreed with China on the elimination of tariffs on 90% of their products by 2010, while the less developed ASEAN countries were given time until 2015 to implement such measures.

In terms of consumer market size, ACFTA is now the biggest Free Trade Area in the world. The end goal of having a Free Trade Agreement is to improve national prosperity for each of its members. Park (2007) examined whether ACTFA would be potentially beneficial for both sides, and concluded that both economic and non-economic factors were in favor of a positive answer. However, at the global level, the scenario that recently emerged proved not to be that simple. The entrance of China into the WTO in 2001 altered not only the delicate equilibrium in the Asian region as a whole, but also at a world level. Many industrialized countries adopted safeguard measures against relatively cheap products coming from Asia. In particular, the Anti-Dumping regulation simultaneously reinforced in the '90s in both the US and the EU reflected the need to defend local markets against the entrance of low-cost products coming from Southeast Asia, in particular from China. In the EU, for example, new Anti-Dumping regulations came into force on January 1, 1995, updated by Regulation 1225/2009. They targeted in particular dumped imports that caused significant injury to European producers. In order to apply such duties, the EU investigation on anti-dumping claims must demonstrate that: (i) there exists dumping by the exporting producers in the country/countries concerned; (ii) material injury has been suffered by the Community industry concerned; (iii) there is a causal link between the dumping and injury found. Such measures were recently adopted more extensively than in the past, raising criticisms and concern. However, as I will argue, the higher level of economic and political integration achieved in Asia following ASEAN-China Free Trade Agreement has substantially changed the effectiveness of such policy instruments, and provoked trade retaliation.

Not only China, but also many other ASEAN countries, like Indonesia and Vietnam, have been highly affected by the Anti-Dumping regulation implemented by the European Union. For example, Indonesia was imposed an additional duty of on average 18.9% for the biodiesel exported to the EU. This, together with a similar duty of an average of 47.7% for Chinese exporters of solar panels, raised two main issues. First, trading partners responded by restricting the import of certain products from the EU. Some European producers, especially in luxury sectors, recently experienced such trade retaliation measures. Second, and more important for the aim of this paper, such trade policies may prove to be in sharp contrast with important initiatives within the environmental policy framework strongly supported by the EU. Case in point, the price for alternative sources of energy may indeed increase because of such forms of protectionism, thus reducing the possibility to achieve the ambitious goals set at the EU level in terms of environmental protection.

This paper explores the effect of the deeper level of integration of Asian countries with the EU economy, with a particular focus on the difficult relation between trade policy and environmental policy. In particular, the success of the EU environmental policy crucially depends on the possibility to complete its climate and energy targets by 2020. The aim of the so-called 20-20-20 integrated plan is to simultaneously obtain: (i) a 20% reduction in EU greenhouse gas emissions; (ii) an increase in the share of EU energy consumption produced from renewable resources to 20%; (iii) a 20% improvement in the EU's energy efficiency. I will argue that the EU should reduce the level of protectionism towards Asian countries if it wants to achieve such ambitious goal. The reason is simple. The EU needs alternative affordable sources of energy coming also from the exploitation of biodiesel and solar power, for example, and this is possible only by opening up trade with those countries where they are cheaply produced. This is even more necessary as Asian economies are becoming deeply integrated because of ACFTA. Therefore, their ability to effectively respond to European protectionist measures is going to increase in the following years. In fact, this reality has already played out. In order to support my thesis, I will consider relevant case studies that show the impact on the European economy of different strategies respectively adopted by China, Vietnam and Indonesia. Such responsive strategies cover a time span of almost a decade and show that a progressively higher level of economic integration not only within ASEAN but also between ASEAN

and China has significantly increased the level of effectiveness of the responses adopted by Asian countries.

The impact of ACFTA on the European Economy

As I introduced above, apart from China, in my analysis I also focus on Indonesia and Vietnam as two interesting cases of recent integration in the Asian market as well as examples of countries subject to anti-dumping duties levied by the EU. Starting from Indonesia, 16% of its GDP is still provided by the agricultural sector that also employs 45% of the labor force. The potential advantages of such a country are represented by perfect climate for agriculture, fertile volcanic soil, abundance of water, and plenty of arable land. Today Indonesia is the world's largest producer of palm oil as well as a leading global producer of other high value commodities such as cocoa, rubber and coffee. Focal industries such as fisheries and agri-food, consumer electronics, furniture, and natural cosmetics have huge potential in the EU market. Demand for imports of focal products is projected to grow by nearly 7 percent a year over the medium term. Recently, the EU demand for agri-food imports has been strong, particularly in response to changes in consumer incomes. As an example, over the last four decades, the palm oil industry has expanded dramatically. The share of palm oil production has increased by 16.8 percent, from only 4 percent in 1962 to 20.8 percent in 2002. This shows the competitive advantage of crude palm oil (CPO) as one important source of Indonesia's export incomes. In addition to raw materials for cooking oil, palm oil is used to make margarine, soap, oleochemicals and now also for *biofuel*, therefore touching upon one of the most important points of this paper. However, as we have already discussed, the European Union applies precise rules for exporters willing to enter its market. Under Common Commercial Policy (CCP), for example, it controls the minimum standard quality items from Indonesia. Even though Indonesia and EU have a bilateral agreement under WTO, some industries are subject to specific quota barrier or standard quality barrier. This is not the only trade barrier, as it will be shown below. Protectionist measures such as antidumping duties have been recently employed towards biodiesel from Indonesia to the European market, thus reducing its import.

Let me now consider Vietnam. In the past years, Vietnam's economy has grown exponentially; its GDP has increased by 10.3%, resulting in considerable expansion of its middle class and increased purchasing power. The implementation of new regulations, more privatization, and a reduction of restrictions for foreign ownerships has attracted numerous foreign investors. The reconstruction of its economy, together with ASEAN economic integration and free trade agreements, helped Vietnam to improve trade with other countries in the region. Indeed, Vietnam's trade with other ASEAN members has increased to 20%, the biggest surge in the whole region. Vietnam has also strengthened its relations with the neighbors through cooperation, equality, mutual benefit and non-interference into other country's internal affairs. ASEAN membership has also given Vietnam the opportunity to reinforce external relationships with non-ASEAN member countries and to actively participate in international cooperation meetings. In addition, Vietnam joined the regional road, electricity, and fuel networks. In short, Vietnam promoted its image as a dynamic country with a foreign policy characterized as independent, self-reliant, politically stable, cooperative and developed. Vietnam has also worked hard to attract foreign investors, creating an appealing and attractive business atmosphere for foreign investors by continuously improving its legal framework and institutes associated with business and investment. If one compares Indonesia and Vietnam in terms of exports, Vietnam has surprisingly outperformed Indonesia in the clothing and footwear industry due to its cheaper labor force and strategic location, which is comparable to China. ASEAN is also pushing Vietnam to become more liberal and open to the other countries, making it possible to build multilateral agreements in trading with ASEAN and non-ASEAN members.

Overall, the strengthening of ASEAN's integration process brought a significant improvement in the socio-economic conditions of Indonesia and Vietnam. It provided these countries easy access to other ASEAN countries as well as China, a higher availability of different products, markets that are more heterogeneous, reduced tariffs, and bigger chance of investments between ASEAN member or other

countries in Asia region. Although today Indonesia maintains a stronger economic position, Vietnam is quickly catching up thanks to skilled but still cheap labor cost, political stability, and a more transparency towards foreigner investors. Once again, thanks to ASEAN and ACFTA.

Turning to China, with more than 1.4 billion people it is currently twice as populated then the entire ASEAN-10 and 6 times more populated than Indonesia. Following the data gathered by Jiang and Li (2013), China's total exports to the six ASEAN members, Singapore, Malaysia, Indonesia, Vietnam, Thailand and Philippines amounted to 193.701 billion USD in 2013. The authors also report evidence of a significant increase as compared to 2011, especially in China's exports to Malaysia (31% more than the previous year). In contrast, total export from China to Myanmar, Cambodia, Brunei and Laos had decreased. However, total exports to Vietnam was USD 34.21 billion in 2012, with an increase of 17.6% over the previous year, accounting for 16.75% of total exports China to ASEAN, exceeding Thailand and Philippines ranked in fourth place. In January 2010, when ACFTA was fully established, ASEAN-China two-way trade grew by 10.9% to 443.6 billion USD in 2013. China's export to ASEAN reached 244.1 billion USD, while ASEAN's export to China reached 199.5 billion USD. Nowadays, China is ASEAN's largest trade partner, and ASEAN is China's 3rd largest trade partner. ASEAN-China bilateral investments increased, amounting to 12 billion USD from January to November 2013, in which China's investment to ASEAN reached 4.52 billion USD while ASEAN's investment to China were 7.53 billion USD. These data show greater economic integration in the Asian region. It means, also, a higher degree of political cooperation also in front of other free trade areas and customs unions like the EU.

The dynamism of China's economy, as well as ASEAN countries has revealed the importance of establishing stable economic, political and social relations. Growing economic ties between ASEAN and China reflect their vibrant economies, their respective trade connections and complementary economic structures. Trade statistics (see Chandra & Lontoh, 2011, among others) showed that Indonesia is the ASEAN member with closest trade relations with China, especially after the entry into force of the ASEAN-China trade agreements FTA. Linked to our previous focus on Indonesia, China is one of Indonesia's major trading partners after ASEAN. The total value of trade between Indonesia and China reached USD 36.2 billion (2010) and the amount is 12.4% of the total trade between Indonesia (see ICRA, 2011). Meanwhile, the trade between the two countries during the period 2006-2010 recorded economic growth on average by 30%.

The previous analysis revealed a greater level of economic integration between Asian countries. This also implies an increase in the political integration and a common commitment to play an even bigger role at the world level. The implications for the European Union are clear: protectionist measures adopted by the EU government may backfire. Moreover, the ambitious environmental policy pursued at the EU level may be hindered if protectionist trade policies reduce the free flow of those goods and services that may facilitate the adoption of alternative sources of energy. In the following analysis, I propose three examples of antidumping duties that generated economic and political tension between the EU and three different Asian nations.

The first case analyzed is the tariffs on Chinese and Vietnamese footwear import imposed by the EU in 2006. The then EU Commissioner, Peter Mandelson, announced that evidence had been found of anti-competitive practices on the part of Chinese and Vietnamese footwear manufacturers. Consequently, a decision was made to impose a duty on shoes imported from these regions over a period of five months. The duty started in April 2006 at a rate of 4%. By October of the same year, the rate had risen to 19.4% for China and 16.8% for Vietnam. Following the EU investigation, evidence showed that the Chinese and Vietnamese shoe manufacturing sectors had benefited from state-backed cheap financing, non-market land rents, tax holidays and improper asset valuation. This allowed Chinese producers to export shoes to the European market at a price lower than that was much lower than under proper competitive market circumstances. Hence, the EU claimed it had evidence of illegal dumping. The Commission also estimated that the resulting tripling of imports from the two countries over the past four years has caused the closure of 1000 footwear companies, the loss of 40,000 jobs, and a drop in production of 30%. Material injury for European producers was then evident. Commissioner Mandelson claimed that the antidumping duties were not protectionist

measures. He added that China and Vietnam were free to exploit the natural competitive advantages of their cheaper labor cost. However, they were not entitled to distort free trade through anti-competitive practices. "Defense against unfair trade is specifically sanctioned by the WTO. I do not use trade defense instruments lightly or casually," he said. Nonetheless, the Chinese government reacted by stating that the Commission had insufficient evidence to back such claims, and that Chinese shoe exporters were not dumping goods into the EU. In that case, however, the reactions by Chinese and Vietnamese governments were not aligned, as they individually responded to the accusations brought up against them. Furthermore, the other ASEAN countries were never involved in the dispute. As a result, EU footwear manufacturers took advantage from the lower competitive pressure from Asia, with no repercussions on other European industries. The only tangible drawback was imposed on final customers. In fact, the Federation of European Sporting Goods Industry (FESI) estimated that European consumers would end up paying the cost of the antidumping duty, as shoe prices increased by 25% on average.

The previous example is related to a sector that is not directly connected to environmental policy. Moreover, as I argued above, the EU did not suffer any form of trade retaliation neither from China nor from Vietnam. However, in 2013, the outcome of a similar protectionist measure was notably different. In November of that year, in fact, the EU imposed tariffs of as much as 42.1 percent on solar glass from China to curb import competition for EU producers. The duties were the preliminary outcome of an investigation opened in February 2013 after a dumping complaint was filed by a European group of producers who made up more than a quarter of EU production of solar glass (the EU solar-glass market was valued at least 200 million EUR). The European Commission found that Chinese exporters were selling the glass used in solar panels at below-cost prices thanks to government-backed subsidies. China's expansion into the European solar glass market caused again material injury for EU producers, given that Chinese exporters increased their share of the EU market from 6.2% in 2009 to nearly 30% in 2012. Consequently, a substantial number of European solar glass producers were forced to either cease production or sell off their manufacturing facilities. John Clancy, the EU Trade Spokesman, said that the Commission's investigation "has demonstrated the existence of dumping from the People's Republic of China that causes injury to the Union industry, and that the imposition of provisional measures is not against the Union interest."

However, this time the response from the Chinese government was more aggressive. The Chinese premier, Li Keqiang, had warned the European Commission that the case would have hurt EU-China trade relations. François Godement, head of the China program at the European Centre for Foreign Relations, had predicted that China would have retaliated, and the French government was against the imposition of such measures. Why did France take this position? The reason is simple. In June 2013 the Chinese government began an inquiry into the import of EU wines at the request of Chinese wine makers. The Chinese Commerce Ministry received an application from the domestic wine industry, which accused wines imported from Europe of entering China's market by use of unfair trade tactics such as dumping and subsidies. As a consequence, China, together this time with other ASEAN countries, decided to restrict the import of Bordeaux wine (China was the primary destination market for Bordeaux wine, as Chinese consumers were ready to pay very high prices for such a luxury wine). This affected not only French producers of wine, which were obviously against such anti-dumping measures, but also the purchasing power of many European consumers willing to buy relatively cheap solar panels produced in China. Therefore, in addition to harming this time a specific European industry (wine), the response by the Chinese government caused a negative ripple effect that spread to the European environmental policy, as it reduced the effectiveness of the 20-20-20 plan.

The last case analyzed connects trade policy and environmental policy even more directly. In July 2013, the EU started applying provisional anti-dumping duties on biodiesel imports from Indonesia, following an investigation that started in April of the same year. In November 2013, the EU voted in favor of introducing definitive anti-dumping duties against biodiesel imports from Indonesia and Argentina. However, due to the simultaneous reinvigoration of the EU environmental policy through the 20-20-20 plan, the demand of biodiesel in the EU continued to rise, despite supply still heavily depended on imports from those countries subjected to the imposed tariff, Indonesia *in primis*. The EU relied on the amiss assumption that they would have been able to easily substitute the cheap

biodiesel from Indonesia with that of other Asian countries, such as Malaysia and South Korea. However, in light of the increasing cooperative effort pursued among ASEAN members, these countries began to systematically reduce the export of biodiesel to EU. Hence, this is a prime example of how the establishment of strong economic collaboration between Asian nations can pose additional challenges not only to EU trade policy, but also to stifle the effectiveness of other interdependent policies, in particular EU environmental initiatives such as the 20-20-20 plan.

Conclusions and implications

The presence of ASEAN and the economic integration achieved following ASEAN-China Free Trade Agreement (ACFTA) has brought substantial changes not only within the Asian continent but also at the global level. In particular, the goal of this paper was to analyze how this may have influenced not only the trade policy adopted by the European Union, but also its environmental strategies. We initially highlighted the cases of Indonesia and Vietnam, which benefited from ACFTA in terms of availability of goods, reduced tariffs, and increased levels of investments. Together with China, they represented an interesting case study to test the implications for European trade policy. In particular, I argued that the deeper level of integration reached by Asian countries has contributed to accelerate two problems faced by the European Union. First, restricting trade against such countries may backfire, as they can now respond by reducing the import of European products, as in the case of Bordeaux wine. Second, the ambitious environmental goals set by the EU, which require the substitution of polluting energy production with green alternatives, relies on the possibility to find economically feasible sources of energy. Case in point, the effective use of photovoltaic systems and the reduction of diesel fuel crucially depends on the respective availability of solar panels and biodiesel at competitive prices. Nonetheless, recent trade policy measures implemented by the EU caused a decrease in the import of cheap solar panels from China and biodiesel from Indonesia! This goes against the ambitious environmental policy promoted by the EU through the 20-20-20 plan. A better coordination between environmental policy and trade policy at the EU level is therefore necessary to fight pollution without spoiling international relations with trade partners that are becoming not only more powerful, but also more aware than in the past of their influence and strategic economic strength as a single entity promoted through ACFTA.

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