

**TOWARDS REGIONALISM THROUGH THE ASEAN - CHINA
FREE TRADE AREA: PROSPECTS AND CHALLENGES**

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(ii)

DECLARATION

I declare that Towards Regionalism through the ASEAN - China Free Trade Area: Prospects and Challenges is my work, that it has not been submitted before any degree or examination in any other university, and that all sources I have used or quoted have been indicated, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.



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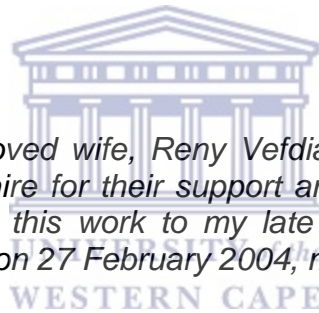
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Key words

Association of Southeast Asian Nation (ASEAN)

ASEAN-China Free Trade Area (ACFTA)

ASEAN Free Trade Area (AFTA)

ASEAN Regional Forum (ARF)

Cambodia, Laos, Myanmar, Vietnam (CLMV)

Dispute Settlement Mechanisms (DSMs)

Disputes Settlement Body (DSB)

Economic Cooperation

Economic Integration

Early Harvest Program (EHP)

Foreign Direct Investment (FDI)

Free Trade Area (FTA)

General Agreement on Tariffs and Trade (GATT)

Least Developing Countries (LDCs)

Most Favour Nation (MFN)

Regionalism

Regional Trade Agreement (RTA)

Treaty of Amity and Cooperation in Southeast Asia (TAC)

World Trade Organization (WTO)



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Towards regionalism through the ASEAN - China Free Trade Area: Prospects and Challenges

1.1. Introduction

Under Deng Xiao-Ping¹, China, the largest developing country in East Asia entered a time of economic reformation and opened up its closed bamboo curtain to the world. This saw a gradual reform in the domestic economic structure in the late 1970s. By the time of Deng's death, the economy had grown tremendously. China gave up its self-reliance policies and started a '*marketization*' reform in 1978, a move which 'sky rocketed' its economic-growth.² The marketization reform involved decentralizing foreign trade decision thus creating and special economic zones namely Free Trade Areas (FTA's)³ to expand an open-door policy to the external world in order to attract foreign investment. In response to the significant role of market forces, there has been a rise in competition, increase in resource allocation and quality, and heightening of consumer satisfaction.⁴ China's industrial production and trade growth have been fuelled by massive inflows of foreign direct investment (FDI), with embedded managerial, technology, and global distribution network advantages; investment in infrastructure; a strong base of cheap, skilled, and highly productive labour; and a growing domestic consumer market.⁵

China's continuous success to prosperity not only focuses on enhancing economic growth, but also on efforts to play a significant role in promoting regional economic cooperation in order to strengthen its dominance in the region.

¹He was the former leader of the People's Republic of China (PRC) and died 1997. People regard him as the chief architect of China's reform. The reform is designed to improve the socialist system, bring its superiority into full play and push forward the drive for modernization. See http://en.wikipedia.org/wiki/Deng_Xiaoping accessed on 21/11/05

²Daungyewa Utarasint, 'ASEAN & China relationship: Prospect in trade and economic cooperation in the era of globalization' (2002) 2

³Article XXIV General Agreement on Tariffs and Trade 1994 (GATT) provides that the creation of a customs union or a free trade area should not lead to higher barriers to third country trade with the customs union or constituent territories of a free trade area.

⁴ *Op cit* 2

⁵ Peter Draper and Garth le Pere, 'Enter the Dragon: Towards a free trade agreement between China and the Southern African Customs Union' (2005) 14, The South African Institute of International Affairs.

China started the strategic plan by restoring diplomatic ties with ASEAN (Association of Southeast Asian Nations) countries,⁶ and more recently, it has joined the World Trade Organization (WTO). This move has enhanced its market attractiveness to foreign investors. A significant implication of this move, however, is the improvement of China's export competitiveness, which correspondingly erodes that of ASEAN.⁷

The ASEAN was formed in 1967, with an initial objective to strengthen the regional security against the communist threat. By the end of the Cold War, countries throughout the world, including ASEAN, appeared to have been released from the security tension under the bipolar world conflict.⁸ Indeed, with the collapse of the bipolar structure between the United States and the former Soviet Union in the late 1980s and early 1990s, countries and regions have altered their priorities. The world economic and political arenas are being replaced by multi-plural cooperation in which each country is responsible for their self-assurance, fortifying their economic growth and extending their success.⁹ In the same indication, ASEAN states have been able to pay more attention to economic development and regional economic integration. Learning from the Asian economic crisis, ASEAN foresaw a threat because they had exposed their weak financial institutions coupled with poor governance to the world and thus eroded foreign investor confidence to invest in these states. As a response to this threat, in 2001, the Chinese Premier Minister, Zhu Rongji proposed an ASEAN - China Free Trade Area (ACFTA).¹⁰ In this light, a plan for a Framework on

⁶ *Op cit* 3. See also: Sheng Lijun, 'China – ASEAN Free Trade Area: origins, developments and strategic motivations' ISEAS Working Paper: International politics & securities issues series No. 1 (2003) 1, where it is argued that from the late 1980s, China intensified its efforts to establish diplomatic relationships with all the remaining ASEAN states as a final step, leading to its eventual official relationship with the ASEAN with Singapore being the last state in this drive.

⁷ Chua Thiam Weng Calvin et al, 'Regionalism is the way to go for ASEAN in the next 10 years'. It has indeed been argued elsewhere that the rise of China's export volume, given its economic size, will depress the prices of all other similar or suitable exports in the international market thus worsening the terms of trade not only for China but also other competing countries. See: Nicholas C. S. Sim, 'The East Asian Divide: A brief overview', Harvard Project for Asian and International Relations, (2001)

⁸ Daungyewa Utarasint, 'ASEAN & China relationship: Prospect in trade and economic cooperation in the era of Globalisation' (2002) at 3

⁹ *ibid*

¹⁰ At the ASEAN plus Three Summit, which is an informal summit of the 10 ASEAN states, China, Japan and the Republic of Korea in November 2000, the Chinese Premier Minister proposed the creation of an expert

Economic Cooperation was hatched which inter alia consented to establishing an ACFTA within the next ten years.¹¹ With the overseas Chinese networks and the proposal of ACFTA, it was thought that ASEAN would utilise the opportunities resulting there from to prosper alongside China.¹²

In 1993 ASEAN and China established a consultative relationship and since then, bilateral economic relations have improved, even though most ASEAN economies are not considered highly complementary to China's economy. Indeed, in 1994, China joined the ASEAN Regional Forum (ARF), and in the following year started regular senior officials' meetings with the ASEAN states at the deputy foreign minister level. Finally, in December 1997, a summit meeting between nine ASEAN members and China, Japan and South Korea¹³ resolved to work towards the ACFTA in the next decade. With the population 1,7 billion people, the agreement created the largest Free Trade Area (FTA) in world.

In November 2001, it was agreed that an ACFTA¹⁴ would be established within ten years. In pursuit of this, the Framework Agreement on ASEAN - China Economic Cooperation was signed in November 2002 under which a free trade



group under the framework of China – ASEAN Joint Committee of Economic and Trade Cooperation to study the feasibility of the FTA.

¹¹ Sheng *op cit* 3

¹² Using China's accession to the WTO as a base, the deputy economic and chief WTO negotiator Long Yongtu promised that ASEAN would be among the first benefit from China's further opening up. See: Jason Leow, "ASEAN – China FTA talks get under way", *Strait Times* (Singapore), 15 May 2002. However, in some circles it has been argued that China is primarily motivated by politics rather than economics is determined to use the FTA as a policy tool whose focus is directed on ASEAN becoming China's FTA partner. See: Naoko Munakata, 'The impact of the rise of China and regional economic integration in Asia: A Japanese Perspective', U.S. – China Economic and Security Review Commission hearing on China's growth as a regional economic power, December 4, 2003, Washington D.C, available on line at http://www.uscc.gov/hearings/2003hearings/written_testimonies/031204bios/naokmunakataa.htm.

¹³ Daungyewa *op cit* 4

¹⁴ The ACFTA incorporates under its umbrella not only liberalization of trade in goods and services, investment but also elements of economic cooperation. It also provides for disputes settlement between the member countries. The largest free trade area in the world with a population of 17 billion upon completion, the ACFTA is being built in stages:

- Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China and its related protocol (concluded in 2002 and 2003 respectively and implemented from January 2004)
- Trade in Goods (concluded in 2004 and implemented in July 2005)
- Dispute Settlement Mechanism (concluded in 2004 and implemented 2005)
- Future Agreement on Investment and Services (negotiation ongoing)

area would be established by 2011¹⁵ for older ASEAN members and 2015 for newer ASEAN members.¹⁶ ASEAN was chosen as China's first FTA partner¹⁷ for purpose of addressing economic threat and security interests perceived by ASEAN nations as posed by China.¹⁸

Of unique importance is the migration of overseas Chinese into the Southeast Asian region. This group of people has become dominant players in contributing and enhancing economic growth in the ASEAN countries. However, whether this group can be relied upon to draw China and ASEAN into closer economic cooperation remains to be seen.¹⁹

The emergence of the People's Republic of China (China) as a major economic and political power appears to present a significant challenge to the Association of Southeast Asian Nations (ASEAN) regionalism and to the world multilateral trading system.²⁰ With its accession to the World Trade Organization (WTO), China now appears determined for political reasons, to use free trade agreements (FTA's)²¹ to consolidate an Asian regional trading system. Cautious of its intentions, ASEAN countries are viewing the rise of China with a mixed sense of threat and hope. There is concern that China's huge and cheap labour force and cost competitiveness will capture ASEAN's market shares in the US, EU and Japan as well as threaten ASEAN industries in their domestic markets. There is also concern that China's cost competitiveness and its rapidly growing domestic market will divert FDI from ASEAN.²²

¹⁵ The ACFTA would be established in 2010 for ASEAN-6 and China, but would only include the newer ASEAN member states of Cambodia, Laos, Myanmar and Vietnam after 2015

¹⁶ These states include: Cambodia, Burma, Vietnam and Laos

¹⁷ This policy directed its focus on ASEAN becoming China's first FTA partner. In November 2000, China, during the 4th ASEAN Informal Summit, proposed the creation of a FTA between China and ASEAN. In October 2001, China and ASEAN completed a feasibility study for a FTA.

¹⁸ M. Ulric Killion, 'Does praxis of Chinese Regionalism threaten multilateral trade?' (January 3, 2005) 3

¹⁹ Daungyewa *op cit* 5


²⁰ See <http://www.aseansec.org/64.htm> accessed on 12 September 2005

²¹ They paved the way for establishing the world's largest free trade zone, comprising 1.7 billion consumers, and to demonstrate a Chinese model for regionalism

²² Because China with WTO accession was to allow full market access for US banks, allow foreign banks to do RMB businesses with Chinese enterprises two years after accession, and lift geographical restrictions on foreign banks five years later. See: Chua *op cit* 8

1.2. Statement of the problem

ASEAN nations are still sceptical of China's new accomplishments in the region. China's accession to the WTO has been the most worrisome subject in the countries with the biggest question being how it will possibly impact on other countries within the Asian - Pacific region. To ASEAN countries, China has for a long time been a durable competitor in their principal export markets for labour-intensive manufactures, electronics, textiles, clothing, footwear, and miscellaneous manufactured products. This raises concerns as to how the ASEAN nations should relate with this development since China has become a stronger export competitor than before. The questions deserving investigation therefore are:

- 
- Why do China and ASEAN wish to create a free trade area if they are competing against each other?
 - What makes a DSM "appropriate" to ACFTA?
 - Is ACFTA compatible with WTO regulations?
 - What are the challenges for and the prospects of ACFTA?

1.3. Research objectives

The main objective of this study is to examine the prospects and challenges facing ACFTA. In so doing, it will examine what ought to be done by the ASEAN member nations to match China's competitive ability having recently joined the WTO. The study will also examine the compatibility of the ACFTA with the WTO rules and mode of Dispute Settlement under ASEAN and NAFTA as well as profound issues relating to ACFTA.

1.4. Research Hypothesis

The accession of China to the WTO, will shift the balance of economic power and muscle to the detriment of ASEAN. The FTA avails ASEAN with accession to markets that China would dominate and gives the members of ASEAN a chance at having a collective voice as a means of exerting greater influence in the flow of international trade and investment in the face of intense competition in the fast growing markets. The FTA also offers ASEAN a chance to strengthen its competitive position because closing its doors to China would effectively lead to its slow demise from international trade.

1.5. Scope

This study is limited to examining the challenges that are posed to both ASEAN states and China in creating the FTA. The study will examine the prospects that stand to sprout from this FTA with the sole aim of assessing whether it would be beneficial or detrimental to either China or ASEAN member states.



1.6. Methodology

The research will be literature based and will evaluate the problems outlined above. It will be necessary at a given stage in the paper to examine the dispute settlement mechanism of the ASEAN and NAFTA for comparative purposes. The study will be based on available books, articles and Internet resources.

1.7. Chapters review

The research is divided into five chapters and is based on Prospects and Challenges for ACFTA. The first chapter serves as the general introduction to the

study. Chapter two addresses an overview of the ACFTA, including Early Harvest Package (EHP) and the compatibility of ACFTA with WTO regulation.

The third chapter explores some issues pertaining to the Dispute Settlement Mechanism (DSM) in the FTA and evaluate of ACFTA DSMs by using the WTO DSMs, ASEAN and NAFTA models. The fourth chapter examines the challenges and prospects that face the implementation of ACFTA. Finally, a conclusion will be drawn from the discussion.



CHAPTER TWO

Overview of the ASEAN – China Free Trade Area

2.1. Background

ACFTA is the typical FTA that is initiated and led by developing economies. Interestingly, it has elicited varied predictions, ranging from nostalgic neo-liberals dreaming of reincarnating the Asian growth miracle, to idealistic activists hoping for a model for regionalism or alternative forms of South-South trade among developing countries.²³

Among all the FTA negotiations that China has been in, the negotiation with ASEAN is definitely the fastest and most fruitful one.²⁴ ACFTA will become the third largest global trading region after the European Union and the North American Free Trade Zone.²⁵ There was suspicion when this initiative was first mooted in 2001 and many players in world trade wondered whether the FTA, whose members are all developing countries with similar economic structures, would finally take root and effectively boost the integration of regional economy.²⁶

Most of the ASEAN countries²⁷ have surpassed the critical time of financial crisis experienced in 1997 – 1998 and have started considering the process of their own integration within the regional and global context. As a new member of the WTO, China is still growing and has developed more recently a deeper integration with the Asian region and the world economy.²⁸ While the crisis has weakened the ASEAN economies, China poses a trade and investment

²³ Natividad Y. Bernardino, 'The ASEAN-China Free Trade Area: Issues and Prospects' (2004) 1 International Gender & Trade Network (IGTN)

²⁴ The establishment of NAFTA, EU, and AFTA took longer than the creation of ACFTA

²⁵ NAFTA, EU, AFTA, MERCOSUR are the Major Regional Trading Agreements in the world

²⁶ *Op cit*

²⁷ ASEAN members include the five original members: Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei Darussalam joined on 8 January 1984, Vietnam on 28 July 1995, Laos and Myanmar on 23 July 1997 and Cambodia on 30 April 1999

²⁸ H. Zhao, 'Foreign trade in the People's Republic of China: past performance and future challenges' Asian Development Bank Review 15 1 (1997), p88–110.

challenge to the entire world. Thus, ASEAN needs to reassess its own position and relative strength, like many other countries, towards China's dominance.²⁹

Economic links between ASEAN and China are closely knit and both parties inevitably need to have a fresh look at the prospects that realise the FTA, considering recent changes and factors relating to their on-going relationships. ASEAN and China also need to adjust its own competitiveness in order to benefit from ACFTA. But, why does China need a stronger economic relationship with the neighboring countries in Southeast Asia?. It is evident that this regional arrangement represents the first real FTA. For China, this is a first FTA it has concluded after the accession into the WTO. For ASEAN, since the creation of AFTA, this is also the first agreement to form an FTA with an outsider.

ACFTA is a natural response to a growing development of FTAs. It appears attractive because it provides preferential access to both sides and it may make good progress that would call attention from outsiders to become more involved with the grouping. A closer examination of Asia reveals that while ASEAN lost its economic attractiveness as a result of the crisis, China is viewed as the rising global economic partner. The competition between both regions is inevitable in drawing foreign direct investment as well as export to third countries.³⁰ Through ACFTA both sides could reinforce each one's own position within the regional and global context.

Through ACFTA, it is true that trade liberalization has been progressive in ASEAN and China. For ASEAN, it varies amongst countries with Singapore being the most advanced, then ASEAN-5³¹ well on its way to liberalization and

²⁹ ASEAN's balance of power strategy since the early 1990s has been based on three pillars: a) the expansion of ASEAN to include eventually all Southeast Asian countries; b) the establishment of an ASEAN Free Trade Area (AFTA); and c) the strengthening of multilateral security cooperation in Southeast Asia through the ASEAN Regional Forum (ARF).

³⁰ Chirathivat, S. (2001), 'Interdependence between China and Southeast Asian economies on the eve of the accession of China into the WTO'. See: Yamaha, & K. Imai (Eds.), 'China enters WTO: pursuing the symbiosis with the global economy. Tokyo: Institute of Developing Economies. See also: H. Zhao, 'Foreign trade in the People's Republic of China: past performance and future challenges'. Asian Development Bank Review '15 1 (1997), p88-110

³¹ Indonesia, Malaysia, Singapore, Philippines, Thailand

the CMLV (Cambodia, Myanmar, Laos, and Vietnam) not yet even WTO members, but they are already involved in the ASEAN Free Trade Area (AFTA). Meanwhile, being a new member of the WTO, China has committed to a comprehensive package of market liberalization with different countries, in the negotiations of entry into the WTO, which will be implemented immediately after its accession to the WTO. In general, China's participation in international organizations provides a measure of its increased global commitments and responsibilities. Integration into the world economy requires adapting to international economic and trade norms in the course of establishing an operating mechanism that will satisfy globally prevalent economic rules. With or without knowledge of such, China's accession to the WTO is in itself, a sign of irrevocable and irreversible commitment to an international regulatory regime.³²

The result of this liberalization has been a large increase of both exports and imports of ASEAN and China all over the world. To a certain extent, this greater reduction in tariff and non-tariff barriers comes from different moves towards more open trade and investment policies. Multilateral institutions like the WTO encourage the participating countries to liberalize multilaterally and unilaterally. Since the 1990's, the regional approach to liberalization has also gained momentum.³³ Different countries in various regions take initiatives to liberalize among themselves including AFTA. In fact, except the CMLV, the rest of ASEAN countries are close to completing the free trade area.³⁴

According to ASEAN Secretariat's Report:³⁵

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% in 1991 to 8.3% 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% in 1994 to 3.9% in 2000. China is now the sixth largest trade partner of ASEAN.

³² *Op cit*

³³ Bhagwati, J., Krisna, P., & Panagariya, A. Trading blocs: alternative approaches to analyzing preferential trade agreements (1999) Cambridge: MIT Press

³⁴ For example, Singapore has already signed bilateral FTA with New Zealand, Mexico, Japan, USA etc and Indonesia is on the process negotiating FTA with USA

³⁵ ASEAN Secretariat accessed at <http://www.aseansec> on 12/12/05

There is strong potential for further linking of their trade and investment despite the fact that the major markets for their exports continue to be the developed countries and they are still major destinations for foreign direct investment among LDCs.³⁶ Both ASEAN and China had identified existing factors as being responsible for hampering their trade and investment. It is their view that a framework for ASEAN–China economic relations should be comprehensive and looking forward to building upon the momentum of China’s accession to the WTO.³⁷ The reduction and elimination of barriers to trade and investments and the move towards greater economic integration is also viewed as a positive outcome in the long run.³⁸

Both ASEAN and China have adapted to a framework of economic cooperation³⁹, which intend to cover six major elements, some of which have been targeted for immediate implementation. The elements are as follows⁴⁰:

- Facilitation measures on trade and investment to cover some issues such as removal of non-tariff barriers, mutual acceptance of standard and conformity assessment procedures down to the promotion of trade in services.
- Technical assistance and capacity building for new members of ASEAN to expand their trade with China.

³⁶ Z. Wang, 'The impact of China's WTO entry on the world labour-intensive export market: a recursive dynamic ECG analysis'. *The World Economy* 22 3 (1999), p379–405

³⁷ Panitchpakdi, S., & Clifford, M. *China and the WTO*. Singapore: John Wiley & Sons (Asia) Pte Ltd (2002)

³⁸ *ibid*

³⁹ The report of an ASEAN-China Expert Group on *Forging Closer ASEAN-China Economic Relations in the Twenty-First Century* made the following recommendations:

- (a) Establishment of an ASEAN-China FTA within 10 years, including special and differential treatment and flexibility for CLMV countries, and an "early harvest" package of mutually agreed list of goods to be liberalized ahead of implementation of China's commitments to the WTO;
- (b) Wide range of trade and investment facilitation measures;
- (c) Technical assistance and capacity building to ASEAN members, particular CLMV;
- (d) Expansion of cooperation in areas such as finance, tourism, agriculture, human resource development, small and medium enterprises, industrial cooperation, intellectual property rights, environment, forestry and forestry products, energy and sub-regional development.

This report perceived the ASEAN-China Free Trade Area as 'an important move forward in terms of economic integration in East Asia' and 'a foundation for the more ambitious vision of an East Asia Free Trade Area, encompassing ASEAN, China, Japan and South Korea'

⁴⁰ Chirathivat. S, 'ASEAN–China Free Trade Area: background, implications and future development' (2002), *Journal of Asian Economics* volume 13, issue 5 (on line), Available: http://www.sciencedirect.com/science?_ob=RedirectURL&_method=externObjLink&_locator=url&_cdi=6559&_plusSign=%2B&_targetURL=http%253A%252F%252F%2520www.aseansec.org%252Fnewdata%252Fa%252Fsean_china_bc.htm.

- Positive consideration in the form of promotion of 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, HRD industrial cooperation, intellectual property rights, environment, energy, etc.
- Establishment of ACFTA within 10 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.

Despite anxieties from businesses in some countries, the six members of ASEAN-China have agreed to slash their import tariffs by up to 85 % on all goods and gradually reach a zero-tariff level by 2010. With effect from July 20, 2005 ⁴¹, six members of ASEAN have begun the journey of entering a free trade agreement with China with the aim of tapping into the massive single market of approximately 1.7 billion people ⁴². As stipulated in the Trade in Goods Agreement of a Framework for Overall Economic Cooperation between China and the ASEAN countries, there are 7,455 kinds of commodities that have reduced tariffs. ⁴³ With a fast growing trade volume, ASEAN and China are trying to show the world that the planned FTA will be an accelerator for the regional economy.

All fears and suspicions of ACFTA become irrelevant since the trade volume has been growing at an average speed of 40 % over the past three years. ⁴⁴ In 2004,

⁴¹ See People's daily newspaper 22 October 2005 accessed at <http://www.bilaterals.org/article> on 29/11/2005

⁴² Compare with the size of these regions: NAFTA population with 424.97 million and EU comprising 455 million.

⁴³ *ibid.* This practice was launched in compliance with the Trade in Goods Agreement of a Framework Agreement for Overall Economic Cooperation between China and the ASEAN countries.

⁴⁴ See ASEAN Secretariat accessed at <http://www.aseansec> on 12/12/05. See also Joe Cochrane, 'A Threat? An Economic Lifeline', News Week, 9 May 2005. See article 'ASEAN and China on track to sign free trade deal by 2013 wrote 'the comments of Malaysian Prime Minister, Abdullah Ahmad Badawi said that China is not a treat. China is a country of opportunity. At the same time we see China as a real challenge. This certainly does not estrange us but will only enhance our competitiveness. (Philippine Daily Inquirer, August 13, 2005).

the trade volume surpassed 100 billion USD.⁴⁵ Furthermore, experts predict that the trade volume will reach 200 billion US dollars before 2010⁴⁶. In addition, the experts believed that implementation of the tariff cut plan would enormously expand trade between the ASEAN and China, and would be of far-reaching significance in the future development of ASEAN-China economic trade relations.⁴⁷

2.2. New Security Concept for both regions

Apart from economic matters, ACFTA also automatically creates a new security concept for both regions; a case in point is the dispute over the Spratly islands⁴⁸. While China and ASEAN endorsed the framework agreement towards the ACFTA in ASEAN Summit, Cambodia in 2002, Chinese Vice Foreign Minister Wang Yi made the point that, "China-ASEAN co-operation in the non-traditional security fields will serve as a helpful trial and practice of China's new security concept, featuring comprehensive, common and co-operative security."⁴⁹

In the light of this, East Asia would be politically divided and ruled by external powers, economically marginalized, and would remain viciously competing with each other to satisfy external markets. Chinese strategists agree on the need for the East Asian integration but differ on its leadership, modality, and vision, i.e. whether to create an East Asian Community thus one ASEAN plus Three (China, Japan and South Korea), or three ASEAN plus one grouping.⁵⁰ China is largely

⁴⁵ See People's daily newspaper on 22 October 2005 accessed at <http://www.bilateral.org/article> on 29/11/2005

⁴⁶ *ibid*

⁴⁷ Mari Pangestu, 'China's Economic Rise and Responses of ASEAN', in Kokubun Ryosei and Wang Jisi (2004) (eds), *The Rise of China and a Changing East Asian Order*. Tokyo: Japan Center for International Exchange

⁴⁸ Philippines, Malaysia, Brunei and China claim Spratly islands as their part. The strengthening dialogue and mutual trust through ARF and ACFTA could establish a good structure for the parties concerned to avoid the argument over the Spratly islands from seriously damaging their relations.

⁴⁹ Meng Yan, "China values ASEAN relations", *China Daily* (Beijing), 1 November 2002.

⁵⁰ See Wang Shilu, "Dongnanya Xingshi de Fazhan yu Zhongguo Xibu Dakaifa" [Development of Southeast Asia and China's Effort to Develop its West], *Dongnanya* [Southeast Asia], no. 2, 2001, p1-7 Cao Yunhua, op. cit., p55-63

comfortable with ASEAN as a grouping and the mainstream view among Chinese-ASEAN specialists is to support a more stable and moderate ASEAN to play a more important role in regional affairs⁵¹ such as the ARF, ASEAN plus One (China) and ASEAN plus Three⁵². China wants to create a friendlier environment with ASEAN through the ACFTA initiative and its recent decision to accede to the Treaty of Amity and Cooperation.

The motivations behind the establishment of ACFTA for China are both political and economic. It is seen that ACFTA is part of confidence building, which includes China's participation in the ASEAN Regional Forum⁵³ and China's accession to the Treaty of Amity and Cooperation in Southeast Asia in 2003.⁵⁴ Furthermore, ACFTA is to allay ASEAN concerns that China poses a threat with its economic ascendancy by providing preferential access to its rapidly growing domestic market. For China, it will take an advantage to various natural resources in ASEAN region, especially oil and its market of 560 million consumers.⁵⁵ Through ACFTA, China will be able to build its geopolitical clout in Southeast Asia and counterbalance the influences of Japan and US. The swift progress of ACFTA has prompted Japan, US, South Korea and India to propose economic cooperation arrangements with ASEAN as well.⁵⁶

The above motivation is one major reason why China would rather not have an FTA with individual ASEAN member states (which makes more economic sense) but have an FTA with the ASEAN as a whole (which makes more political sense). Here, political considerations weigh heavily. The ACFTA talks mean that China can engage ASEAN countries constructively for at least ten years under one

⁵¹ *ibid*

⁵² The terms are used in ARF with dialogue partners (China, Japan, South Korea)

⁵³ China joined the ASEAN Regional Forum (ARF) in 1994; and participated in regular senior officials meetings with the ASEAN states at the deputy foreign minister level. Subsequently, it became a full dialogue partner of ASEAN in July 1996.

⁵⁴ Treaty of Amity and Cooperation in Southeast Asia (TAC) was signed on 24 February 1996. The purpose of this Treaty is to promote perpetual peace, everlasting amity and cooperation among ASEAN countries. China's accession to the TAC is conducive to the long-term stability and development of relation between China and ASEAN as well as the maintaining of the region's peace and stability.

⁵⁵ Chia Siow Yue, 'ASEAN-China Free Trade Area' (2004) 15, Singapore Institute of International Affairs.

⁵⁶ *ibid*

friendly political and economic framework.⁵⁷ Since some ASEAN countries desire to ride on the booming Chinese economy and the fears on the part of others of the Chinese economic competition, ASEAN countries have the common intention to engage and negotiate hard but peacefully with China, either to ride on the Chinese economy or to reduce the Chinese competition.⁵⁸

2.3. Legal Framework for ACFTA

A legal framework provides the institutional foundation for the arrangement in Regional Trade Agreement/Free Trade Agreement RTA/FTA. Such a legal framework is itself subject to certain constraints, primarily regarding whether the concerns of each member will be addressed.

The AFTA is the legal instrument for ASEAN. Therefore, it is necessary to learn the ASEAN's experience in this regard. It has been proposed that the ACFTA took on the model of the AFTA with some further options. One option was to extend the AFTA to China. In fact, in some ASEAN countries, the formulation of the ACFTA was understood as an extension of the AFTA to China.⁵⁹ Unfortunately that would not be an advisable and practical option. For that reason, first, China perceives that ACFTA is not a mere extension of the AFTA to China. From a practical point of view, the reason is simple as there would be limited room for China to address its concerns in ACFTA. Secondly, given that ASEAN has its own plan of forming its own regional free trade area, the ACFTA will have to exceed the timetable of the AFTA.⁶⁰

⁵⁷ Sheng Lijun, 'China-ASEAN Free Trade Area: Origins, Developments and Strategic Motivations' (2003) 16, ISEAS Working Papers on Social

⁵⁸ *ibid*

⁵⁹ See http://www.ing7.net/2002/feb/04/text/bus_2-1-p.htm accessed on 12/10/06. E.g. an influential Philippino news medium, the Inquirer News Services, in a report of 4 February 2002, called on ASEAN peers to study for at least 1 year a proposal to expand the AFTA to include Mainland China' in a report.

⁶⁰ Starting January 1, 2002, ASEAN-6 brought tariff rates of many ASEAN products down to 0 - 5 %. The other four member states CLMV will do so in 2006. The ASEAN-6 will eliminate all tariffs and remove quantitative restrictions and non-tariff barriers in 2010. The rest of the ASEAN member states will achieve these goals in 2015. This explains why the leaders of China and ASEAN decided to forge the FTA over 10 years.

In addition, an RTA is generally open to accession by economies or economic groupings that share its underlying objectives, although the constituent members have special regard to the individual circumstances of such economies or economic groupings when considering their requests for accession.⁶¹ On the contrary, AFTA is by nature exclusive. Meanwhile, the ACFTA will follow the general pattern of RTA's. Therefore, the legal instrument of the ACFTA cannot model itself on that of the AFTA or even under the guise of a modified AFTA. The details of the legal instrument of the ACFTA have been laid down and apparently the Framework Agreement for the ACFTA⁶² does not refer specifically to the AFTA.

2.4. Framework Agreement for ACFTA

The Framework Agreement for ACFTA was signed on November 4, 2002 in Phnom Penh, Cambodia. The formal agreement was based on a decision made by both regions a year earlier during the Annual ASEAN Summit held in Bandar Seri Begawan, Brunei.⁶³ The framework agreement sets the elements and basis for negotiations towards the realization of an ASEAN-China Free Trade Area by 2010 for the 6 original ASEAN members (Indonesia, Malaysia, Thailand, Singapore, Philippines, Brunei) and by 2015 for the 4 new ASEAN members (Laos, Vietnam, Cambodia, Myanmar).⁶⁴ Tariff reduction and elimination on trade of goods have come into effect on July 1, 2003 based on applied MFN tariff rates at said cut-off date.⁶⁵

⁶¹ The ACFTA is intended as a foundation for the more ambitious Vision of an East Asia Free Trade Area, encompassing ASEAN, China, Japan, and Korea. See also ASEAN-China Expert Group on Economic Cooperation, Forging Closer ASEAN-China Economic Relations in the Twenty-first Century (October 2001) at p 30.

⁶² The Head of Government/State of ASEAN Member States signed the Framework Agreement and China in Phnom Penh, contains a preamble and 16 Articles, and provides the legal instrument for enhancing the ASEAN-China economic, trade and investment relations from the short-term to the long-term.

⁶³ See <http://www.aseansec.org/64.htm> accessed on 12 September 2005

⁶⁴ Article 3 (4) and Article 8 (1) of the Framework Agreement on Comprehensive Economic Cooperation between Association of South East Asian Nations and the People's Republic of China

⁶⁵ *ibid* Article 3 (2), (3).

Apart from being a legal instrument to govern the future ASEAN-China economic cooperation, the Framework Agreement also lays down overriding principles and a general pattern for the ACFTA. It contains guidelines and principles, scope and modalities for establishing a free trade area including early harvest package (EHP), special and differential treatment (S&D) and flexibility, taking into account the different levels of development between ASEAN countries and China⁶⁶.

The first area is related to trade and investment facilitation.⁶⁷ This free trade area will focus on the enhancement of information exchange on legal enactments, regulations and production. The removal of non-tariff barriers⁶⁸ such as licensing requirements and quantitative restrictions are also stipulated in this free trade area. Member countries will also liberalize trading and distribution rights in the manufacturing of products and simplifying customs procedures.⁶⁹ The countries involved will also accept each other's compatibility assessment procedures and facilitate visa arrangements to get a better flow of business personnel. The free trade area will also require the member states to avoid double taxation agreements, promote e-commerce and encourage the business sectors to exchange ideas and improve channels of communications.⁷⁰

The other area related is the capacity building and technical assistance. The free trade area will ensure the enhancement of capacity of ASEAN member states most especially the newer members to do business with China.⁷¹

The promotion measures included in the free trade area will also give favourable or positive consideration to the non-World Trade Organization members of ASEAN.

Last but not least, the measures of institutions will also relate to the reinforcement of existent cooperative mechanism between ASEAN and China

⁶⁶ See Framework Agreement that was signed in Phnom Penh, Cambodia on 4 November 2002

⁶⁷ Article 5

⁶⁸ Article 6

⁶⁹ Article 2 (f)

⁷⁰ Article 2 and article 7 (3)

⁷¹ Article 7 (4)

and the creation of additional institutions to promote bilateral trade between ASEAN and China.

2.5. Early Harvest Package (EHP)

The EHP was incorporated in the Framework Agreement on ASEAN –China Comprehensive Economic Cooperation⁷². It is a trading protocol under the proposed free-trade area between ASEAN and China that proposes a faster tariff reduction in unprocessed agriculture and manufactured goods. Given that tariff arrangement is a crucial part of any FTA, the EHP is therefore an integral part of the ACFTA. Given that it will primarily allow ASEAN to reap 'early harvest', the EHP highlights the Framework Agreement.

A zero tariff regime is envisioned for trade in goods between China and ASEAN by 2010 for the more advanced ASEAN members and a later timetable of 2015 for the less advanced members. However, a distinct feature of the agreement contained in Article 6 and 4 annexes of the document, referred to as the Early Harvest Program, calls for the implementation of tariff reduction and elimination on certain agricultural goods ahead of schedule supposedly for the parties to enjoy the early benefits of the free trade area.⁷³

The EHP focuses on farm goods (products) whether fresh or processed as well as some industrial products, but excluding sensitive products of member countries.⁷⁴ Some 600 product items are covered under the EHP, including primarily live animals, meat and edible meat offal, fish, dairy produce, other animal products, live trees, edible vegetables, fruits and nuts.⁷⁵ The EHP implementation was intended to be not later than 1 January 2004. Tariffs are supposed to be completely eliminated within 3 years of the EHP's implementation.

⁷² Article 6 and 4 annexes of document

⁷³ Article 6. See also Serrano, Segfredo, 'Briefing paper on the AFTA, ASEAN-China FTA and Early Harvest Program', Department of Agriculture Republic of the Philippines, (2004), Manila, Philippines

⁷⁴ Article 6 (3)

⁷⁵ Article 6 (3) (a) (i)

A longer timeframe will be accorded to the newer ASEAN member countries, namely CLMV. In addition, ASEAN and China have also agreed to explore the feasibility of an EHP for trade in services.

According to the EHP, ASEAN and China will progressively eliminate tariffs on selected products even before the FTA is fully effective.⁷⁶ Therefore, the package will presumably provide the incentives to accelerate the establishment of the ACFTA.

Interestingly, the EHP also includes specific economic co-operation activities, which shall be undertaken or implemented on an accelerated basis.

The free trade area covers trade in goods, services and investment with a provision on other areas of cooperation such as trade facilitation, technology transfer, human resources development, telecommunications, transport, tourism and sub-regional development projects.⁷⁷

For trade in goods, the agreement allows for tariff reduction and elimination on two categories of products: normal and sensitive tracks.⁷⁸ Aside from those covered by the Early Harvest Program, the normal track products should have reduced or eliminated tariffs mutually agreed by parties over a period from January 1, 2005 to 2010 for ASEAN-6 and China and until 2015 for CLMV. Sensitive track products, on the other hand, are those submitted by any party with end tariff ceilings and end dates different from the normal schedule but which have to be mutually agreed by parties.

2.6. The Compatibility of ACFTA with WTO regulations

Generally, FTAs are governed by Article XXIV of GATT 1947. This Article

⁷⁶ Article 3 (4) (ii)

⁷⁷ Article 7 (2)

⁷⁸ Article 3 (4)

authorized and of course, circumscribed customs unions and free-trade areas. The purpose of Article XXIV is to ensure that regional integration complements and does not threaten the multilateral trading system.⁷⁹ Under the provision, WTO members are bound to grant to each other treatment as favorable as they give to any country in both the application and administration of import and export duties and charges.⁸⁰

As one of RTAs, the ACFTA has to work within the WTO framework because the WTO outlines the qualifications of any RTA's among WTO members. As a matter of fact, the framers of the GATT 1947 and the Uruguay Round Agreements in 1994 anticipated certain types of RTAs.⁸¹ The GATT contracting parties adopted a decision in 1979⁸² allowing derogations to the MFN (most favor nation) treatment in favour of developing countries. In particular, its paragraph 2(c) permits preferential arrangements among developing countries in goods trade. It has continued to apply as part of GATT 1994 under the WTO.

There should be commonality between the ACFTA and its contextual WTO in terms of trade liberalization and rule-based trading framework. Taking trade liberalization as an example, the WTO was established to help trade flow smoothly, freely, fairly and predictably. It administers trade agreements, acts as a forum for trade negotiations, settles trade disputes, reviews national trade policies etc. According to the relevant provisions of the WTO, members may enter into RTA's among themselves to reduce trade barriers in products and services. However, these agreements must not create greater trade barriers for other WTO

⁷⁹ See John H. Jackson, 'The Jurisprudence of GATT & WTO – Insights on Treaty Law and Economic Relations, (2002) p101-102, Higher Education Press

⁸⁰ *ibid*

⁸¹ There is WTO annual report for RTA. It is noted that since 1995, there are 220 RTA worldwide, among which over 100 agreements covering trade in goods or services, or both, have been notified to WTO. Of the RTAs notified to the GATT/WTO, 121 agreements notified under article XXIV of GATT

⁸² Differential and more favorable treatment, reciprocity and fuller participation of developing countries (Decision of 28 November 1979, L/4903).

member countries. In other words, they are designed to ensure that the countries, which form RTA's, move to genuinely, free trade among themselves.⁸³

Conclusively, the ACFTA will most likely provide leverage for China as well as ASEAN and even the developing world as a whole in the WTO. Nevertheless, the compatibility of ACFTA and the functioning of the WTO provide a guarantee that ASEAN and China will not deviate from their obligations to the WTO Agreement.



⁸³ Although RTAs are permitted to be create, however Article XXIV: 8 (a) (i) and 8 (b) of the GATT require a detailed plan and schedule to show how members will move to free trade. In practice, therefore, trade restriction may remain among members of an RTA, as long as the spirit of the RTA is that of non-discrimination and that is not used to disguise ad hoc or partial discrimination.

CHAPTER THREE

The Dispute Settlement Mechanism (DSM)

3.1. The Dispute settlement mechanisms (DSMs)

As an aim of international law, the settlement of disputes is supposed to be fair, and just to the parties involved and it should be quick and efficient. Increasingly, DSM's are moving towards an adjudication regime,⁸⁴ similar to that of the WTO and other advanced RTA's such as EU and NAFTA as a reflection of the growing importance of the rule of law in regional integration. While it sometimes appears as if each new regional agreement is reinventing the wheel, some general rules can be detected in designing a new DSM.⁸⁵ In particular, it may legally classify several types of DSM's and provide alternatives to construct an effective DSM within combination of six legal factors such as jurisdiction, institutional feature, binding effect and enforcement, standing of non-state actors, enforceability of awards at national courts and transparency of proceedings.⁸⁶

The coverage of a particular DSM will be indicated by jurisdiction.⁸⁷ It can be showed in determination of DSM whether it applies to the disputes relating to all agreements, such as the WTO DSM, or covers only disputes with a specific subject.⁸⁸ The institutional feature of a DSM refers to the distinction between the permanent tribunals and *ad hoc* arbitration tribunals, such as tribunal in NAFTA, such as WTO panels and Appellate Body, such as AFTA Appellate Body. The binding effect of dispute settlement awards or reports depends on whether the decisions of dispute settlement tribunals are binding to the member states, while enforcement, on the other hand, measures the effectiveness of a DSM by

⁸⁴ M. Cremona, 'Regional Integration and the Rule of Law: Some Issues and Options' in R Devlin and A Estevadeordal (eds) (2003) p156 Bridges for Development – Policies and Institutions for Trade and Integration (Inter-American Development Bank Washington D.C)

⁸⁵ A. Schneider, 'Getting A long: The Evolution of Dispute Resolution Regimes in International Trade Organizations' (1999) p700 Michigan J International

⁸⁶ *ibid* 703

⁸⁷ Yan Luo, 'Dispute Settlement in the Proposed East Asia Free Trade Agreement: What We Can Learn From the EU and the NAFTA' (2005) p15

⁸⁸ *ibid*

focusing upon its mechanisms for treaty compliance.⁸⁹ Both the direct access of non-state actors to the DSM and the enforceability of dispute settlement awards or reports in national courts are important factors determining the impact of a DSM to domestic legal system of a Member state. Finally, transparency refers to the clarity of procedures and decisions and the extent to which they are made public.

3.2. WTO Dispute Settlement System

The dispute settlement system of the WTO is the central element in providing security and predictability to the multilateral trading system.⁹⁰ The WTO's dispute settlement arrangements are placed under the supervision of a single Dispute Settlement Body (DSB). The DSB has the sole authority to establish panels, adopt panel and Appellate reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspensions of concessions and obligations.

The first layer of dispute settlement under the understanding is a consultative process⁹¹ whereby the disputing members first attempt to negotiate mutually acceptable settlement of the problem at hand.

Consultations are without prejudice and are confidential. Through the consultation process, the disputing members are to attempt to reach a mutually satisfactory resolution of the matter. If consultations fail to resolve the dispute within 60 days of receipts of the request, the complaining member may then

⁸⁹ *ibid*

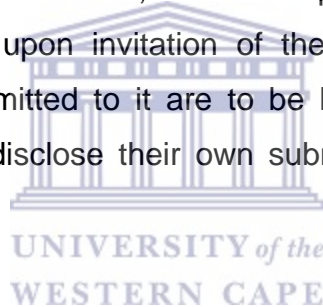
⁹⁰ See <http://www.wto.org> accessed on 22/11/2005

⁹¹ Article 4.2 of the understanding provides that each member is required to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representation made by another member concerning measures affecting the operation any agreement. Upon receipt of a written request for consultation, the member to which the request is made must reply within 10 days of receipt of the request and enter into good faith consultations within 30 days of its receipts. A failure to respond to such a request, the requesting member may immediately request the establishment of a panel. Any member making a request for consultations must notify the DSB and any Council or Committee responsible for the relevant agreement. The request must include the reasons for the request, the measure at issue and the legal basis for the complaint.

request the establishment of a panel. In cases where a third member considers that it has a substantial trade interest in the consultations, it may notify the consulting members of its desire to join the consultations. If the responding member does not consider that this third member has a substantial interest in the matter it may refuse that request to participate. If its request is refused the third member remains free to initiate its own consultations on the matter.⁹²

A panel⁹³ shall be established no later than the second meeting at which the DSB considers the request: the second meeting shall be convened within 15 days of a request for it to be held. The panel is to be constituted (i.e. its members are to be chosen) within 30 days of its establishment.⁹⁴

There are fixed time periods for the completion of panel reviews.⁹⁵ All meetings of the panel are held in closed session, with the disputing Members and any third parties being present only upon invitation of the panel. Deliberations of the panels and documents submitted to it are to be kept confidential, except that members are permitted to disclose their own submissions to the panel if they choose.



⁹² Article 4.2

⁹³ Article 7 of the DSU sets out the panel's standard terms of reference. The composition of panel is addressed in Article 8. The composition of panels consists of "well qualified governmental or non-governmental individuals". A panel's three or five members are to be independent, of diverse background and wise experience; are not drawn from the countries involved in the dispute under review unless those countries so agree, and if a developing country is involved in the dispute it can request that the panel include at least one member from a developing country

⁹⁴ In Paragraph 5 of Article 8, panels are comprised of three, unless disputing members agree to a panel of five within 10 days of the establishment of the panel. Upon the establishment of a panel by the DSB, the WTO Secretariat proposes panelist nominations to the disputing Members. With respect to the function panel's play under the DSU, Article 11 provides that they are to assist the DSB in discharging its responsibilities under the understanding.

⁹⁵ Article 12 of understanding says that a panel shall sit for a period between 6 and 9 months for completion of panel reviews. If a panel believes that it cannot issue its report within the specified time, it must inform the DSB in writing of the reasons for the delay and provide an estimate of the additional time. This article also sets out the panel working procedures. One week after establishment of the panel the terms of reference agreed upon. Thereafter the panel is expected to set deadlines for written submissions and Members are expected to meet those deadlines.

In doing the tasks, panels may seek information from relevant outside source,⁹⁶ although if a panel wishes to seek information or advice from any individual or body within the jurisdiction of any member, it must inform the authorities of the member before doing so.

The DSB adopts the panel report within 60 days of its issuance, unless one party appeals, or there is consensus not to adopt it. Adoption cannot take place until 20 days after circulation of the report. Members must state any objections to the report in writing, prior to the DSB meeting that considers it.

Parties to a dispute are given the right to appeal against the panel report, the appeal being limited to issues of law covered in the panel report and to legal interpretations developed by the panel. The Appellate Body, established by the DSB, consist of persons of recognized authority and who demonstrate expertise in law, international trade and the subject matter of the covered agreements generally, and unaffiliated with any government and is a member of the WTO.⁹⁷

In addition, WTO DSMs also provides the member states to retaliate within 30 days of the adoption of the report, of the action to comply with the report's recommendations and rulings. It is given, "reasonable period of time" for compliance. If the member of government found at fault fails to implement the recommendation and rulings, it may voluntarily grant compensation to the injured party to the dispute. The injured party may request the right to retaliate if, however, no agreement on compensation is reached and again the rule that consensus is needed to block progress applies: the request will be granted unless there is consensus to reject it.⁹⁸ Further, on condition that the member states agree, they can report to arbitration in other circumstances than a

⁹⁶ Article 13 DSU

⁹⁷ Appeal proceedings, if requested, should as a rule not take more than 60 days. At most, they should take 90 days. The Appellate Body report should be adopted by the DSB, unless there is consensus not to adopt it, within 30 days of issuance, and should be unconditionally accepted by the parties. An appeal is asked for when the disputing Members consider that the panel has made a legal error. The Appellate Body consists of seven people, each of whom serves a four-year term. Three members of the Appellate Body serve on each case on a rotating basis

⁹⁸ See <http://wto.org> accessed on 22/11/2005

disagreement over the amount of compensation when clearly defined disputes arise. The Director General may offer good offices,⁹⁹ conciliation or mediation ex officio and, along with the chairman of the DSB, is required to give such help if so requested by the a least-developed country involved in a dispute.

3.3. NAFTA Dispute Settlement Mechanisms

In general there are several options for a dispute settlement mechanism. NAFTA¹⁰⁰ (North American Free Trade Agreement) adopted a formal dispute settlement mechanism, which covers all the disputes, except for disputes regarding antidumping and countervailing, on “the interpretation or application [of the NAFTA]” or “wherever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations or cause nullification or impairment”.

When NAFTA became effective in 1994, it incorporated several specialized DSM's to deal with disputes relating to different subject matters.¹⁰¹ Article 102 conveys the objectives of the agreement, including the elimination of barriers to trade in goods and services, promotion of fair competition, investment and the protection of intellectual property rights in the member states. The treaty has three principal mechanisms, namely investor-state dispute resolution in Chapter 11, Anti-dumping and Countervailing Duty (AD/CVD) DSM in Chapter 19 and the general DSM in Chapter 20.¹⁰²

⁹⁹ In 1996 it was recognized that special recognition should be given to a situation when a developing country and a least-developed country member were involved in a dispute. Developing countries may choose a faster procedure, request longer time-limits, or request additional legal assistance.

¹⁰⁰ NAFTA became effective in 1994 and it is a free trade agreement between the USA, Canada and Mexico.

¹⁰¹ A L.N. 'Dispute Settlement under NAFTA' in E Chambers and P Smith (eds), *NAFTA in the New Millennium* (Centre for US-Mexican Studies San Diego 2002) 426

¹⁰² F Abbott, 'The Political Economy of NAFTA Chapter Eleven: Equality Before the Law and the Boundaries of North American Integration' (2000) 23 *Hastings Intl & Comparative L Rev* 303, 304.

Chapter 20 is the legal basis of dispute resolution relating to treaty interpretation or application.¹⁰³ The main inter-state dispute settlement provisions are stipulated in this chapter. A Free Trade Commission, with a representative from each member state oversees the implementation of the agreement.¹⁰⁴ As a general rule Article 2005 (1) permits a complaining Party to choose between NAFTA and WTO procedure to settle disputes that arise under both NAFTA and the WTO.

Dispute Settlement under Chapter 20 involves three stages. Firstly, under Article 2006, the complaining party may request consultations. Secondly, should the consultations fail to resolve the dispute within 30 days of such request, either party may request that the Free Trade Commission convene to attempt to resolve the dispute. Thirdly, if the Commission fails to resolve the dispute within 30 days after convening either party may request the establishment by the commission of a five-person Arbitral panel.¹⁰⁵

Article 2018 (1) requires the disputing parties to agree on the resolution of the disputes, which normally shall conform to determinations and recommendations of the panel. On failure of the parties to agree on a mutually satisfactory resolution within 30 days of receiving the panel's final report, the complaining Party may suspend NAFTA benefits in accordance with Article 2019.

The provisions of Chapter 20 incorporate three distinct methods of dispute settlement namely Consultation, the creation of a Commission and Arbitration. A dispute resolution thus progresses through these various stages.

Apart from Chapter 20, NAFTA also includes Chapter 11 and Chapter 19 DSM's that allow the participation of private parties. Under Chapter 19, the Parties may file claims based upon Anti-dumping and Countervailing Duty determination

¹⁰³ NAFTA Secretariat, 'Overview of the Dispute Settlement Provisions of the North American Free Trade Agreement', available online at: http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=8 (accessed on 13 March 2005).

¹⁰⁴ See 1992 NAFTA Treaty, Art 2001

¹⁰⁵ Article 2008

made by national administrative authorities. The Bi-national panels are established via Article 1904, which are empowered to determine final Anti-dumping and Countervailing Duties. The Bi-national panels replace the judicial review powers of the national courts of the member states. The establishment of Bi-nationals panel are important in regard to the relationship with national courts. Moreover, the bi-national panel process is quite novel in the sense that it is directed to complaints alleging a failure to correctly apply national Anti-dumping and Countervailing Duty (AD/CVD) law.¹⁰⁶ Formally, it is an inter-state DSM, but in practice, the private party is the engine of this DSM.¹⁰⁷

Chapter 19 functions to replace judicial remedies like litigation via Bi-national panels. This demonstrates the manner in which specific problems between parties are identified and procedures for dispute settlement established to anticipate and resolve such disputes. Interestingly, given the considerable overlaps between Chapter 19 and WTO AD/CVD rules, there is also “forum shopping” between Chapter 19 DSM and the WTO DSM.

The Chapter 11 investment DSM is so far the most profound but also most controversial one. It lays down the provisions on Arbitration of investor-state disputes, an innovation unseen in other agreements. NAFTA is the first multilateral trade or investment agreement to grant private persons standing to sue governments directly for monetary damages. Article 1122 (1) allows for this innovative form of arbitration. The arbitration is normally submitted under the ICSID Convention, under the Additional Facility Rules of ICSID or under the UNCITRAL arbitration rules. Distinctively, the final award of the international arbitration tribunal is enforceable in domestic courts. This kind of enforceability has in fact created an innovative form of “judicial dialogue” between the international tribunal and domestic courts.¹⁰⁸

¹⁰⁶ *Ibid* 427

¹⁰⁷ G Villanueva and L Serna ‘Private Parties in the NAFTA Dispute Settlement Mechanisms: The Mexican Experience’ (2003) 77 *Tulane Law Rev* 1017, 1020

¹⁰⁸ R Ahdieh, ‘Between Dialogue and Decree: International Review of National Courts’ (2004) 79 *New York University Law Rev* 2029, 2031

Though Chapter 11 DSM established a legal framework, which provides attractive financial guarantees to the investors, but it did not build a framework strong enough to accommodate social policies.¹⁰⁹

3.4. ASEAN Dispute Settlement Mechanisms

The ASEAN has also put in place a dispute settlement mechanism, which authorizes parties to refer a dispute to a panel established in accordance with the Protocol on Dispute Settlement Mechanism.¹¹⁰

The 2004 Protocol on Enhanced Dispute Settlement Mechanism (the Protocol) indicates the ASEAN's movement towards a legalistic, rule-based institution.¹¹¹

This Protocol was designed specially for dispute resolution although members have other alternative methods of resolving disputes.¹¹² It consists of 21 articles and two Annexes, provides a detailed set of rules for the whole dispute settlement process - from consultation, panel proceeding, appeal, to implementation and compensation. Articles 1 and 2 set out the general framework of DSM i.e. the coverage of application and administration of the Protocol. In this matter, the Senior Economic Officials Meeting (SEOM) is introduced as an equivalent of the DSB in the WTO DSM.¹¹³ Articles 3 and 4, which are identical to Article 4 and 5 of DSU, provide for consultation, good office, and conciliation or mediation procedures in the same manner and with the same timetable as the DSU.¹¹⁴

¹⁰⁹ Abbott (n 102) 309

¹¹⁰ The system of ASEAN DSM may be modelled on the WTO Dispute Settlement System yet it is not judicialised as the WTO. The three main mechanisms as set out in the ASEAN's Agreement on the Dispute Settlement are as follows: Article 2 Consultations, Article 3 Conciliation or mediation and Article 4 panel procedures.

¹¹¹ This protocol was signed on 29 November 2004 and replaced 1996 Protocol on DSM, accessed at <http://www.aseansec.org/16755.htm> (January 05)

¹¹² This protocol stipulates the alternative methods to settle the dispute such consultation, Good Offices, Conciliation or Mediation and Establishment of Panels stated in article 3, 4, 5

¹¹³ Article 2.1 of the Protocol

¹¹⁴ Article 3.4 of the Protocol

Articles 5 to 11 of the Protocol relate to the panel process, from the establishment of the panel to its functioning. The ASEAN panel, established by SEOM, has its own working procedures as provided for by Annex II of the Protocol. Notably, the ASEAN panels are under tougher time pressure than the WTO panel since they have to submit their findings and recommendations within 60 days of their establishment.¹¹⁵

Under Article 12 the panel ruling is appealable to an independent Appellate Body established by the ASEAN Economic Ministers (AEM), which has a similar function to the WTO Appellate Body.¹¹⁶ This is one of the most significant improvements of the 2004 Protocol. The Appellate Body, which comprises seven persons, has the power to uphold, modify or reverse the legal interpretations adopted by the panel. Once issued, the SEOM shall adopt its report if the parties unconditionally accept it unless of course, SEOM decides by consensus not to adopt the report.¹¹⁷

Most importantly, the issue of implementation may be raised at the SEOM by “any” Member at any time after their adoption, and will remain on the SEOM’s agenda until the issue is resolved.¹¹⁸ Before it is finally resolved, the party concerned is obligated to provide the SEOM with a status report in writing stipulating its progress in the implementation at least 10 days prior to each such SEOM meeting.¹¹⁹

The Protocol also differentiates from the DSU in terms of compensation and the suspension of concessions, since it takes a broader interpretation of the “sector”, supplementary to the principle that the suspension of concessions should be in

¹¹⁵ Article 8.2 of the Protocol. With respect to implementation, the Protocol imposes a fixed period – 60 days – to comply with the report after the adoption of that report from panels or Appellate Body, unless the parties to the dispute agree on a longer period of time, as provided by Article 15.1. In exceptional circumstances, if the actions required complying with the panel or Appellate Body report are complex the request for a longer period of time shall not be unreasonably denied.

¹¹⁶ Article 12.1 of the Protocol

¹¹⁷ Article 12.3,6 and 13 of the Protocol

¹¹⁸ Article 15.6 of the Protocol

¹¹⁹ *ibid*

the same sector.¹²⁰ Article 16.3 (e) reads, “for the purpose of this article, ‘sector’ means: with respect to goods, all goods”. Accordingly, if the losing party fails to implement a panel or Appellate Body report concerning trade in goods, the retaliation may involve all sectors of trade in goods and the pressure for compliance is therefore increased.

Finally, Article 17 of the Protocol establishes an ASEAN DSM Fund to meet the expenses of the panels, the Appellate Body and any related administration costs.¹²¹ It is a revolving fund, separate from ASEAN Secretariat’s regular budget.¹²²

Generally, the ASEAN DSM is predominantly modelled on the WTO DSM. However, in some points, the Protocol may be considered as an advanced version of the DSU, since it learned lessons from the current controversies of the WTO DSM and cured some of its drawbacks. For example, the new ASEAN panels and Appellate Body are entitled not only to decide the conclusion of consistency of the national measures in dispute, but also to make practical suggestions to the implementation. This might be an effective means to avoid future disagreements on the meaning of compliance in the panel or Appellate Body reports.

Nevertheless, there is no standing for non-state actors and its reports are not enforceable in national courts. With respect to transparency, the whole proceeding is confidential although in limited circumstances, the non-confidential summary of the information contained in parties’ written submissions could be disclosed to the public.¹²³

¹²⁰ Article 16.3 (a)

¹²¹ Article 17.2 of the Protocol

¹²² Article 17.1 of the Protocol

¹²³ Article 8.5, 12.9 and 13.2 of the Protocol

3.5. Evaluation of ACFTA DSM System

The ACFTA¹²⁴ sets up a new DSM resembling the WTO DSM but with several improvements. There are two main reasons for this choice. First, the above discussion on political and economic dynamics of ASEAN-China shows a DSM resembling the WTO DSM, which is less legalistic than the European Court system but still highly legalized.¹²⁵ Secondly, the WTO rules as a whole have been generally accepted by ASEAN - China.¹²⁶ In settling the dispute, parties concerned frequently referred to the WTO agreements in the course of negotiation even before China became a Member of the WTO.¹²⁷ Therefore, the choice of taking the model of the WTO DSM and making several improvements to it particularly in areas that address the special concerns of the ASEAN-China countries, as the ASEAN did to its new DSM, is more likely to be accepted by this region in negotiations. It is also likely function well.

The close link between the ACFTA system and the WTO system can be seen in the Article 4 to 9 which provides for the procedure of dispute settlement mechanism such as conciliation, mediation, the establishment of arbitral tribunal after the consultations have failed. This procedure is identical to the WTO.

In conclusion, learning from ASEAN and WTO DSM, ASEAN and China have considered the following measures in formulating their dispute settlement mechanism:

- 1) Recognition of the historical reluctance of ACFTA members to use a juridical process to resolve disputes. Among many of the ACFTA members,

¹²⁴ Article 11 (2) stated that pending the establishment of the formal dispute settlement procedures and mechanism under paragraph 1 above, any disputes concerning the interpretation, implementation or application of this Agreement shall be settled amicably by consultation and mediation.

¹²⁵ Article 4 up to Article 9 set down the ACFTA DSM, which the system may be modeled on WTO DSM.

¹²⁶ Article 2 (5), (6) of Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-Operation Between the Association of Southeast Asian Nations and the People's Republic of China.

¹²⁷ J Nakagawa 'Lessons from the Japan-China "Welsh Onion War"', (2002) 36 (6) JWT 1019.

- there is a tradition of resolving disputes in as non-litigious a manner as possible;¹²⁸
- 2) Dispute settlement mechanisms within the ACFTA should be without prejudice to the rights and obligations under the WTO Agreement and other international agreements and should not duplicate or detract from WTO institutions and procedures;¹²⁹
 - 3) ACFTA members should be encouraged to work within the framework of existing international agreements and conventions for the resolution of disputes involving private parties and to adopt appropriate domestic legislative arrangements to give effect to the aims of these agreements and conventions, including adequate enforcement of them.¹³⁰
 - 4) The ACFTA should specify the kinds of disputes, which are covered by the dispute settlement mechanism. It is also advisable for the disputant members to opt for either the ACFTA dispute settlement mechanism or the WTO mechanism when the disputants are also WTO members. Where disputant members do not so choose, the ACFTA dispute settlement mechanism shall govern all disputes that may arise between members.¹³¹

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¹²⁸This allows the parties to take consultations, conciliation or mediation, appointment of Arbitral Tribunal as stated in Article 4, 5, 6 and 7 of Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-Operation between the Association of Southeast Asian Nations and the People's Republic of China. Art 2 (5), (6) of Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-Operation Between the Association of Southeast Asian Nations and the People's Republic of China.

¹²⁹ Article 2 (5), (6)

¹³⁰ *ibid*

¹³¹ Article 2 (5), (8)

CHAPTER FOUR

The challenges and prospects of ACFTA

4.1. Trade and economic prospects for both regions

The establishment of the world's largest free trade area - encompassing China and the ASEAN - has the potential to produce a wealth of benefits but faces a rocky road ahead. However, the mutual interests between the two sides will overcome the difficulties looming before the proposed ACFTA.

For China, it is an advantage for it to secure the foreign policy environment at a time of domestic preoccupation and to promote economic exchange that assists internal economic development when carrying out this free trade agreement. It is also able to let China calm regional fears and reassure Asian neighbours about how China will use its rising power and influence to boost its regional and international power and influence.¹³²

China expressed full confidence in the economies of the ASEAN region and their future prospects hence, recognizing the strong fundamentals in their economies. China underlined its conviction that the economics of the East Asian region would continue to be one of the fastest growing in the world. ASEAN member states and China agreed on the need to consolidate their close economic relations by promoting trade and investment, facilitating market access, improving the flow of technology and enhancing the flow of and access to trade and investment related information.¹³³

¹³² Daungyewa Uthasint, 'ASEAN & China relationship: Prospect in trade and economic cooperation in the era of globalization' (2002) 11-13

¹³³ J. Lu, 'China's diplomatic strategy towards ASEAN at the turn of the century', Speech delivered at the Contemporary China Research Centre, City University of Hong Kong on December 15, 1997

They reaffirmed their common interest in developing the Mekong Basin and pledged to strengthen their support for the riparian countries by promoting activities in the areas of trade, tourism and transport. They indeed, reaffirmed support for universality of World Trade Organization membership and for the early entry of China and of the ASEAN applicants to the WTO.¹³⁴

Economically, it is a welcome initiative for ASEAN as it will allow them to induce greater efficiency and productivity into their manufacturing in the first few years of the free trade agreement and the opportunity to export goods into the Chinese market. It may also induce Japan which is widely perceived to be stagnant to go down the same liberalization path as China has done.¹³⁵ ASEAN will also get to benefit from more collaboration projects with China with greater infusion of Chinese capital in projects such as the Singapore-Kunming Railway or the Bangkok-Kunming Highway. A combined ASEAN-China market will be a super market consisting of 1.7 billion consumers and a gross GDP of US\$2 trillion.¹³⁶ The ACFTA also has the potential to push ahead ASEAN's own FTA, which has been slow in progress. China will also serve as a greater import of primary products from ASEAN as its economic growth takes off. ASEAN through economic integration with China can also reduce its dependence on the US and in the process find its own niches in industries, resource-processing is one of the examples in case.

If regional integration made trade negotiations easier, perhaps they would help the world evolve towards freer trade, culminating in globalization. ASEAN should take note of challenges ahead that might hamper the possible success of the AFTA.

¹³⁴ Joseph Yu-Shek Cheng, 'The ASEAN-China Free Trade Area: Genesis and implications' (2004) p271 Australian Journal of International Affairs, Vol. 58, No. 2

¹³⁵ *ibid*

¹³⁶ See Hu Xuan (China Daily) 19 July 2995 accessed at http://www.bilaterals.org/artilce-print.php3?id-_article=2338 on 29/11/2005

From an economic perspective, ACFTA is marketed as a "win-win" initiative. It aims at forging closer economic relations between China and ASEAN through lowering of trade and investment barriers and through joint technical and economic cooperation projects. The lowering of trade and investment barriers will result in an enlarged integrated market, promote specialisation, trade according to comparative advantage, and enable exploitation of economies of scale, thus contributing to lower costs and increased economic efficiency. Trade creation occurs when domestic production is replaced by lower cost imports from an FTA member, boosting regional income and welfare. However, there is also the cost of trade diversion as some imports may now be sourced from higher cost regional partners. In addition, there may also be welfare gains or losses due to terms of trade changes. ACFTA will also attract more investments, both from regional investors as well as investors from non-ACFTA countries.¹³⁷

In relation to the impact on real GDP, ASEAN's GDP will increase by 0.9% or US\$5.4 billion while China's GDP will increase by 0.3% or US\$2.2 billion, representing a total GDP increase of US\$ 7.8 billion. Among ASEAN countries, the biggest percentage increase will be enjoyed by Vietnam while Indonesia will enjoy the biggest absolute increase. There are negative repercussions on other countries and regions.¹³⁸

4.2. Leadership

Empirical evidence shows that the level of regional arrangement in terms of integration cannot be high or the FTA cannot be a success if there is no strong leadership in a regional arrangement or an FTA. Thus, due to its size and

¹³⁷ Chia Siow Yue, 'ASEAN-China Free Trade Area' (2004) p13-15 Singapore Institute of International Affairs. See also Chia Siow Yue (2004). "The Rise of China and Emergent East Asian Regionalism", in Kokubun Ryosei and Wang Jisi (eds), The Rise of China and a Changing East Asian Order. Tokyo:Japan Center for International Exchange.

¹³⁸ *ibid*

economic power, China is the undisputed leader of ACFTA.¹³⁹

It does not augur well if some people in China take for granted China's leadership in the ACFTA and Asia as a whole¹⁴⁰ as this would cause apprehension among other countries in the region over China's eventual role as it pursues its agenda. Therefore, balancing the interests of the members of the ACFTA is high on the leadership agenda of the ACFTA. In this regard the voting arrangement is at the heart of this issue.

4.3. The Decision-making system

The policy-making system is at the core of FTA. NAFTA¹⁴¹ and APEC apply the consensus mechanism, while the EU adopted the weighted voting system.¹⁴²

The policy-making system becomes relevant to the issue of leadership in the ACFTA.¹⁴³ If a Chinese leadership in the ACFTA were inevitable, the weighted voting system would be an appropriate option.¹⁴⁴ If each member should be treated equally, the 'one member, one vote' approach would then become the only option. However, this approach can only be adopted at the expense of a strong leadership in the ACFTA. In this context, the consensus mechanism would be an advisable compromise. On one hand, the mechanism leaves room for big powers to assume a certain leadership role; while on the other, each member can have its voice heard. Under the consensus mechanism, while each ACFTA member is entitled to one vote, votes do not count in decision-making.

¹³⁹ Q Kong, 'China's WTO Accession and the ASEAN-China Free Trade Area - The Perspective of a Chinese Lawyer' (2004) 7(6) *JIEL* 839, 842

¹⁴⁰ Susan V Lawrence, 'Enough for Everyone', *Far Eastern Economic Review* (2002) p18

¹⁴¹ Chapter 20, Article 2001 (4) of the NAFTA

¹⁴² Article 148 (2) of Treaty Establishing the European Community (as amended by Subsequent Treaties) provides for a different number of votes for the EC members

¹⁴³ See for example, Raymond Jose G. Quilop, "China – ASEAN Relations and Challenges"; paper presented at the Fourth China-ASEAN Research Institutes Roundtable held at the University of Hong Kong from 18-20 October 2001

¹⁴⁴ Theoretically, a weighted voting system can be based, for example, either on members' respective share in the total GDP of the members or on the contribution to the overall trade flow among the members

The reason is that decisions will be made after an issue has been discussed and an agreement reached with the support of all members. Given the limited number of members of the ACFTA, the consensus building should not be as difficult and time-consuming as in the WTO context.

4.4. Balancing the interest of ACFTA members

The ACFTA has to address not only China and ASEAN concerns but also those of non-WTO ASEAN countries. They are Cambodia, Laos and Viet Nam and at the same time, three least-developed countries by the United Nations definition i.e. Cambodia, Myanmar and Laos (CML). They demand more favourable treatment in the FTA. Therefore, the members' concerns should be properly addressed. Here, Japan's experience can serve as a useful lesson.¹⁴⁵ Indeed, with respect to the tariff arrangement, which is crucial to trade liberalization, attention must be paid to the interests of various members. There may be a common effective preferential tariff arrangement. As an initial step, each constituent member submits lists of various products, including the list of products subject to further tariff reduction and the list of products temporarily not subject to tariff reduction. In this regard, the Indochinese countries and Myanmar should be given special treatment regarding the timetable for tariff reduction.¹⁴⁶

China has agreed to grant preferential tariff treatment to the three least developed ASEAN countries, and extend to the three non-WTO members the same MFN status that it grants to WTO members.¹⁴⁷ Nevertheless, given the one-sided nature of the concessions on the part of China, it remains to be seen how these concerns and requests of ASEAN will be addressed in the course of implementation.¹⁴⁸

¹⁴⁵ Heribert Dieter, 'East Asia's Puzzling Regionalism', *Far Eastern Economic Review* (2001) p29

¹⁴⁶ See People's Daily newspaper on 2 October 2002 accessed at <http://www.bilateral.org/artilce> on 30/11/2005

¹⁴⁷ *ibid*

¹⁴⁸ See the Inquirer News Services on 15 July 2002 accessed at <http://www.ing7.net/bus/2002/jul/16/text/bus-2-1-p.htm>

4.5. Non-Members Finding Post-PTA More Restrictive

Competition and scale effects accrue to ASEAN and China as a whole but trade and location effects are mostly about transfers between one part of the region and another. The crucial possible downside is trade diversion. What was tariff revenue to the government before regionalism accrues to firms in partner countries? The loss in government revenue translates to a loss in the country's welfare.¹⁴⁹ This loss can be serious where tariff revenue is a substantial share of total government revenue. For example, prior to its entry to ASEAN, Cambodia derived 56% of its total tax revenue from customs duties, with two thirds of these levied on imports from ASEAN countries.¹⁵⁰ Countries that are dependent on tariffs for revenue generation will tend to compensate for the loss of revenue from the removal of tariff due to FTA by increasing the tariff to non-members.¹⁵¹

4.6. Trade Diversion

The regional agreements tend to divert trade by creating preferential treatment for member's countries vis-à-vis non-members with the net effect of trade diversion.¹⁵² Reducing trade as a result between members and the rest of the world could then misallocate global resources. ASEAN-China could possibly follow the same line of action as the European Union in using anti-dumping and

¹⁴⁹ Krugman and Obstfeld, *International Economics Theory and Policy*, 5th Ed, 2000 available at <http://econ.worldbank.org/view.php?type=5&id=947> accessed on 1/2/2006

¹⁵⁰ Fukase and Will Martin, 'A Quantitative Evaluation of Vietnam's Accession to the ASEAN Free Trade Area Authors: Emiko November 1999 available at <http://econ.worldbank.org/view.php?type=5&id=947> accessed on 1/2/2006

¹⁵¹ A. Panagariya, 'Preferential trade liberalization: the traditional theory and new developments', (2001) *Journal of Economic Literature* XXXVIII (2001), p287–331 available at http://www.sciencedirect.com/science?_ob=RedirectURL&_method=externObjLink&_locator=url&_cdi=6559&_plusSign=%2B&_targetURL=http%253A%252F%252F%2520www.aseansec.org%252Fnewdata%252Fasean_china_bc.htm

¹⁵² *ibid*

voluntary export restraints against East Asia, but this time against different non-member nations.¹⁵³

4.7. Upcoming challenges

ACFTA is seen as to boost the region's attractiveness. The integration of both regions seems to be necessary given the increasing competition in the global economy following the Asian crisis and China's entry into the WTO. The entry together with a rising trend of FDI in China serves as a wake-up call to all Asian countries to improve their competitiveness. China also looks at ASEAN to improve ties and further economic relationships that should also support to China's strong growth. Therefore, the ACFTA could also be catalyst to attract outsiders like Japan, the U.S.A., the EU and others to forge a closer partnership with the grouping.¹⁵⁴

On the other hand, some ASEAN members are still reluctant to open their markets to the Chinese products for fear that they could flood and devastate their economies. The increased competition in ASEAN's domestic markets as a result of liberalization for the Chinese products could negate any potential benefits from having a better access to the Chinese market and to the FDI now flowing into China. ASEAN still need to be careful in such a FTA not to lose out their interests along the way.¹⁵⁵

The CML countries would benefit from a later stage to apply the tariff liberalization while countries like Indonesia, the Philippines, Thailand and Vietnam will be quite affected by the opening up of their markets. Thus, most ASEAN countries, at the moment, are busy working to individually re-evaluate their own position with China. There are costs and benefits with any liberalization exercise. Proper sequencing is still essential because domestic

¹⁵³ *ibid*

¹⁵⁴ S. Chirathivat, 'ASEAN-China economic partnership in an integrating world economy', Chulalongkorn Review 14 (2002), p98-114.

¹⁵⁵ *ibid*

industries might need time to adjust. Overall, countries must work to get benefits, which should appear to outweigh its costs.¹⁵⁶

There are also some sceptical arguments that ASEAN needs to exercise some caution and to work more 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 at different things and not quite competing with similar flows to the ASEAN region. Moving into an ACFTA might not be responding to ASEAN's own needs to strengthening its own grouping.¹⁵⁷

Whatever the arguments given, a new ACFTA has given breath to the debate that there is greater validity in forming a FTA for the entire Asia. This would mean that Japan and Korea for example, could join the FTA as well. After all, this also contributes to a new round of debate about the timing where East Asia might form a pact together as a grouping in the wake of the much stronger economic blocs in Europe and the Americas.

It is, in this sense, that ASEAN–China bilateral deals might be useful politically to keep the momentum going and pressure other countries into joining 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 similar exercise with China, Australia and New Zealand. The Japan-Korea free-trade agreement is something to be related by both sides. All these rising trends give strong impetus toward an Asian-wide FTA. While new deals may boost trade, however,

¹⁵⁶ 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, p1

¹⁵⁷ *ibid*

they have to escape a confusing "spaghetti bowl" of conflicting and overlapping rules.¹⁵⁸

Conclusively, ACFTA has contributed to the rethinking of East Asia, not for only a geographic concept, but more strongly as an institutional arrangement. This regional approach may take time to realize, but still ought to be seen as the next most desirable option. ASEAN and China are considered as developing countries with high dependency on outside markets, rather than a self-fulfilling grouping that can stimulate their own economic growth. Thus, by creating an ACFTA and developing appropriate institutions to carry out their cooperation, both regions are likely to gain more benefits in the long run with regard to issues of common interests.



¹⁵⁸ Bhagwati, J., Krishna, P., & Panagariya, A, 'Trading blocs: alternative approaches to analyzing preferential trade agreements', (1999). Cambridge: MIT Press.

CHAPTER FIVE

CONCLUSION

Motivations for ACFTA are both economic and political. However, in non-economic terms, ACFTA will contribute to improving political and social relations between ASEAN and China while building on existing geographical closeness and historical and cultural ties. With these ties, ASEAN-China collaboration will contribute to a balance of power in East Asia and provide for a larger and more effective voice in the international fora.

ASEAN governments welcomed the Chinese initiative for a number of reasons. First, China is a huge and dynamic economy and its growing demand for ASEAN goods and services could serve as a new engine of growth and investment. Secondly, China's WTO entry will also mean a trading partnership based on international rules and discipline. Of paramount importance is the fact that closer ASEAN-China economic ties will also enable ASEAN to reduce dependence on the US, EU and Japan. Further, China's offer of special treatment and development assistance for the CLMV group as well as the extension of WTO most-favoured-nation benefits to the non-WTO members of ASEAN have helped them to accept the China initiative more readily. Thirdly, China and ASEAN will be able to go further than the WTO in liberalising agricultural trade, as China's temperate agriculture and ASEAN's tropical agriculture are complementary in many product areas. Thailand, in particular, looks to accelerating agricultural exports to China. Nonetheless, there are continuing concerns over the impact of preferential opening of ASEAN markets, as many ASEAN labour intensive manufactures will not be able to compete with China on price.

Although ASEAN and China are not yet considered as major trading partners, the two sides have begun to trade more in several products, suggesting a future intra-regional trade and perhaps, investment, brought about by rise in income,

product differentiation and economies of scale. The Asian crisis has weakened the economies of many ASEAN member countries but this does not deny them the opportunity to focus on the new type of economic landscape in the integrating Asia, where China has a strong presence. Linking ASEAN and China together with a focus on regional and sub-regional or even a much localized potential spots for high growth and investment could help them grow further in both regional and global economy.

For ASEAN and China, economic development remains the most important source of legitimacy for the governments and ruling elites. The ACFTA therefore has to deliver not only in terms of economic growth for both region but, hopefully, it should also facilitate the narrowing of the gap between the more developed and the developing ASEAN members. ACFTA is expected to generate the goodwill and trust to contain the territorial disputes among the parties concerned, and to promote cooperation in the handling of transnational problems such as environmental protection and drug-related crimes.

The agreement to establish the ACFTA represents a challenge to what can be achieved in the mutual engagement process. In the long run, the development may generate new domestic coalitions and regional coalitions in support of stronger regional economic cooperation.

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