

ASEAN-China FTA : Potential Outcome for Participating Countries*

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1. Introduction

The last few years of the twentieth century, that marked East Asia, was the Asian crisis, especially for many countries in the ASEAN region, and the emergence of China, in both politics and economics. Now, the first few years of the new century are hit by the event of September 11 attacks that choke the growth engines of the world, the US in particular and the EU and Japan, to a certain extent. The threat of a war against terrorism and a worsening world economy combined make East Asia look vulnerable.

Most countries in the region are readjusting to the new reality of the world economy. ASEAN countries, for instance, cannot afford to have another crisis and thus need to boost their own economic resilience. China, on the other hand, has not deterred from its commitment to remain open and globally integrated, now a new member of the WTO and a strong new growth engine of the world. Relatively speaking, ASEAN economies have been weakened by the crisis, while China poses a formidable challenge, thus needs ASEAN to reconsider its own position vis-à-vis the rise of China.

The proposed establishment of an ASEAN-China Free trade Area comes at the time of an uncertain global environment. ⁽¹⁾ China called for a setting within ten years to ASEAN countries as part of an economic partnership between the two. ⁽²⁾ It gives a special and differential treatment and flexibility to the least developed members of ASEAN. Response from ASEAN countries differs but overall they agreed to work toward these new challenges posed by China.

There will be many preparations needed for both sides in an FTA. Whether linking it or not, this new challenge will be there with the emergence of China and the rethinking of ASEAN's own economic integration up to date. As the agreement will take into effect sometime in the near future, the negotiations are actually taking place quite intensively. The details of the FTA need to take into consideration possible implications for participating countries which remain to be interpreted. This paper would be dealing with this central issue.

2. Background

At first glance, one would think that an ASEAN-China FTA is a natural response to the growing popularity of FTAs. ⁽³⁾ An FTA is attractive because it provides preferential access to

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⁽¹⁾ From Prime Minister Zhu Ronji at the ASEAN China Summit in Singapore in November 2000.

⁽²⁾ Export Group's Report was considered at the ASEAN-China Summit in Brunei in November 2001.

both sides, and may draw attention from outsiders to become more involved with the group.⁽³⁾ Looking closer, one would find that ASEAN is losing its economic attractiveness due to the crisis while China is viewed as an appealing global economic partner. The reality is that China diverts foreign direct investment from the region as it competes with ASEAN for exports to third markets (Chirathivat (2001), (2002), (Panitchpakdi and Clifford (2002))). Linking the two sides together in an FTA could reinforce each one's own position within the regional and global context.

Trade liberalization has been gradual in ASEAN and China. For ASEAN, progress varies among countries with Singapore the most advanced, the ASEAN-5 well on their way to liberalization, and the CMLV⁽⁴⁾ (Cambodia, Myanmar, Laos and Vietnam) not yet even in the WTO, but with all now involved in AFTA. China, on the other hand, has committed to a comprehensive package of market liberalization in its negotiations to enter. China's accession to the WTO will require a lot of changes, and this will not be quickly or easily understood throughout China.

The result of the liberalization process has been a large increase in foreign trade for both ASEAN and China. The reduction in tariff and non-tariff barriers has been motivated on different fronts. Multilateral institutions like the WTO encourage member countries to liberalize multilaterally and unilaterally. Since the 1990's, the regional approach to liberalization has also gained momentum (Bhagwati, Krishna and Panagariya (1999)). Different countries in various regions have taken initiatives to liberalize among themselves including AFTA. In fact, except the CMLV, the rest of the ASEAN countries are close to completing their free trade area.

The ASEAN-China FTA builds on historical and cultural linkages. Within this context ASEAN-China economic relations have grown rapidly in recent years as detailed in a report by the ASEAN Secretariat.⁽⁵⁾

“ASEAN-China trade totalled US\$ 39.5 billion in the year 2000. ASEAN's share in China's foreign merchandise trade has been continuously on the rise, increasing from 5.8 per cent in 1991 to 8.3 per cent in 2000. ASEAN is now China's fifth biggest trading partner. Meanwhile, the share of China in ASEAN's trade has grown from 2.1 per cent in 1994 to 3.9 per cent in 2000. China is now the sixth largest trade partner of ASEAN.”

There is strong potential for further linking trade and investment between ASEAN and China despite both claiming their major export markets in the developed countries and both being major destinations among LDCs for foreign direct investment. Both ASEAN and China have identified existing measures that hamper their trade and investment.⁽⁶⁾ In the view of both sides, market opportunities would be increased if appropriate measures were taken, and trade and investment potential would then be realized. Thus a framework for ASEAN-China

⁽³⁾ For Example, Japan seems to watch very closely this new development. One has to also refer to Koizumi speech of January 14, 2002 in Singapore about the new cooperative partnership with ASEAN.

⁽⁴⁾ The new members of ASEAN included Vietnam (in 1995), Myanmar and Laos (in 1997) and Cambodia (in 1999).

⁽⁵⁾ ASEAN Secretariat (2001), “Forging closer ASEAN-China economic relations in the twenty-first century”, a report submitted by the ASEAN-China Expert Group on Economic Cooperation, October, p.1.

⁽⁶⁾ See ASEAN Secretariat (2001), *ibid*, op.cit, pp. 26-27.

economic relations should be comprehensive and forward-looking building upon the momentum of China's accession to the WTO.

ASEAN and China are working to adopt a framework of economic cooperation containing six major elements, some of which could be implemented sooner than others. These elements are as follows.⁽⁷⁾

- Trade and investment facilitation measures which cover a wide range of issues like the removal of non-tariff barriers, mutual acceptance of standards and conformity assessment procedures to promote trade in services.
- Provision of technical assistance and capacity building particularly to new members of ASEAN to expand their trade with China.
- Trade promotion measures, consistent with the WTO rules, to be given to the non-WTO members of ASEAN.
- Expansion of cooperation in various areas such as finance, tourism, agriculture, human resource development industrial cooperation, intellectual property rights, environment, energy, etc.
- Establishment of an ASEAN-China FTA within ten years, with special and differential treatment given to ASEAN's new members.
- Establishment of appropriate institutions between ASEAN and China to carry out the framework of cooperation.

3. Implications

With the ASEAN-China FTA to become an integral part of the future course of ASEAN-China economic relations, one could ask what would be the economic benefits of such an initiative. Certainly, there are strategic interests for both sides to be considered. How would ASEAN deal with China's dominance in an economic area with a population of 1.7 billion, GDP of about US \$ 2 trillion and total trade estimated at US\$ 1.23 trillion? ⁽⁸⁾ It will be the largest FTA in the world in terms of population and one made up of developing countries at different levels of development.

For the ASEAN-6 (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam), average tariff rates on Chinese products are already low compared to Chinese tariff rates on ASEAN products which are still quite high even with China's accession to the WTO (see Table 1).

⁽⁷⁾ See further details in ASEAN Secretariat (2001), *ibid*, op.cit, p. 29.

⁽⁸⁾ In comparison to the EU and NAFTA, each possesses a GDP size of over 9 trillion US dollars. ASEAN Secretariat (2001), *ibid*, op.cit, p. 30.

Table 1: Tariff rates

Unit : %

ASEAN applied to China		China applied to ASEAN	
Fruits & vegetables	5.0	Fruits & vegetables	27.4
Coal	9.4	Oil seeds	21.4
Food products	5.0	Petroleum products	8.4
Electrical goods	4.8	Rice	112.8
Drinks/tobacco	6.2	Chemical, rubber & plastic products	19.2
Machinery	3.4	Electrical Goods	16.6
Average	2.3	Average	9.4

Source : Chulalongkorn and Monash General Equilibrium Model (CAMGEM), Chulalongkorn University

Non-tariff barriers imposed by China against ASEAN are also in general much higher than the reciprocal non-tariff barriers (see Table 2).

Table 2 : Tariff equivalents of non-tariff barriers

Unit : %

ASEAN applied to China		China applied to ASEAN	
Other commodities	13.6	Other commodities	76.6
Milk products	17.0	Rice	100.0
Drinks/tobacco	51.2	Metal products	83.7
Textiles	7.3	Leather products	76.8
Mineral products	9.6	Forestry products	96.8
Average	9.2	Average	69.1

Source: Same as Table 1

In an FTA, abolishment of trade barriers will allow trade expansion between ASEAN and China which could be realized through trade creation or through trade diversion. The removal of trade barriers will lower costs, expand intra-regional trade and increase economic efficiency. This will help to boost real income in both regions as resources flow to sectors where they can be more efficiently and productively utilized.

In addition to the increased trade within the FTA, non-members might come to engage in greater trade and investment with the FTA members as their economies become more outward oriented. By enlarging the market, establishment of the ASEAN-China FTA will intensify competition, increase investment and bring about economies of scale which will have spill-over effects in research and development and technological improvement in the long-run. It remains to be seen what would be the “dynamic” time-path (Bhagwati (1993)) of such a creation.

There are, however, also potential concerns associated with an ASEAN-China FTA. Even after the FTA is fully implemented, varying degrees of discrimination across products and countries will remain due to differences in the rules of origin. The rules of origin create significant costs for administrative surveillance and implementation. This could cause complications if different countries in ASEAN and perhaps China get involved in an increasing number of separate but overlapping FTAs. ⁽⁹⁾ That is why in preference to an FTA,

⁽⁹⁾ Singapore-Japan FTA has been formalized while Singapore continues to negotiate with the USA, Australia and New Zealand. Thailand has also entered into dealing a FTA with Australia, New Zealand and perhaps Japan and even China as well.

some economists ⁽¹⁰⁾ advocate a customs union which is characterized by a common external tariff (CET) equivalent to the lowest tariff prevailing in any of the member countries.⁽¹¹⁾

Apart from the issue of rules of origin, a large number of members in an FTA might confuse investors as to which rules, obligations and incentives correspond to which partner. Also, the time and effort that will be required to negotiate and implement the FTA are still unknown, and the process may distract attention from the bigger WTO agenda. At this point, ASEAN and China have yet to start the long process of negotiation for trade liberalization under the FTA.

4. Simulation Results

The effects of an ASEAN-China FTA have been simulated for this paper using the model of, the Global Trade Analysis Project (GTAP)⁽¹²⁾ as adapted in the Chulalongkorn and Monash General Equilibrium Model (CAMGEM) of Chulalongkorn University, Thailand. The model contains 45 countries and 50 production sectors. The structure of the model is outlined in Appendix 1.

In the modeling exercise, it is assumed that rates of trade protection are reduced to zero with all tariff and non-tariff barriers eliminated. Results are reported for simulation of elimination of tariff barriers first and then for elimination of non-tariff barriers.

What could happen to China?

Macroeconomic Impact

The results from GTAP simulation show that ASEAN-China FTA will lead to a decline in price level due to the reduction of China's import tariff rates. In addition, FTA will result in higher demands for China exports due to the reduction of ASEAN's tariff rates and greater competitiveness of China products in the world market. Higher export demands lead to greater demands for primary inputs such as labor and land. As the result, average wage rate will increase by 0.61% while land rent will increase by 0.23%. In addition, the import tariff cut will result in a decline the GDP deflator by 0.17%

Tariff elimination between ASEAN and China will boost the total China's exports by 2.37%. The **trade creation** effect will lead to a sharp rise in China's exports to ASEAN by 23%, Vietnam by 91.6%, Thailand by 55% and Phillipines 46.6%. In addition, the exports to other countries will slightly expand due to cost reduction from import tariff cut which strengthens the competitiveness of Chinese products in the world market. (see Table 3.)

The ASEAN-China trade agreement will also create **trade diversion**. China will increase its import value from ASEAN by 53.3% while decrease its import value from USA by 2.39 % Japan by 1.31%, and the EU by 1.5% (see Table 3.)

⁽¹⁰⁾ Like A.Krueger (1997) "Problems with overlapping free trade areas" in T. Ito and A. Krueger, *Regionalism and Multilateral Trade Arrangements*, The University of Chicago Press, Chicago.

⁽¹¹⁾ However, a major disadvantage of a customs union is that it requires greater degree of policy coordination and collective decision-making and budgetary mechanisms to distribute the tariff revenue between members.

Rajan, R. and R. Sen (2002), "Singapore's new commercial trade strategy : The pros and cons of bilateralism", Centre for International Economic Studies, Adelaide University, Discussion Paper NC 0202, p. 11.

⁽¹²⁾ In a 45 regions' and 50 sectors' GTAP model.

The FTA has impact not only on external demand but also internal demand. Higher export income and lower commodity prices will increase private consumption in China by 0.4%. Aggregate savings will rise by 0.17 %. Private investment is expected to increase by 0.74%, caused mainly by greater export opportunities. Overall, the welfare of China will improve by 1,787 million US dollars.

Sectoral Impact

The GTAP results show both positive and negative FTA impact on each sector in Table 4. On the positive side, some sectors such as textiles, wearing apparel, motor vehicles and parts, and electronic equipments are expected to gain from improving market access to ASEAN's market due to lower barriers. While sectors such as textiles, other food products, motor vehicles, and other mineral products gain from lower input costs due to lower China's tariffs. On the negative side, some sectors may experience lower output resulting from import substitutions.

- **Positive Impact from Market Access into ASEAN market**

Wearing apparel gain benefits from ASEAN's tariff reduction of 4.5%. Exports to ASEAN will increase by 31.5%. Moreover, lower cost of wearing apparel due to China's tariff cut, together with a better market access into ASEAN, lead to an increase in the total sectoral exports by 1.4% and a rise in the trade balance for the products by \$307.9 millions.

Electronic equipments gain benefits from ASEAN's tariff reduction of 4.8%. As a result, the exports to ASEAN will increase by 16.6% while the total sectoral exports will increase by 4.1%. The output of electronic equipments will expand at the rate of 2.1%. The trade balance for the products will rise by \$255.9 millions.

Motor vehicles and parts gain benefits from ASEAN's tariff reduction of 10.7%. The exports to ASEAN will increase by 491.9% while the total sectoral exports will increase by 58.74%. Meanwhile, China's imports from ASEAN will rise by 473.5%. As a result of the FTA, there will be a significant rise in intra-industry trade in vehicles and parts between the members.

- **Positive Impact from Lower Costs**

Other food products will benefit mainly from the lower cost of productions due to China's tariff rate cuts. When tariff rates of agricultural products are reduced, the intermediate input costs of other food products will decline, resulting in the decrease of costs by 0.2%. This greater competitiveness will rise the export demand by 4.2%. Lower price, improvement

of Chinese income and higher export demand will rise the output of other food products by 0.24%⁽¹³⁾

Textiles will benefit, not only from ASEAN market access but also from lower cost of production due to China's tariff rate cuts. When tariff rates of its intermediate input are reduced, the intermediate input cost of textiles will decline, resulting in the decrease of cost and price by 0.03%. This greater competitiveness will rise the export demand by 5.5%. An increase in wearing apparel outputs, improvement of Chinese income and higher export demand will rise the output of textiles by 1.2%.

Electronic equipments will not only benefit from a better market access into ASEAN but also from lower costs of production. The cost and price of Chinese products will reduce by 0.3% and this will result in a higher export demand.

- **Negative Impact from Import Substitution**

Rice will experience a decline in outputs due to import substitution. China's tariff reduction of 112.8% will increase imports from ASEAN by 234% while the sectoral total imports will rise by 251%. As a result, the output of rice will drop by 3.3% and the sectoral trade balance will decline by \$515.8 millions.

Sugar is expected to face a decline in outputs due to import substitution. China's tariff reduction of 26% will increase imports from ASEAN by 103% while the sectoral total imports will rise by 22.6%. As a result, the output of sugar will drop by 6.3% and the sectoral trade balance will decline by \$275 millions.

Vegetable oils is likely to have a slightly lower output caused by import substitution, particularly from Malaysia. A 35.1% cut in China's tariff will lead to a 146% increase in import from ASEAN. Total import in the sector will increase by 25.3%. While the trade balance will decline by \$548.5 million.

Poultry and seafoods will face a higher competition from ASEAN. A 25.7% tariff cut in imports of poultry and seafoods will increase imports from ASEAN by 89%. The output in this sector will decrease by 0.47% and the trade balance will worsen by \$61.4 millions.

What could happen to ASEAN?

Macroeconomic Impact

ASEAN-China FTA will mainly benefit ASEAN through an increasing market access in China's huge market. A rise in ASEAN's exports, such as rice, sugar, vegetable oil, textiles and leather products increases the demand for primary factors of products. Wage and rental price of land will rise by 1.0% and 3.6%, respectively. This leads to an increase of 0.6% in the GDP deflator. The higher demand for Thailand's exports will rise in the export price index by 0.34%.

⁽¹³⁾ It should be noted that according to the GTAP model, a sharp rise in food product output and primary input constraint may limit output growth in wearing apparel and leather products.

The FTA results in a significant trade creation. Namely, there will be 53.3 % surge in ASEAN's exports to China while ASEAN's imports from China will rise by 23%. This leads to an increase in the total exports of 0.95%. Due to cheaper products from China and expansion of overall economy, ASEAN's total imports from China and the rest of the world will increase by 1.27%. As a result, trade balance may decline by \$177.7 millions.

The FTA will create some trade diversion effects. The intra-trade within ASEAN members will significantly decline. For example, exports of Thailand to Vietnam and the Phillipines will be declined by 6% and 5.3% respectively. While the exports of ASEAN to USA and Japan will drop 0.83 % and 1.41 respectively.

The FTA expands not only ASEAN's external sector but also internal sector. Gross domestic investment in ASEAN will rise by 0.83%. While the private consumption and savings will increase by 0.46% and 0.78% respectively. As a result, the real GDP will increase by 0.38%. This leads to an 545.2% increase in welfare of the ASEAN.

Sectoral Impact

According to the GTAP results of sectoral impact shown in Table 5. Like China's case, the FTA creates both positive and negative impacts on productive sectors. On the positive side, some sectors such as rice, sugar, vegetable oils, and textile, chemical, rubber and plastic products, and vehicles and parts may benefit from more exports to China. On the negative side, due to lower ASEAN's trade barriers, imports from China cause a decline in ASEAN's output of vegetable and fruits. In addition, better cost competitiveness of Chinese other food products, wearing apparel and leather products due to the FTA will be likely to suffer ASEAN output.

- **Positive Impact from Market Access into China's Market**

Rice, particularly from Thailand and Vietnam, will benefit from a 112.8% reduction in China's import tariff. As a result, the exports to China will increase 234.4%, causing total exports and production of rice, an increase of 24.7% and 3.5% respectively. The trade balance will rise by \$468.7 millions. The domestic price of rice will increase by 2%.

Sugar, particularly from Thailand and Vietnam, will benefit from a 26% reduction in China's import tariff. As a result, the exports to China will increase 103.1%, causing total exports and production of sugar an increase of 23% and 5.9% respectively. The trade balance will rise by \$328.7 millions. The domestic price of sugar will increase by 1.3%.

Vegetable oils, particularly from Malaysia, will benefit from a 35.1% tariff reduction. The exports to China will grow by 146% while total exports will increase 13.1%. As a result, output in this sector will expand 6.7% while trade balance will rise by \$834.8 millions.

Textiles will benefit from a 22% reduction in China's tariff rate and an expansion in Chinese's wearing apparel sector. ASEAN's export of textiles to China is likely to grow by 133%, leading to a 9.6% surge in total textile exports. As a result, the production will expand by 3.3% while the trade balance will gain \$388.9 millions.

Chemicals, Rubber and Plastic products are likely to gain from 19.2% cut in tariff barriers. ASEAN's exports to China will surge by 77.6% while the total exports will grow by

3.8%. This leads to an output expansion of 1.7% and the trade balance will increase by \$285.4 millions.

Vehicles and parts will benefit from a 20.1% tariff cut. The exports of automobile industry to China will grow by 473.5% while its total exports will increase by 8.1%. As a result, production will expand 0.8%.

- **Negative Impact from Lower Cost of Imports**

Vegatables and Fruits will experience a decline in output due to import substitution. ASEAN's tariff reduction of 5% will increase imports from China by 19.8% while the sectoral total imports will rise by 5.1%. As a result, the output will drop by 0.4% and the sectoral trade balance will decline by \$72.9 millions.

Wearing and apparels, like other food, will face a higher competition from Chinese lower cost of production and ASEAN's 4.51% tariff cut in imports. These will increase imports from China by 107.5%. Total imports of wearing apparels are likely to increase by 5.9%. As a result, the output in this sector will decrease by 0.38%.

The overall result of the simulation is that there are trade gains for both ASEAN and China from forming an FTA. Trade creation will more than offset trade diversion for ASEAN while for China there is no obvious trade diversion. It remains to be seen how ASEAN and China will use these opportunities to strengthen their economic relationships. The simulation shows that China would look increasingly at ASEAN as an alternative source of inputs for natural resource-based or intermediate products. China still needs sources of imported inputs to satisfy the needs of its manufacturing industries which domestic suppliers may not be able to meet. With continuing strong growth in China, ASEAN could come to play a crucial role in supplying China's demand for such products.

5. Framework Agreement

At the suggestion of Chinese Premier Zhu Rongji at the ASEAN Summit in Singapore in 2000, the ASEAN-China Expert Group was formed to prepare a report on "Forging closer ASEAN-China economic relations in the twenty-first century".⁽¹⁴⁾ This report was presented at the following ASEAN Summit held in Brunei, November 2001. At the Brunei summit, ASEAN and Chinese leaders endorsed the proposal creating a framework on bilateral economic cooperation aimed at establishing an ASEAN-China FTA within 10 years with flexibility to be accorded newer ASEAN members. The leaders also agreed that the framework should provide for an "early harvest" in which the lists of products and services will be determined by mutual consultation.⁽¹⁵⁾

According to the ASEAN Secretary General, the proposed FTA would allow each side to respond to the challenges and seize the opportunities. ASEAN member governments are adopting important policy measures, perhaps the most important since the creation of AFTA. It is then up to the business community to seize the opportunities and respond to these

⁽¹⁴⁾ A report submitted by October 2001. See http://www.aseansec.org/newdata/asean_china_bc.htm.

⁽¹⁵⁾ See Press Statement by the Chairman of the 7th ASEAN Summit and the Three ASEAN +1 Summits, ASEAN Secretariat (2001), (unpublished).

challenges.⁽¹⁶⁾ The governments of both sides have agreed to work out details of the proposed agreement. They could submit guidelines and principles for establishing the FTA to the leaders by the end of 2002 when the ASEAN-China Summit is to be held in Cambodia.

In principle, this framework agreement must be more progressive than the WTO commitment, which means that both sides would have to work closely to further relax their trade barriers against each other. In order to move ahead with the framework agreement, both ASEAN and China have agreed to set a tentative timetable for eliminating tariffs according to three product categories (see Table 6):

- The first set of products involves the “early harvest” proposal focused on the top ten trading products from each country for which tariffs would be phased out fastest.
- The second set of products includes those normal items for which governments could phase out all tariff rates at the end the framework agreement period.
- The last set of products, which is to be kept to a minimum, covers sensitive items, such as industries that need more time to adjust, and for these inclusion in the FTA would be step by step.

Table 6 : Tentative timetable for elimination of tariffs between ASEAN and China

Time Products categories (HS6 digits)	First year	Third year	Last year
1. Top ten trading Products (early harvest)	China	China	China
	A minimum of 60% of the total tariff lines must have tariffs of 0-5 %	100 % of items in the Inclusion List would have tariffs of 0 %	Same as the third year
	ASEAN	ASEAN	ASEAN
	A minimum of 40% of the total tariff lines must have tariffs of 0-5 %	100% of items in the Inclusion List would have tariffs of 0-5 %	100% of items in the Inclusion List would have tariffs of 0%
2. Normal products	Each side would have an Inclusion List with tariffs of 0-15 %	Each side would have an Inclusion List with tariffs of 0-5 %	Each side would have tariffs of 0 %
3. Sensitive products	Each side would agree on the tariff range	Each side would agree on the tariff range	Each side would have tariffs of 0-5 %

Source : author interviews

According to these principles, the two parties should gradually lower tariff rates on globally competitive products at a faster pace than on sensitive products. Also, for the newer ASEAN members, China would offer the right to implement tariff reductions a few years later.

In fact, FTA provisions would go beyond reduction of tariffs to cover also reduction and elimination of non-tariff barriers, liberalization in services trade and liberalization in investment. However, it will take time to negotiate all these issues in the process of establishing the FTA. It remains to be seen how both sides would identify and continue to work on the issues.

⁽¹⁶⁾ See H.E Rodolfo C. Severino, Secretary General of ASEAN remarks, at the First Meeting of ASEAN-China Business Council and Trade and Investment Facilitation Workshop, ASEAN Secretariat, Jakarta, 8 November 2001 (mimeograph).

6. Upcoming Challenges

ASEAN linking up with China in an FTA is expected to boost the region's attractiveness for investment. Such integration among the two sides seems to be necessary given increasing competition in the global economy following the Asian crisis and China's entry into the WTO. China's WTO entry together with the strong flow of foreign direct investment into the country serves as a wake-up call to all Asian countries to improve their competitiveness. For its part, China looks to ASEAN to improve ties and strengthen economic relationships in support of its growth. The ASEAN- China FTA agreement could also attract outsiders like Japan, the USA, the EU and others to take a closer look at their partnerships in the region.⁽¹⁷⁾

On the other hand, some ASEAN members are still reluctant to open their markets to China fearing a flood of Chinese goods. The increased competition in ASEAN's domestic markets as a result of liberalizing trade with China could negate any potential benefits from having better access to the Chinese market and to the FDI now flowing into China. ASEAN still needs to be careful in such an FTA not to sacrifice its own interests.

The CML countries would benefit by waiting till a later stage liberalize tariffs while Indonesia, the Philippines, Thailand and Vietnam are more prepared to open up their markets. Thus, most ASEAN countries, at the moment, are busy working to reevaluate individually their own positions with China. There are costs and benefits with any liberalization exercise. Proper sequencing is still essential because domestic industries might need time to adjust. Overall, countries must seek to get benefits that outweigh the costs.

Skeptics argue that ASEAN needs to exercise caution and work to ensure a win-win result. Much of the FDI flowing into China might not have been diverted from ASEAN as these capital flows are directed toward different objectives and are not competing with similar flows to the ASEAN region. Moving into an ASEAN-China FTA might not address ASEAN's needs to strengthen its own grouping.

Whatever the arguments given, the proposal to establish an ASEAN-China FTA has given breath to the debate about forming an FTA for all Asia. This would mean that Japan and Korea, for example, could join the FTA agreement as well. This also contributes to a new round of debate about the timing for East Asia to form a trade group in the wake of the much stronger economic blocs in Europe and the Americas.

It is in this sense, that an ASEAN-China deal might be useful politically to keep the momentum going and pressure other countries to get with the free trade program for fear of losing benefits. Furthermore, with bilateral free-trade pacts proliferating within the region, the firming up of an East Asian FTA is moving closer. Singapore is negotiating simultaneously with Japan, the US, Australia, New Zealand and South Korea. Thailand is doing a similar exercise with China, Australia and New Zealand. A Japan-Korea free-trade agreement is being considered by both sides. This trend creates strong impetus for an Asia-wide FTA. While new deals may boost trade, however, there must be avoidance of a confusing "spaghetti bowl" of conflicting and overlapping rules (Bhagwati (1997)).

⁽¹⁷⁾ Japan's manufacturers are also under threat from China's cheap labor and cheap goods. Unemployment has been rising across the country and it's vital to adopt new technology and find new ways to compete. Japan's industries are now struggling with the shifting of industries to the region as a way to survive. *Far Eastern Economic Review*, April 25, 2002.

The ASEAN-China FTA has contributed to new thinking about East Asia, not just as a geographic concept, but as an institutional arrangement. This regional approach may take time to realize, but still ought to be seen as the most desirable option. It is still the case that ASEAN and China are considered developing countries with strong dependency on outside markets rather than a self-contained group. However, by creating an ASEAN-China FTA, and developing appropriate institutions to carry out cooperation, both regions could gain in the long run.

7. Conclusion

Although ASEAN and China are not yet considered major trading partners of each other, trade between them is expanding in some products suggesting growing future importance of intra-regional trade and perhaps investment brought about by rising income, product differentiation and economies of scale. For many ASEAN member countries, the Asian crisis caused economic weakening, yet they must face the challenge of a new type of economic landscape in an integrating Asia where China is now a strong presence. Linking ASEAN and China together with a focus on regional and sub-regional or even very localized potential spots for high growth and investment could help them to grow further in a regional context and also in a global economy.

A new tentative framework of economic cooperation looks useful at this stage for ASEAN and China. This framework aims broadly to bring the two sides together, while addressing specific targets as well such as an ASEAN-China FTA. Politically, China proposed such a scheme to ASEAN. They agreed to a timeframe for establishing the FTA of ten years. There would be trade gains for both sides. Trade creation will offset trade diversion overall with some ASEAN imports diverted from current trade partners to China. However, with China's strong growth, imports from ASEAN could be absorbed to expand exports without causing significant trade diversion. China could look to ASEAN as an additional source of inputs for natural resource based and intermediate products.

ASEAN and China, as newly industrializing regions, would still rely on outside sources for education, technology and infrastructure development, requiring them to link to wider global production centres through the activities of multinational companies. These firms from Japan, the USA and the EU, for example, will turn to an ASEAN-China FTA for labor-intensive and other skilled-related products. Intra-industry specialization would result from the new arrangement between ASEAN and China, allowing for an efficient division of labor as well as generating interesting cooperation between the two.

Creation of an ASEAN-China FTA would be an exercise that could contribute to the concept of an "Asian Economic Community" (Dutta (2002)). In other words, East Asia is being transformed from a mere geographic concept into a regional institutional arrangement. With the prospect that an ASEAN-China FTA could contribute to an Asian institutional identity and lead an escape from the "spaghetti bowl" effect, the new framework would also be a step toward globalization and away from the economic crisis that ripped through the region in 1997 and 1998.

Appendix 1

Summary of the Global Trade Analysis Project (GTAP) model applied in this study

This paper makes use of the GTAP model known among economists in the area. The Chulalongkorn CAMGEM Project is based on this model and has been applied to a number of important global trade analyses. The GTAP model in its latest version contains 45 countries and 50 production sectors.

The model (ASEAN Secretariat (2001)) is structured on the following elements: (a) a regional household whose Cobb-Douglas preferences are defined over composite private expenditures, composite public sector expenditures and savings; (b) demand arising from private expenditures governed by a constant difference of elasticity (CDE) function; (c) production described by a multi-level Leontief-type production function defined over value added and intermediate inputs generated from the Social Accounting Matrix (SAM) constructed for each region with value added produced through a constant elasticity of substitution (CES) function; (d) macro closure of a CGE model with balances in each region composed of government deficit or surplus, aggregate saving and investment, and balance of trade.

Finally, the equilibrium of the model is defined as a set of prices and quantities for goods and factors in all regions such that (a) demand equals supply for all goods and factors; (b) each industry earns zero profit; and (c) gross investment equals aggregate savings in each region. The model is neoclassical in nature as prices in each region's product and factor markets are assumed to be flexible and arable land for agriculture in each region is assumed to be fixed.

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Table 3. Impact of ASEAN-China FTA on Trade Flow (%)

	CHINA	ASEAN	THAI	MALAY	INDO	PHI	SING	VIET	JAPAN	USA	EU	ROW	Total
CHINA	-100.00	23.07	55.01	28.36	23.67	46.58	1.52	91.59	0.04	0.13	0.12	0.07	1.91
ASEAN	53.27	-0.79	64.74	-	-	-	-	-	-1.41	-0.83	-1.04	-1.21	0.76
THAI	63.33	5.45	0.00	-1.42	-4.62	-5.28	0.79	-6.05	-1.82	-1.11	-1.45	-2.38	0.74
MALAY	52.98	-	-2.40	0.00	-1.61	-3.35	0.37	-6.01	-1.51	-0.98	-1.24	-1.58	0.63
INDO	26.85	-	-2.70	-0.71	0.00	-2.94	0.76	-10.06	-0.75	-0.63	-0.72	-0.78	0.46
PHI	31.34	-	-1.17	0.95	0.78	0.00	1.73	-4.80	0.55	2.18	0.91	0.72	1.55
SING	68.58	-	-1.67	-0.55	-0.79	-3.27	0.00	-8.72	-0.83	-0.76	-0.83	-0.85	0.83
VIET	10.06	-	-1.18	9.08	-0.77	3.92	1.20	0.00	1.93	-0.52	4.96	0.51	2.80
JAPAN	-1.31	0.23	-0.81	0.33	-0.27	-0.88	1.24	-5.73	0.00	0.05	0.05	0.03	-0.07
USA	-2.39	0.54	-0.34	0.81	0.00	-0.76	1.19	-3.58	0.02	0.00	-0.02	-0.02	-0.04
EU	-1.50	0.38	-0.25	0.50	0.03	-1.69	1.23	-3.81	-0.02	-0.02	-0.02	-0.03	-0.04
ROW	-2.08	0.63	-0.55	0.62	-0.24	-1.14	1.52	-3.90	0.15	-0.03	-0.02	0.02	-0.09
Total	1.61	1.03	0.95	0.97	0.67	0.43	1.17	1.43	-0.07	-0.05	-0.03	-0.07	0.07

Table 4. Impact of ASEAN-China FTA on China's production sectors

Sector	MFN		Output			Price	Export	Import	Change in				
	ASEAN	China	T	I	E	%	%	%	Trade balance				
	%	%	%	%	%	%	%	%	\$ mill.				
Agriculture	1 Paddy	0.00	0.00	-0.83	0.15	-0.95	0.16	-0.18	-2.40	0.01			
	2 Wheat	0.00	0.00	-0.52	-0.04	-0.48	0.20	-0.81	-0.20	3.59			
	3 Cereal grain nec	0.76	1.76	-0.52	0.02	-0.53	0.20	0.37	-0.07	1.42			
	4 Veg,fruit,nut	5.04	27.43	0.31	0.29	0.06	0.37	2.68	35.32	4.94			
	5 Oil seeds	1.45	21.25	-4.23	0.03	-4.35	-0.51	6.84	-6.01	42.93	S		
	6 Sugar cane,sugar beet	2.00	0.00	-2.87	-0.56	-2.31	-0.36	2.39	-7.51	53.78	S		
	7 Plant-based fibers	0.29	8.14	1.02	0.26	0.73	0.44	-1.03	1.90	-26.91			
	8 Crops nec	2.96	15.88	-1.17	0.28	-1.40	0.01	4.30	26.38	-180.48	S		
	9 Livestocks	2.22	7.83	0.43	0.18	0.26	0.08	-0.46	0.57	-0.13			
	10 Animal products nec	3.36	20.60	0.35	-0.03	0.37	0.25	-0.69	1.74	-13.53			
	11 Raw milk	0.00	0.00	0.64	0.04	0.59	-0.26	0.34	0.34	0.00	C		
	12 Wool,silk-worm cocoon	2.06	7.17	1.96	-0.60	2.53	-0.93	4.13	-0.55	15.00	C		
Natural Resources	13 Forestry	2.42	2.19	0.37	0.11	0.26	0.42	-1.81	3.41	-15.32			
	14 Fishing	10.40	17.62	-0.17	0.06	-0.22	0.18	-0.21	2.27	-2.18			
	15 Coal	9.36	3.37	0.48	0.09	0.38	0.30	-0.73	1.47	-9.00			
	16 Oil	0.43	7.90	0.19	-0.12	0.29	0.17	0.23	2.63	-63.17			
	17 Gas	13.90	0.00	0.48	-0.02	0.50	0.26	2.40	0.68	-3.48			
	18 Minerals nec	3.42	0.44	0.59	-0.03	0.59	0.15	0.93	1.08	-7.02			
Agro-industry	19 Meat products	1.55	23.92	0.67	-0.31	0.95	-0.22	1.94	0.31	2.65	C		
	20 Poultry,seafoods	4.86	25.71	-0.47	-0.41	-0.10	0.16	-0.05	45.37	-61.40	S		
	21 Veg oil and fats	1.98	35.13	-7.49	-0.15	-7.40	-0.59	3.37	25.30	-548.45	S		
	22 Dairy products	7.32	12.59	0.65	0.36	0.32	-1.33	12.77	-0.93	3.21	C,T1,T2		
	23 Processed rice	0.00	112.79	-3.28	0.09	-3.39	-0.25	4.54	251.27	-515.79	S		
	24 Sugar	0.54	26.06	-6.28	0.18	-6.41	-0.11	2.51	22.62	-275.03	S		
	25 Food products nec	4.97	27.69	0.24	0.26	0.00	-0.20	4.16	10.47	-18.81	C,T1,T2		
Manufacturing	labor intensive	26 Beverages,tobacco prods	6.22	49.72	0.97	2.06	-0.55	-0.27	39.74	68.11	91.08	C,T1,T2	
		27 Textiles	11.35	22.05	1.22	0.53	0.67	-0.03	5.45	2.18	107.29	C,T1	
		28 Wearing apparel	4.51	31.50	1.02	-0.92	1.86	-0.09	1.37	3.58	307.92	T1	
		29 Leather products	6.91	10.18	0.70	-1.54	2.11	-0.04	0.83	1.28	122.29	T1	
		30 Wood products	14.68	6.88	-0.76	-0.38	-0.40	-0.25	2.01	10.15	-189.18	S	
		31 Paper prods,publishing	5.08	11.14	0.33	0.18	0.16	0.00	2.42	1.72	-40.87		
	Capital intensive	32 Petroleum,coal products	0.32	8.36	0.51	0.21	0.32	0.05	6.66	1.51	18.89	T1	
		33 Chem,rubber,plastic prods	6.35	19.16	0.50	0.26	0.24	-0.08	3.08	1.64	-81.25	T1,T2	
		34 Mineral products nec	8.37	19.20	0.77	0.42	0.38	0.08	4.29	5.83	45.51	T1	
		35 Ferrous metals	3.68	11.20	0.89	0.25	0.60	0.09	4.06	1.43	98.26		
		36 Metals nec	2.33	6.90	0.52	-0.01	0.48	0.03	2.34	2.34	-47.86		
		37 Metal products	7.05	13.51	0.78	0.36	0.41	0.05	3.46	2.59	75.58	T1	
		Technology intensive	38 Motor vehicles and parts	10.71	20.11	1.40	0.85	0.68	0.01	58.74	1.38	213.89	T1
			39 Transport equipments nec	0.14	5.19	1.04	-0.10	1.03	0.01	3.47	1.76	17.90	
40 Electronic equipments	4.81		16.63	2.09	0.82	1.44	-0.29	4.07	2.74	255.91	C,T1,T2		
41 Machinery,equipments nec	3.35		10.20	0.59	-0.04	0.60	0.02	1.65	1.49	-263.55			
42 Manufactures nec	3.14	14.47	0.59	-0.32	0.88	-0.01	1.21	2.01	138.62	C			
Services	43 Electricity	0.00	0.00	0.49	0.17	0.33	0.12	-0.66	0.84	-3.37			
	44 Gas manufacture,distribution	3.00	7.72	0.44	0.22	0.25	0.18	0.42	0.42	0.00			
	45 Water	0.00	0.00	0.42	0.16	0.27	0.11	0.44	0.44	0.00			
	46 Construction	0.00	0.00	0.74	0.25	0.51	0.10	-0.39	0.40	-1.58			
	47 Trade,transport	0.00	0.00	0.49	0.06	0.43	0.01	0.04	0.37	-31.76			
	48 Finance,business,recreation	0.00	0.00	0.41	0.02	0.39	0.08	-0.30	0.51	-37.66			
	49 PubAd,defence,educ,health	0.00	0.00	0.12	0.20	-0.06	0.21	-0.79	0.67	-14.14			
	50 Dwellings	0.00	0.00	0.42	0.11	0.32	0.07	0.45	0.45	0.00			

Note:

T: Total Effect, I: Internal Effect, E: External Effect

Table 5. Impact of ASEAN-China FTA on China's production sectors

Sector	MFN		Output			Price	Export	Import	Change in			
	ASEAN	China	T	I	E	%	%	%	Trade balance			
	%	%	%	%	%	%	%	%	\$ mill.			
Agriculture	1 Paddy	0.00	0.00	3.04	0.03	3.00	2.86	-9.01	3.90	-4.44		
	2 Wheat	0.00	0.00	-0.26	0.10	-0.36	0.44	-0.54	1.36	-19.55	R2	
	3 Cerial grain nec	0.76	1.76	-0.27	0.01	-0.28	1.72	-3.84	3.95	-26.03	R2	
	4 Veg,fruit,nut	5.04	27.43	-0.41	-0.12	-0.28	1.67	-1.98	5.14	-72.94	S,R2	
	5 Oil seeds	1.45	21.25	2.56	0.00	2.56	2.69	-5.90	6.56	-50.68		
	6 Sugar cane,sugar beet	2.00	0.00	1.63	0.03	1.59	2.20	-9.09	4.21	-79.64		
	7 Plant-based fibers	0.29	8.14	0.26	0.01	0.24	1.89	-4.00	3.62	-67.16		
	8 Crops nec	2.96	15.88	-1.00	-0.05	-0.94	1.30	-1.56	1.94	-83.56	S,R2	
	9 Livestocks	2.22	7.83	-0.29	0.06	-0.35	1.66	-5.36	3.61	-8.74	R2	
	10 Animal products nec	3.36	20.60	-0.03	0.02	-0.04	1.39	-1.29	3.18	-24.16	R2	
	11 Raw milk	0.00	0.00	-0.31	0.06	-0.38	1.52	0.19	0.19	0.00	R2	
	12 Wool,silk-worm cocoon	2.06	7.17	0.80	0.26	0.53	0.42	0.98	2.43	-3.43		
Natural Resources	13 Forestry	2.42	2.19	0.25	0.13	0.12	0.57	-1.13	1.54	-17.24		
	14 Fishing	10.40	17.62	-0.08	0.04	-0.12	1.10	-3.29	2.32	-30.36		
	15 Coal	9.36	3.37	-1.90	-0.33	-1.55	0.73	-3.36	2.23	-39.01	S,R2	
	16 Oil	0.43	7.90	-0.65	0.14	-0.78	1.03	-0.57	1.07	-140.26	R2	
	17 Gas	13.90	0.00	-1.33	0.07	-1.39	0.84	-2.48	1.59	-111.67	R2	
	18 Minerals nec	3.42	0.44	-0.69	0.14	-0.82	0.54	-2.35	1.21	-134.52	R2	
Agro-industry	19 Meat products	1.55	23.92	-0.29	0.12	-0.40	1.07	2.14	2.00	-7.70		
	20 Poultry,seafoods	4.86	25.71	0.37	0.01	0.36	0.87	1.20	2.44	28.53		
	21 Veg oil and fats	1.98	35.13	6.67	0.14	6.48	0.85	13.12	1.46	834.87	T1	
	22 Dairy products	7.32	12.59	-0.40	0.07	-0.47	0.53	-0.32	0.59	-9.99		
	23 Processed rice	0.00	112.79	3.53	0.02	3.48	2.07	24.74	3.20	468.70	T1	
24 Sugar	0.54	26.06	5.89	0.03	5.82	1.34	23.06	2.03	328.71	T1		
25 Food products nec	4.97	27.69	-0.11	0.04	-0.15	0.68	0.01	1.66	-16.72			
Manufacturing	labor intensive	26 Beverages,tobacco prods	6.22	49.72	1.60	-0.67	2.27	0.41	25.77	7.44	148.11	T1
		27 Textiles	11.35	22.05	3.34	0.14	3.16	0.02	9.64	3.67	388.90	T1
		28 Wearing apparel	4.51	31.50	0.38	1.73	-1.32	-0.07	0.90	5.93	22.24	C
		29 Leather products	6.91	10.18	-0.16	1.89	-2.01	0.05	0.33	3.50	-52.17	E2
		30 Wood products	14.68	6.88	0.33	0.13	0.20	0.42	0.40	2.53	51.17	
	Capital intensive	31 Paper prods,publishing	5.08	11.14	0.79	0.06	0.72	0.30	2.16	1.12	21.81	
		32 Petroleum,coal products	0.32	8.36	0.16	0.13	0.03	0.42	-0.46	0.62	-66.45	
		33 Chem,rubber,plastic prods	6.35	19.16	1.74	0.05	1.68	0.38	3.77	1.55	285.45	
		34 Mineral products nec	8.37	19.20	0.54	-0.35	0.88	0.31	3.62	3.00	-46.99	
		35 Ferrous metals	3.68	11.20	0.56	-0.04	0.59	0.20	3.21	1.17	-118.81	
		36 Metals nec	2.33	6.90	1.79	0.21	1.56	0.29	2.73	1.02	31.49	
		37 Metal products	7.05	13.51	0.78	-0.25	1.02	0.14	3.07	2.23	-32.26	
	Technology intensive	38 Motor vehicles and parts	10.71	20.11	0.80	0.27	0.51	0.12	8.11	1.41	-78.38	T1
		39 Transport equipments nec	0.14	5.19	0.48	0.54	-0.07	0.21	0.93	0.85	-41.92	
		40 Electronic equipments	4.81	16.63	0.51	0.37	0.14	0.10	0.60	0.93	161.05	
41 Machinery,equipments nec	3.35	10.20	0.86	0.46	0.38	0.08	0.95	0.76	-241.74			
42 Manufactures nec	3.14	14.47	-0.07	0.34	-0.41	0.17	-0.07	0.99	-99.44			
Services	43 Electricity	0.00	0.00	0.59	0.12	0.46	0.38	-2.10	1.23	-0.06		
	44 Gas manufacture,distribution	3.00	7.72	0.56	0.09	0.47	0.50	0.64	0.64	0.00		
	45 Water	0.00	0.00	0.50	0.12	0.37	0.35	0.46	0.46	0.00		
	46 Construction	0.00	0.00	0.79	0.25	0.53	0.29	-0.99	0.98	-49.57		
	47 Trade,transport	0.00	0.00	0.02	0.14	-0.12	0.42	-1.14	1.16	-694.37		
	48 Finance,business,recreation	0.00	0.00	0.07	0.14	-0.06	0.37	-1.38	0.98	-339.90		
	49 PubAd,defence,educ,health	0.00	0.00	0.22	-0.03	0.25	0.56	-2.06	1.40	-138.85		
	50 Dwellings	0.00	0.00	0.45	0.06	0.39	0.28	0.63	0.63	0.00		

Noter:

T: Total Effect, I: Internal Effect, E: External Effect