

# ACFTA 3.0: Greater integration likely, but who benefits?

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# Contents

The geopolitics of trade	3
From deepening ties to rising imbalances	4
ACFTA 3.0: a new chapter?	7
Conclusion: Inescapable geopolitics	9
References	10



# The geopolitics of trade

The rules-based global trade system has been a primary driver of economic growth and development for both China and ASEAN. The creation of a stable, orderly trade framework built on the principles of progressively reduced trade and investment barriers and non-discrimination has provided the springboard for successful export-led development models and higher standards of living across the region and beyond.

That system is now under greater pressure than at any time in its eight decades' history.

True, harmful trade policy interventions have been proliferating since 2009, following the Global Financial Crisis (GFC) and successive trade-thwarting events such as the Brexit, US-China trade tensions, the Covid-19 pandemic and the increased prevalence of armed conflict. Between then and now, the US has introduced over 11,000 restrictive trade measures, and China nearly 9,000, which illustrates the scale of the retreat from openness.<sup>1</sup>

But things have come to a head under the Trump 2.0 administration.

The US, the primary architect, and historically the leader of the global trade system, now seems determined to smash it to pieces. Trump's reciprocal tariff regime, first announced in April 2025, eviscerates the cornerstone principle of Most Favored Nation treatment; the handful of agreements reached with partners to reduce previously threatened tariff levels are unapologetically mercantilist and protectionist. Given the role of the US and its status as the largest economy and largest importer in the world, the erratic conduct of the US places the entire system in jeopardy.

At such a time, the strong commitment demonstrated by China and ASEAN to the principles of rules-based trade, and their pursuit of progressively freer trade, should be welcomed. The impending upgrade to the ASEAN-China Free Trade Agreement (ACFTA 3.0) sends a strong message that not every country or region in the world is

prepared to abandon a system and a set of principles that have underpinned peace and prosperity for decades.

That said, the geopolitical landscape, in which ACFTA 3.0 is embedded, cannot be overlooked. The intensifying US-China rivalry casts a long shadow. Even with a temporary trade truce in place, China is faced with higher US tariffs than most other economies in ASEAN, and failing some type of trade deal or extension of the truce, those tariffs will soon be snapping back to their previous triple digit levels, further widening the gap between the tariffs China faces on US exports and those applied on ASEAN members.

Lower tariffs than those on Chinese exports to the US should, in theory, benefit ASEAN exporters. In practice, however, the new environment has intensified competition, with Chinese goods that might otherwise have gone to the US flooding non-US markets, including ASEAN. Complicating matters further for ASEAN is that China is its largest trading partner and an important source of investment in infrastructure, manufacturing and technology. Hence, greater integration with China, through an updated ACFTA, presents a mix of tensions and opportunities for ASEAN.



Image by Ellis Garvey

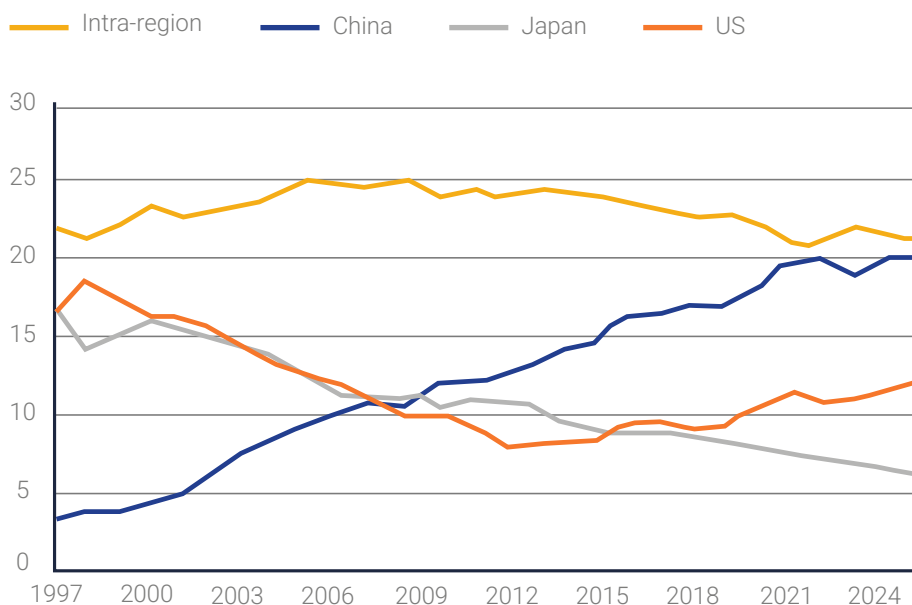
# From deepening ties to rising imbalances

ASEAN member states have benefitted from increasing economic integration with China for the better part of the past four decades. China's market-opening reforms in the 1990s and accession to the World Trade Organization (WTO) in 2001 created a powerful new engine of growth for the export-led ASEAN economies, one that fuelled expansion and lifted standards of living.

Between 2001 and 2011, ASEAN's exports to China grew at a compound annual growth rate (CAGR) of 24%, while imports rose by 23%.<sup>2</sup> In 2007, China overtook Japan to become the largest source of extra-regional imports for ASEAN, and post-GFC it emerged as the largest export destination and trading partner for ASEAN outside the bloc.

## Exhibit 1: ASEAN's goods trade: the rise and rise of China

share in total, %



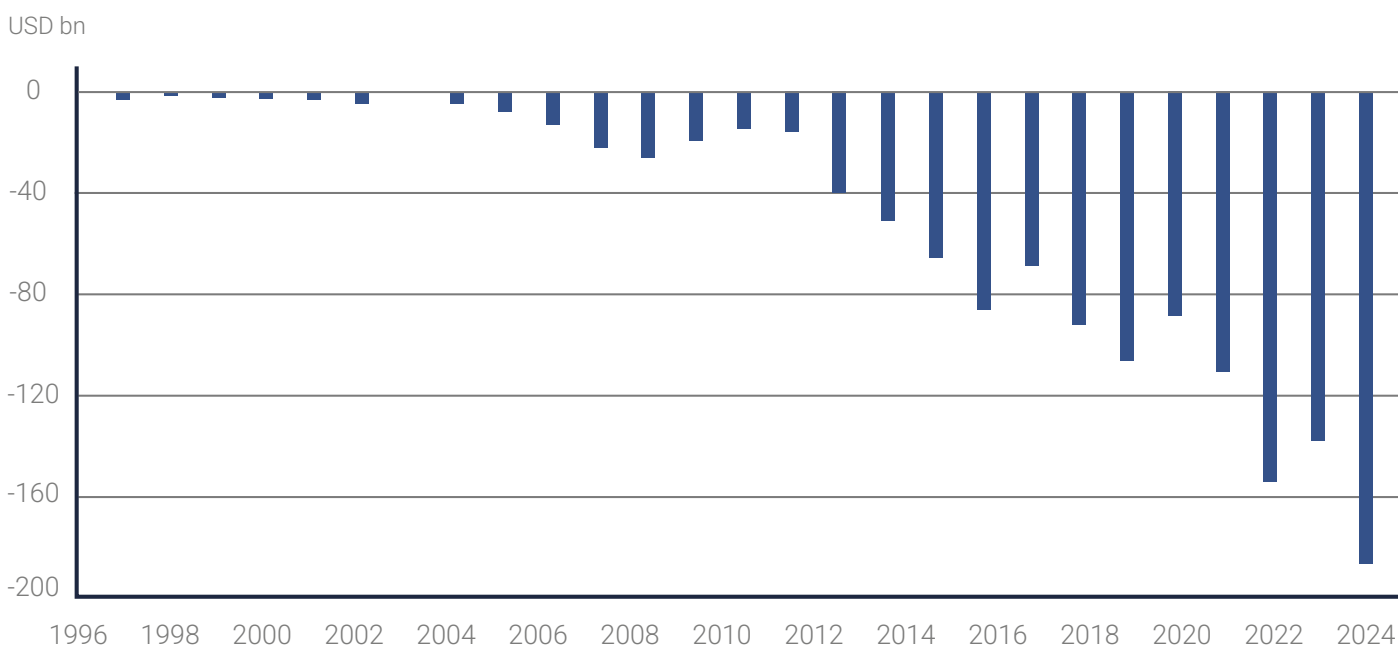
Source: UNCTAD; Asia Decoded

Trade ties have continued to strengthen in recent years. From just US\$20bn in 1995, bilateral goods trade surpassed half a trillion US dollars in 2019, and is on course to match intra-region trade numbers in 2025. However, they have also turned more lopsided. With imports from China fast outpacing export, the trade deficit has exploded over the past decade.



Image by Gan Zhongxue

## Exhibit 2: ASEAN's trade deficit with China has increased



Source: UNCTAD; Asia Decoded

Other than Indonesia, whose commodity exports have benefitted from strong raw materials demand from fast-growing Chinese industries such as electric vehicles and solar panels, China's share in the total exports of major ASEAN economies has stagnated in the past 10 years.

This is because a key feature of China's growth since the GFC has been its declining import intensity. Rapid onshoring of manufacturing has increasingly made China less dependent on other countries, including those in Asia, for meeting domestic demand or operating its value chains.

By contrast, China's import share in most ASEAN markets has continued to rise.<sup>3</sup> The trend has accelerated with the emergence of 'connector' economies in the region, notably Vietnam, which have enabled China to partly re-route exports to the US as bilateral tensions between the US and China have intensified. Consequently, ASEAN's imports from China have exceeded intra-region imports since 2019.<sup>4</sup>

Historically, a services trade surplus has provided a measure of balance. In particular, Thailand, Vietnam and Singapore have benefitted substantially from a surge in

Chinese tourists over the past several years. In addition to directly raising tourism's contribution to growth, this has created employment, lifted incomes and spurred domestic demand. However, Chinese tourists have been slow to return following the pandemic, further impacting the dynamics of the relationship.<sup>5</sup>

### China shock 2.0

More recently, China's industrial overcapacity and outbound investment have emerged as far greater challenges for the bloc. Faced with a consumption slump at home and an increasingly hostile US market, Chinese manufacturers have rapidly increased the export of low-cost goods to the rest of the world. The bulk of these goods have landed in ASEAN, with the region's six major economies seeing a 22% jump in imports from China year-to-date, as compared to a 16% increase in all of 2024 and a 5% decline in 2023.<sup>6</sup>

The challenge is the broad-based nature of these imports. While cheap Chinese shipments of raw materials and intermediate inputs reduce cost pressures for downstream industries and help contain final prices, increasing imports of labour-intensive and low-skilled consumer products

squeeze ASEAN's small and medium manufacturers and threaten to accelerate deindustrialisation.

The policy space to manage these pressures without fuelling trade tensions is narrow. Efforts to court Chinese investment to bolster local industry and reduce import dependence have yielded mixed results so far, with little evidence of positive spillovers into domestic manufacturing and employment. Many Chinese investors continue to rely on suppliers and component chains located in the mainland, limiting integration with local ecosystems.

At the same time, growing dependence on Chinese capital comes with new geopolitical risks. Washington is no longer focused solely on keeping out 'Made in China' products. It is increasingly wary of 'Made by China' goods, as the heightened scrutiny of transshipments from ASEAN

countries underscores. Separately, while multinational corporations are still diversifying supply chains out of China to parts of ASEAN and elsewhere, deeply intertwined manufacturing ecosystems could see ASEAN become locked into a subordinate role in China's supply chains.

## De-risking

These strains in ASEAN–China relations are unfolding against a backdrop of rising protectionism, trade fragmentation and the erosion of the international rules-based order. Notwithstanding the growing frictions, alienating a long-standing economic partner in such an environment could create new risks. The strategy, therefore, should be to de-risk from China without disengaging, to balance the benefits of integration with strategic autonomy.



Image by TruckRun

# ACFTA 3.0: a new chapter?

The provisions of both the original ACFTA and its subsequent upgrades have a clear intention: to reduce barriers to trade and investment and deepen integration between the regions. While that is a worthwhile goal, it begs several questions as to the nature of the deepened integration and the distribution of the resulting benefits.

While it is reasonable to expect higher levels of Chinese FDI in ASEAN as a result of the agreement, the precise nature of that investment is critical. For Chinese FDI to positively impact developmental trajectories in the region, it would have to include meaningful technology transfers to local partners, the development of local supply chains to provide needed inputs, shared managerial knowhow, employment of local labour, including in management positions, and adherence to strict environmental standards.

China's past track record on these issues has not always been stellar. If the ACFTA 3.0 results in increased Chinese FDI that is primarily about access to low-cost unskilled labour and access to needed raw materials resulting in environmental degradation, the benefits to ASEAN will be limited.

As far as trade is concerned, ASEAN runs a services trade surplus with China and competitive firms in the region could find greater opportunities in the China market thanks to the agreement. Most ASEAN nations, however, traditionally run trade in goods deficits with China, and as shown earlier, the gap has been widening in recent years. China is actively boosting its industrial manufacturing industries through subsidisation and other preferences. The result is excess industrial capacity that inevitably finds its way into export markets at artificially low prices. With the doors to the US market no longer thrown wide open, these products are increasingly ending up in Southeast Asia, arguably threatening to drive local producers out of business.

Chinese subsidisation holds a couple of important implications. Even with whatever level of enhanced market access to the China market ACFTA 3.0 might provide for Southeast Asia, will most nations here actually see a further deterioration in their trade deficits with China? If so, the export-led development models so many have staked their future on will look even shakier, especially given the rising barriers to US market access.

But we have started to see growing trade antagonisms between ASEAN and China as a result of dumped Chinese excess industrial capacity. Some countries have already implemented or are considering anti-dumping tariffs against China that have produced strong rebukes from China and the potential for retaliation. Indonesia, for example, has launched investigations that look into the dumping of Chinese products, and has also tightened its import rules.

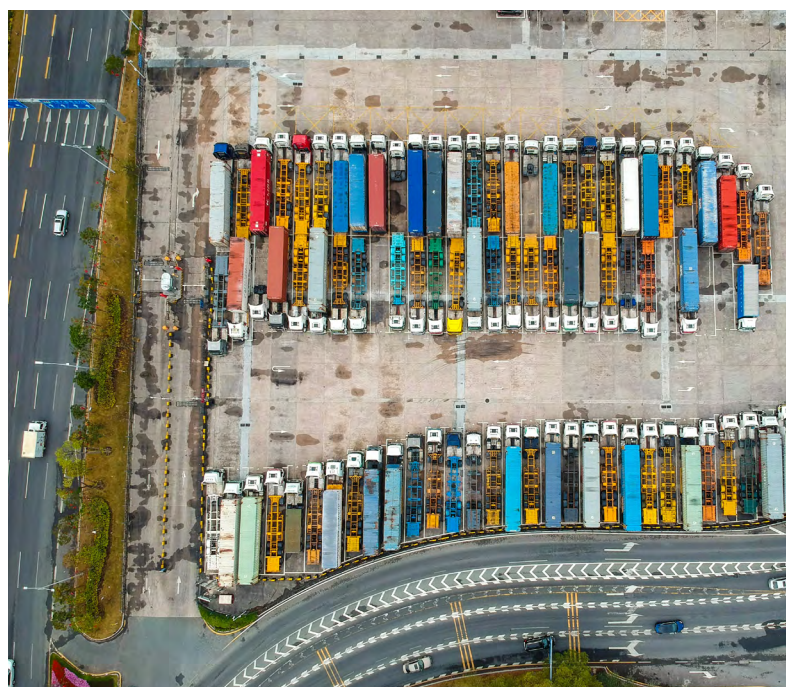


Image by Zhu Edward

Governments in ASEAN have broadly not responded with substantial defensive measures yet, in part because they still see themselves as benefiting from cheaper imports, and in part because of their deep economic ties with China. But, if trade antagonisms do flare-up, the updated ACFTA would do little to head-off a potential cycle of retaliation and counterretaliation, and its enhancement of market access might even worsen the underlying dynamic of low-cost Chinese imports pressuring local producers.

However, the implications of ACFTA 3.0 will vary from country to country in the ASEAN region. The digital economy provisions, for example, could further strengthen the already strong position of Singapore and Malaysia as digital ecommerce platforms. The impact of digital provisions on less developed members such as Laos is less clear, although anything that builds the capacity of MSMEs to participate in the regional and global economy would be positive. Thailand could see further investment in its already strong automotive and green economy sectors, although the extent to which any such investment would strengthen the local industrial base or simply benefit larger Chinese firms remains to be seen.

On the other hand, firms in the Philippines might be cautious about deepening business ties with Chinese firms, given the geopolitical flashpoints between the two countries. The current political discord in Indonesia over employment pressures would not improve if the agreement results in Chinese imports displacing local manufacturers. And for the SMEs that predominate in the region, but especially in Cambodia, Laos and Myanmar, the administrative burden of sorting out paperwork and administrative differences between ACFTA 3.0 and other regional accords such as RCEP might prove to be more trouble than it is worth.

The larger question of course is the extent to which ACFTA 3.0 will represent an upgrade over RCEP or if it will be just another acronym in an already over-crowded alphabet soup. The devil always lies in the details and the actual implementation of what has been agreed—neither of which is entirely clear at this point.

While ACFTA 3.0 should achieve its worthwhile goal of deepened integration, the extent and the nature of that integration may or may not result in balanced benefits, both on an overall basis and for individual countries.



Image by Haris Illahi

# Conclusion: Inescapable geopolitics

We are in the midst of the most consequential geopolitical rivalry since the end of the Cold War. Unfortunately, both the US and China have come to see Southeast Asia as a playing field on which to contest that rivalry. Most of the region's countries have historically struck a balance between the two powers, maintaining beneficial economic and strategic relations with both. That balancing act is growing more difficult and might be further complicated by the deepening integration with China signaled by the augmented ACFTA.

The US and China are both applying pressure in different ways (both subtle and not so subtle) to draw the region's countries closer to their orbits. The transshipment provisions the US has put in place as part of the reciprocal tariff regime, for example, are a barely disguised effort to get ASEAN (and other) countries to reduce their participation in China-centric supply chains. China is not an innocent bystander, either. Its anti-foreign sanction law would sanction anyone who complies with US anti-China sanctions, and Chinese officials have not been subtle

about warning the region about the consequences of cooperating with US efforts to squeeze China out of supply chains.

While ACFTA 3.0 points the ASEAN region towards a deepening integration with China, any benefits derived would have to be assessed against the potential retribution it would face from the US.

For China, while the trade pact will provide an easy way to redirect excess capacity and further deepen its position in neighbouring markets, the longer-term implications are broader. Closer economic ties with Southeast Asia will cement its position as the pre-eminent power in the region. Although this is perhaps already the case given President Trump's seeming ambivalence towards closer ties with the region.

For ASEAN, the trading relationship with China reflects a necessity and strategy. A deepened trade pact consolidates its position as a supporter of free trade. It provides ASEAN economies a better way to hedge against external shocks, secure access to services and digital trade, and most importantly, develop some agency in the great power competition that will define our world for some time to come.

The economic risks are evident, as this note shows. There is a chance the region is overwhelmed by Chinese exports. But there are opportunities if ASEAN can leverage the agreement to build its trade in services surplus, enhance intra-regional trade through the ASEAN Trade in Goods Agreement (ATIGA) and attract higher-quality investment.

Whether the agreement is remembered as a milestone in building resilience or a step towards deeper dependency will depend on ASEAN's resolve (and policies). Far from being a final chapter, ACFTA 3.0 marks a new test for ASEAN, particularly given the geopolitical context: ASEAN must prove it can channel geopolitics into growth and development, or risk being left more vulnerable to the very forces it seeks to manage.



Image by Camillo Corsetti Antonini

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