



# Chapter 3

---

## Issues on the ASEAN–China Free Trade Area

Inkyo Cheong  
*Inha University, Republic of Korea*

Yeri Ryu  
*Gyeongsang National University,  
Republic of Korea*

# 1. Economic Development of ASEAN Member States

It is quite reasonable to say that the Association of Southeast Asian Nations (ASEAN) has played a significant role in the economic development and regional cooperation of Southeast Asian countries over the past 3 decades. Without the role of ASEAN, the international status of the 10 Southeast Asian countries with diverse backgrounds would be much lower. ASEAN has been at the centre, coordinating the positions of each Member State and enhancing the status of Southeast Asian countries in East Asia and the Pacific beyond economic integration in the region. Representative achievements include the ASEAN Economic Community (AEC) and ASEAN+1 free trade agreements (FTAs) with countries such as China, Japan, and the Republic of Korea (henceforth, Korea). In addition, during the Regional Comprehensive Economic Partnership (RCEP) negotiation process, ASEAN presented important ideas and contributed to the successful conclusion of the negotiations. It is also widely recognised that the Economic Research Institute for ASEAN and East Asia (ERIA) has played an important role in formulating ASEAN policies.

For a country to grow and develop its economy, it is necessary to ease or abolish unnecessary regulations so that the price system operates smoothly, allocating resources efficiently. The domestic economic law system, such as the protection of intellectual property rights, must also be established in accordance with the principles of the market economy. In addition, international economic policy is important, trade must be opened up, and the domestic business environment should be favourable enough to attract foreign direct investment (FDI). This can be summarised as the need for reform and opening up so that the domestic economic system meets global standards. Reform and opening up are not as easy as they appear because they cause conflicts of interest amongst stakeholders. Considering the domestic political environment, gradual reform is inevitable. In the late 1990s, FTA regionalism attracted worldwide attention because the international community recognised that reform and opening up through FTAs was the most realistic approach. This is called the 'lock-in effects of FTAs'.

Korea is exemplary in this respect. Pushed into the foreign exchange crisis in the aftermath of the East Asian economic crisis, Korea strategically announced FTA policies in late 1998 to promote reform and openness policies. Over the past 20 years, FTA policy has been a fundamental pillar of trade policy in Korea, along with the trade rules of the World Trade Organization (WTO). The Korean government made smart use of FTA policies to improve its business environment and ease excessive regulations, although excessive regulations and practices persist in some sectors. In fact, many improvements have been made to the economic system through the implementation of FTAs.

Improving the business environment of ASEAN Member States (AMS) must be accompanied by the efforts by individual AMS in addition to policies at the ASEAN level. Since the domestic circumstances of AMS differ across countries, the areas of economic reform that should be prioritised will be different. We believe that these priorities will be discussed much better by experts from AMS than by the researchers of this paper.

We would like to suggest the following three points. First, today, supply chain stability is the most important economic issue for all countries around the world. Recent global economic risks and challenges are discussed in section 3. In a situation where the WTO is not functioning properly, the importance of trade agreements is increasing in response to intensifying geopolitical risks. FTAs, which are highly regarded in terms of the scope and level of market opening and the comprehensive scope of trade rules, will contribute to the stability of the supply chain. Therefore, the ASEAN–China Free Trade Area (ACFTA) must be upgraded for this purpose. As supply chains have been severed or distorted due to hegemony conflicts between the United States (US) and China, the coronavirus disease (COVID-19) pandemic, natural disasters, and the Russia–Ukraine war, countries around the world have become alarmed about their economic security. Although no international definition of economic security has been established, it is generally defined as various measures to maintain the stability of the supply chain from external shocks. Ryu (2023) defined economic security as a state in which safe and resilient supply of strategic resources is maintained, future core technologies are supported and nurtured, and economic activities of the people are not hindered from external factors.

No country can completely stabilise its supply chain with domestic policies in the open economic system. Close international cooperation is needed to increase the stability of the supply chain. The supply chain can be divided into backward linkages for domestic production activities and forward linkages that allow intermediary products to be put into foreign production activities. FTAs can strengthen the stability and resilience of forward and backward linkages. AMS, which have a high share of manufacturing in their overall economy and are closely linked to the global supply chain, should strengthen their awareness of economic security. In summary, upgrading existing FTAs would strengthen economic security for member countries and will be a shortcut to improving the business environment.

Second, since agreements become outdated over time, it is necessary to negotiate upgrades to existing agreements. Concluding and implementing high-quality FTAs can dramatically improve the business environment. According to the Doing Business report released by the World Bank, some AMS have improved in their business environment rankings (Fung, 2022). Although some countries, such as Singapore, have a world-class business environment, the evaluation of the business environments of latecomer countries (Viet Nam, Cambodia, Myanmar, and the Lao People's Democratic Republic) is still low.

All AMS must properly implement the RCEP agreement. The sanitary and phytosanitary measures, technical barriers to trade, transparency, etc. included in the RCEP are regulated at a higher level than existing agreements signed by AMS. However, ASEAN's other FTAs, which are currently in effect, must be negotiated to improve the content of the FTAs. Since the ACFTA is the first agreement signed by ASEAN with a non-ASEAN country, its content and system are outdated, and must be revised as soon as possible.

Third, proactive industrial policies are needed to reap higher economic gains from the implementation of FTAs. Economic effects do not occur simply with the conclusion of an FTA. Considering current circumstances, it is necessary to support the business sector in enhancing the utilisation of FTAs and policies to attract FDI, which is important for industrial development, technology spillover, and regional development.

AMS must continue to reform their legal and trade frameworks to improve the ease of doing business while investing in infrastructure and sophisticated manufacturing capabilities. Consideration should be given to providing incentives such as tax exemptions, subsidies, and preferential treatment of land for foreign companies that wish to relocate manufacturing facilities or supply chains to ASEAN. Moreover, the ASEAN region, which has a large domestic market and abundant labour force, is increasing its value as a production base. AMS are expanding their industrial ecosystems, focusing on competitive sectors such as electric parts (the Philippines, Malaysia, and Viet Nam); automobiles (Thailand); semiconductors (Thailand); processed food (Thailand and the Philippines); and aerospace parts (Singapore). Sophisticated policy efforts are needed to develop these industrial livelihoods further.

## 2. ASEAN's Economy and the ACFTA

### 2.1. Overview

The total gross domestic product (GDP) of the 10 AMS is about US\$3 trillion, and the overall GDP of ASEAN increased at an average annual rate of 5% during 2010–2019. AMS also stood out in trade, recording high growth. Between 2016 and 2020, ASEAN's total exports increased by 21% from US\$1.15 trillion to US\$1.39 trillion, similar to China's growth of 23% from US\$2.1 trillion to US\$2.59 trillion (Paterson, 2022).

The population of ASEAN is 660 million, accounting for 8.5% of the world's population, and ASEAN is the world's most populous region after China and India. The median age of ASEAN's population is 30.3 years old, which is much younger than that of mainland China (38.4 years old). As the population is growing, ASEAN enjoys a demographic dividend. Over the next 10 years, ASEAN's population is projected to increase by 140 million.

AMS have long been closely linked to the global trade system, and their trade-to-GDP ratios are well above the global average. With average per capita GDP of US\$4,500, there is large room for income growth. ASEAN can provide an abundant labour force with much lower wages than China. Its demographic dividend, expanding middle class, and improved business climate have attracted significant FDI from around the world. As of 2020, the US, Hong Kong, Japan, and China, respectively, provided the highest amounts of FDI in ASEAN.

Foreign investors that are considering investing in AMS face several difficulties, including a weak local supply chain. Thailand must import many raw and intermediate materials from China, Japan, Korea, and other countries for production purposes. Due to technological disadvantages, many intermediate goods are not locally sourced (HSBC, 2020). Viet Nam is facing severe domestic supply chain vulnerabilities. When large foreign companies consider entering the Vietnamese market, they have to build a local industrial ecosystem by partnering with upstream and downstream firms. In areas close to the Viet Nam–China border, these difficulties can be mitigated by the procurement of Chinese parts.

The shortage of skilled workers is another major challenge for ASEAN to overcome. Thailand promotes investment in high-tech industries but struggles to attract quality talent (HSBC, 2020). The lack of infrastructure in many AMS is also an issue:

Vietnam's infrastructure is still relatively poor at present, with only 24% of paved roads and transport networks particularly inaccessible. Therefore, when choosing a specific location to invest in, it is difficult to find upstream and downstream providers geographically as well as efficient logistic services providers (HSBC, 2020).

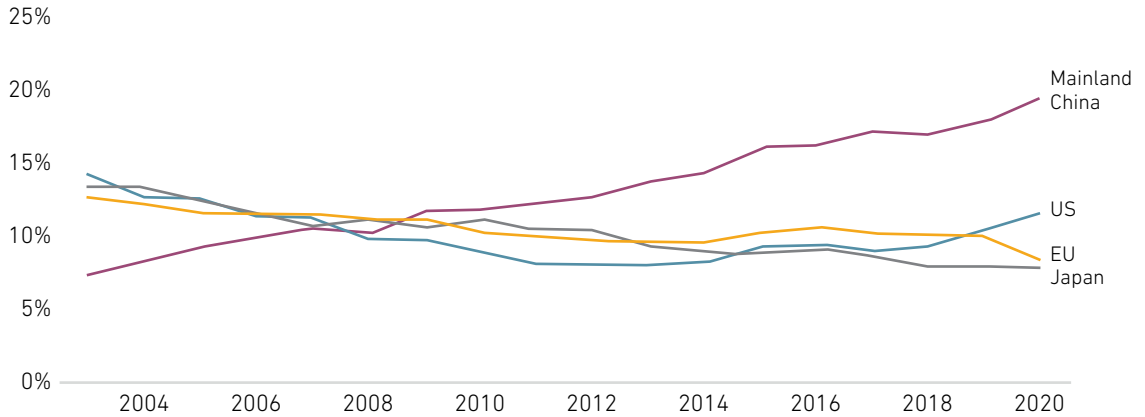
Logistics infrastructure is one of the prerequisites for foreign investors. AMS must continue to increase infrastructure investment to catch up with other countries.

## 2.2. ASEAN–China trade

The trade volume of goods between ASEAN and China in 2021 was US\$878.2 billion, up 28.1% from the previous year. China's exports to ASEAN reached US\$483.69 billion, up 26.1% year on year, while China's imports from ASEAN reached US\$394.51 billion, up 30.8% year on year. Since 2019, ASEAN has been China's largest trading partner (Embassy of China in Brunei Darussalam, 2022). Amongst AMS, the largest trading partners with China are Viet Nam, Malaysia, Thailand, Singapore, and Indonesia, respectively.

As with most countries around the world, AMS have rapidly increased trade with China, while trade with the US, the European Union (EU), and Japan has gradually contracted (Figure 3.1). The ACFTA, which came into effect in 2010, may have contributed to the expansion of trade between China and ASEAN, but no study has quantitatively analysed it. Although many studies have analysed the ex-ante effects of the ACFTA using the computable general equilibrium model, it is difficult to find studies that have conducted empirical analyses after the agreement entered into force.

**Figure 3.1 ASEAN's Major Trading Partners**  
(% share of ASEAN's total trade value)



ASEAN=The Association of Southeast Asian Nations, EU=European Union, UK=The United Kingdom

Note: UK left the EU on 31 January 2020.

Source: [www.ASEANstat.org](http://www.ASEANstat.org)

During the ongoing US–China conflict, the US has enacted many domestic laws to support strategic industries, and the global supply chain is being reorganised with supply chain intervention policies such as decoupling, onshoring, nearshoring, and friend-shoring. Russia's invasion of Ukraine in February 2022 served as a driving force for the US to rally its allies. The US is pursuing new trade forums with countries that support its trade policies. In 2021, the US regularised the Trade and Technology Council meetings with the EU and is promoting the Indo-Pacific Economic Framework for Prosperity (IPEF) with countries in the Asia-Pacific region and the Americas Partnership for Economic Prosperity with countries in Latin America. In this geopolitical environment, many countries are forced to choose between the US and China. AMS with diverse political and economic backgrounds will not be able to choose one country, and most countries will hope to continue economic cooperation with both the US and China in an effort to maximise the national interest while reducing geopolitical risk.

Today, securing supply chain stability is not an option but a necessity for survival and a key requirement for business sectors and countries. The importance of supply chain stability and resilience will increase over time. China is the top priority for AMS in terms of supply chain stability. Paterson (2022) accurately presented the reasons for this. First, the ASEAN region depends on China for securing intermediate goods for the production of tradable goods, and a significant part of ASEAN's trade growth has been supported by trade with China. As exports to China account for 15% of all ASEAN's exports, trade with China cannot be underestimated. Between 2016 and 2020, ASEAN's exports to China increased by 51%, while exports to the rest of the world increased by 16% (ASEANstats, n.d.). The ACFTA provided conducive conditions for the high amount of trade between ASEAN and China.

Second, countries must import intermediate goods to produce exports. The dependence of AMS on intermediate goods from China has been increasing. From 2018 to 2022, imports from countries other than China increased by 13.8%, while imports from China increased by 33% – 2.5 times higher (ASEANstats, n.d.). This suggests that China is supporting the backward linkage of ASEAN industries. This applies to most countries in East Asia.

In the context of today's international trade, where global value chains are active, trade in intermediate goods has more diverse impacts on the economic effect of FTAs than trade in final goods. Sheng, Tang, and Xu (2012) demonstrated this using an extended gravity model, including imports and exports between AMS and China for parts and intermediate goods. They calculated a new economic effect that many researchers do not consider when assessing the impact of the ACFTA with empirical models that are built on only final goods. Intermediate goods trade expands the forward and backward linkage effects, revitalises the industrial ecosystem of the importing country, and creates new trade opportunities. In other words, simply analysing the effect of tariff elimination on final goods trade underestimates the ripple effect of the implementation of an FTA. In addition, depending on the production network, the forward and backward linkage effects of intermediary goods activate trade with third countries, which can have a positive impact on the world economy.

## 2.3. From crisis to an opportunity

As US President Biden refers to systemic competition with China over the next 10 years, it seems inevitable that competition and conflict between the US and China will continue in the future (Blinken, 2022). For China, ASEAN could be an important partner in countering the US containment and blockade, but as seen in the IPEF, the US will want to entice ASEAN over to its side due to its geopolitical importance. AMS are crucial in the Indo–Pacific strategy of the US. AMS also need to judge the current international situation wisely. To avoid being forced to choose between the US and China, a diplomatic strategy towards the US and China is needed at the ASEAN level – rather than at the level of individual AMS.

The current US–China conflict could be an opportunity for ASEAN to redefine the structure of economic cooperation with China. The US is taking strong protectionist measures (America First) for high-tech industries, and the supply chain of high-tech industries such as high-performance semiconductors will be reorganised around the US and its allies. Japan, Korea, Taiwan, and the EU will align with the US on industrial policies, either formally or informally. Currently, the US, Japan, Korea, and Chinese Taiwan are participating in the Fab 4 semiconductor alliance. The US has also embarked on a policy of reducing its trade dependence on China. However, even though China's labour costs have risen, it is not easy to exclude Chinese products entirely because no other country can match China's competitiveness

in general purpose products. In other words, a complete decoupling would cause the US to endure huge economic losses. As a result, the Biden administration switched to strategic decoupling from the full decoupling under the Trump administration. In any case, the US will gradually reduce its dependence on China.

China has also been pursuing policies in response to the US decoupling policy. China's external dependence has already been greatly reduced, and international trade has shifted to supply chain management with East Asian countries through the Dual Circulation policy (DCP). In this process, ASEAN has become the largest cooperative partner in China's DCP. ASEAN overtook the EU and the US to become China's largest trading partner in 2020, and this situation will continue for a substantial period in the future.

Since the reorganisation of the global supply chain, China's strengthening of economic exchanges with ASEAN has become evident in the electronics industry. Korea and Taiwan were major exporters of integrated circuits to China, but China has recently expanded trade in parts for semiconductors and electronics with AMS. Intra-industry trade between ASEAN and China is growing rapidly in these sectors. Major trade items include microprocessor chips, chip capacitors, and analogue-to-digital converters.

Behind ASEAN's trade expansion is the ongoing restructuring of supply chains in East Asia. As economic uncertainty grows due to the US–China trade war and hegemonic struggle, many Japanese and Korean companies have started to relocate production to ASEAN, enticed by cheap wages and favourable investment incentives. These companies are setting up integrated circuit factories in Malaysia, Viet Nam, and Thailand; and shifting their supply chains to ASEAN to meet demand in Chinese companies (Medina, 2020; HSBC, 2020). To respond to the containment of China by the US, China is pushing to strengthen its own supply chain through the Made in China 2025 initiative, the DCP, and the Belt and Road Initiative. Despite the Chinese economy's size and reserve of resources, it is difficult to maintain stable economic growth without economic cooperation with foreign countries. China and ASEAN have high complementarity, and the ASEAN market has high growth potential. ASEAN, through the economic integration of the AEC, forms one of the fastest growing major economies in the world (HSBC, 2020). ASEAN should make active efforts to transform the current supply chain crisis into an opportunity to expand the industrial ecosystem in the region and the trade network with China. This reorganisation of the supply chain may not shift the entire supply chain to ASEAN but could result in an expansion of the ASEAN–China supply chain.

Policies and efforts are needed from ASEAN to ensure that China transfers more of its raw materials and intermediate goods, machinery and facilities, and technology and know-how to ASEAN in the future. The ACFTA needs to be improved to achieve higher economic gains. In addition to low labour costs, ASEAN should use FTAs to encourage multinational companies to do business in their markets.



In October 2019, ASEAN and China agreed to upgrade the ACFTA. The ACFTA applies zero tariffs to 90% of Chinese and ASEAN products, but it needs to give more products duty free status. Furthermore, economic and trade systems should be improved via deregulation. The existing bilateral FTAs between China and each AMS should be improved with the goal of creating a favourable business environment that goes beyond the RCEP.

## 3. Global Economy and Geopolitical Risks

### 3.1. Overview

The IMF (2023) projected that the world economy would grow by 3.0% in 2023. This is a 0.3 percentage point increase from the IMF (2022) forecast. However, certain factors still oppress the global economy. In 2023, the world economy was expected to experience a significant economic downturn in the context of normalising monetary policy and the aftermath of the coronavirus disease (COVID-19) pandemic. High interest rates led to the bankruptcy of Silicon Valley Bank, which subsequently pushed several banks in the US and Switzerland to the brink of default. Those countries' financial authorities, concerned about a banking crisis, were able to put out the urgent fire by providing funds quickly. However, funding shortages are appearing in many countries around the world.

The major risks to global economic growth include the transfer of the private debt burden to the real economy following a sharp rise in interest rates, the dilemma of fiscal roles, and the high geopolitical risk. Economic vitality will shrink due to monetary tightening pressures, additional fiscal capacity limitations, and policy space constraints resulting from sensitive market sentiment. The fragmentation of international cooperation will emerge due to the reshaping (reallocation) of global supply chains caused by competition between the US and China and the COVID-19 pandemic, as well as rapid changes in geopolitical factors since the onset of the Russia–Ukraine war. In addition, the risk of another pandemic could increase uncertainty and downward pressure on the global economy. With no means or devices to check protectionism, economic nationalism is rampant. For example, the intent of the EU's supply chain due diligence policy may sound reasonable, but it can also be seen as a non-tariff barrier. Such a measure was unimaginable in the past when WTO rules were strictly followed. But now, as protectionism is prevalent, barriers to imports are being set up without hesitation.

The spread of national protectionism and competition for hegemony between the US and China are heating up the competition for industrial dominance. As the US–China conflict escalates, the international community's attention is focused on the follow-up regulations of the US on technology and investment. With bipartisan congressional support, it is expected that the US will expand and

strengthen its foreign policy against China. Since the Trump administration, the US has promoted the following measures: (i) China's investment regulation in the US; (ii) import regulation (Article 301 tariff); (iii) high-tech export controls (semiconductors); and (iv) regulations for US companies investing in China.

Major countries' establishment of domestic-centered supply chains and protectionist industrial policies to nurture core industries will have a negative impact on global exports and investments. The WTO rules prohibit active industrial policies accompanied by subsidies and protectionist trade policies. However, countries no longer appear to be paying attention to the WTO rules. The US is subsidising industry enormously through the Infrastructure Investment and Jobs Act, the CHIPS and Science Act, the Inflation Reduction Act, and the executive order to advance biotechnology and biomanufacturing. The EU is also pursuing policies to protect industries in the region through supply chain due diligence, the Carbon Boundary Adjustment Scheme, the Core Raw Materials Act, and offshore subsidy guidelines. These laws and measures were created to contain China directly or indirectly. The US has a decisive influence on China's supply chain through export controls and investment screening. The US Department of Commerce is considering suspending export licences entirely for Huawei and is continuously strengthening foreign investment screening.

## 3.2. Building the domestic US supply chain

The US is pursuing an America First policy and an extreme industrial policy to build a domestic supply chain system. Following policy actions on semiconductors, electric vehicles, and batteries, it is announcing measures favourable to US companies in other areas, including building materials needed for infrastructure construction. On 15 November 2021, the Biden administration enacted the Infrastructure Investment and Jobs Act, which entails a budget of US\$1.2 trillion. The infrastructure act was part of the Build Back Better Act, and its purpose was to strengthen the competitiveness of the US through unprecedented infrastructure investments. The law includes the principle of using domestically produced building materials. An infrastructure task force was launched the same day the law was enacted to oversee the enormous scale of infrastructure projects.

The infrastructure act was designed to apply the requirements of 'Buy America', a US-made procurement preference scheme. The Buy America regulations mandate the use of US-made steel, manufactured goods, and building materials in federally funded projects. These regulations stipulate that the entire manufacturing process of US steel, from casting to coating, must occur in the US. However, in the case of manufactured products, the method of calculating the price and cost of components is unclear. Since this regulation was difficult to apply due to the production characteristics of each item, a separate guideline was needed.

In April 2023, the Office of Management and Budget (OMB) of the White House failed to prepare clear regulations for building materials – even in the implementation of Buy America – so it applied temporary guidelines and announced that it would finalise and announce separate standards in the future. New guidelines were revealed on 7 February 2023.

The OMB then took action to ensure that the Buy America system could be applied across the government in the federal government's infrastructure projects. The items regulated as building materials include non-ferrous metals, plastics and polymers, glass, fibre optic cables, wood, and drywall (gypsum plaster, etc.).

The WTO Agreement on Government Procurement and most FTAs stipulate that international competitive bidding be undertaken when purchasing goods or services (construction, etc.) of a certain amount with government finances. Regarding this, the recently revised OMB's Buy America guidelines can be adopted by other countries, regardless of the principles of internationally open government procurement in the WTO Agreement on Government Procurement and FTAs. However, there may be room for trade disputes in the future.

The Biden administration's Build Back Better policy is ostensibly to increase infrastructure investment in the US and foster strategic industries through subsidies and tax support. It also serves to keep China in check. Therefore, US policy will reorganise the global supply chain and further affect the global industrial landscape.

In the case of semiconductors, companies that received federal government subsidies were banned from investing in China for the next 10 years. The CHIPS and Science Act, enacted in August 2022, will provide US and foreign semiconductor companies with US\$52.7 billion in subsidies in aggregate. At the end of February 2022, the US Department of Commerce announced guidelines for the subsidy requirements. After that, Samsung Electronics expressed its intention to build a new US\$17 billion foundry plant in Texas, while Intel and TSMC are planning investments of US\$20 billion and US\$40 billion, respectively, to build new production facilities. Companies receiving subsidies or tax benefits from the federal government must abide by the 'guardrail' clause, which prohibits new semiconductor production facilities in China for the next 10 years.

The US is pursuing a strategy to exclude China from its supply chain through subsidy requirements for electric vehicles and batteries. However, China has been the world leader in the production of rare metals such as lithium, neodymium, and cobalt; and is prominent in the production of electric vehicles. This market dominance has motivated the US to check China's rise. The Inflation Reduction Act, which stipulates subsidies for electric vehicles and batteries, requires production in the US and the use of raw materials procured from the US or countries with which the US has signed FTAs. Batteries are a key component of electric vehicles, and many electric vehicle companies use Chinese-made materials such as lithium and cobalt. These auto makers have been producing batteries using raw materials from China, but have just begun the construction of massive production facilities for batteries in the US.

The building materials guidelines aimed at preventing federal subsidy outflows abroad by clarifying procurement requirements in the US based on Buy America regulations. In addition to establishing an industrial base, the government seeks to create jobs and stimulate the economy by revitalising production activities in the US through federal subsidies. Behind this, two goals are at play: (i) improving self-sufficiency in general purpose products, and (ii) reducing dependence on Chinese products. During the COVID-19 pandemic, the US has been experiencing difficulties in supplying basic goods due to supply chain distortions and logistics disruptions. The US sees China as capable of ‘weaponising’ trade dependence, as it is the world’s largest supplier of many products or ‘the world’s factory’.

In the second half of President Trump’s presidency, the US pushed for economic separation (decoupling) from China. The Biden administration has switched to strategic decoupling (a similar concept to the ‘de-risking’ adopted at the Hiroshima G7 Summit in May 2023). As discussed above, China faces serious trade barriers in high-tech industries (e.g. semiconductors, electric vehicles, and batteries), while general purpose products are subject to reshoring and domestic use requirements, as seen in the building materials regulations for infrastructure construction projects.

The next 10 years will be crucial for the US to prevent China from forming a new international order. During the Biden administration, US industrial policy will continue expanding subsidies on the number of strategic industries with intensive requirements. The effects of these US policies are already visible. According to Han (2023) and Duong (2023) on recent supply chain distortions in Korea and Viet Nam, respectively, trade with China has significantly decreased in these countries, and these countries’ trade with other East Asian countries and the US is rapidly increasing. This trend is likely to continue, and China’s participation in global supply chains may be gradually reduced.

### 3.3. Abuse of national security logic

Launched in 1948, the General Agreement on Tariffs and Trade (GATT) stipulates general exceptions in Article 20 and national security exceptions in Article 21. General exceptions are allowed only when certain conditions are met, but measures for national security are virtually unlimited.<sup>1</sup> However, security exceptions were not frequently invoked when the multilateral trade system was firmly maintained by WTO members, because they had the will to respect and develop the multilateral trading system.

---

<sup>1</sup> Regarding the international trade dispute in which the US imposed high tariffs on steel and aluminum for reasons of national security, in December 2022, the WTO Dispute Settlement Body judged that the high tariffs imposed by the US on foreign steel and aluminum in 2018 due to national security threats are not in accordance with Article 21 of GATT, which allows the WTO to restrict imports for reasons of national security.

Recently, however, a trend of contempt for the open economic system is spreading due to the abuse of national security logic. Although the need for stable economic operations and technological self-sufficiency to respond to malicious and deliberate disruptive acts by other countries by reducing excessive external dependence is acknowledged, there is always a risk of spreading an inefficient autarky stance that is in direct opposition to international trade theory.

As a result, the reinforcement of inward-oriented logic have been raised. The possibility of rent-seeking by stakeholders under the guise of security also increases in this process. It is necessary to establish economic and technological security strategies and trade policies that pursue protection and cooperation in a balanced way. A rational approach based on the analysis of the deterioration in economic feasibility and the resulting ripple effect is needed.

### 3.4. Active industrial policy

During the Trump administration, the US restricted trade with China through various measures, such as imposing high tariffs under Section 232 of the Trade Expansion Act, 1964, reshoring using taxes and subsidies, strengthening investment screening, and restricting people-to-people exchanges. In the Biden administration, the US has raised human rights issues in the Xinjiang Uighur region, and in addition to the existing Trump measures, new measures such as industrial subsidies for fostering strategic industries and strengthening export controls have been imposed.

Major countries around the world are implementing industrial policies through subsidies. The EU's supply chain reorganisation policies are aimed at strengthening regional production capacity, reducing dependence outside the region, and diversifying imports, with a focus on semiconductors, batteries, and rare minerals. A strategy is under way to restrict China from its core position in the supply chain and strengthen the EU's industrial competitiveness through subsidies, investment in technology development, and restrictions on exports.

The US Infrastructure Investment and Jobs Act, enacted in November 2021, provides subsidies to projects throughout the entire battery process, including core mineral mining and smelting and battery cell manufacturing. The US has implemented additional legislation, such as the CHIPS and Science Act and the Inflation Reduction Act in August 2022. The former includes provisions that prohibit companies receiving benefits from the US government from expanding semiconductor-related facilities in China and other countries of concern for the next 10 years, while the latter provides subsidy benefits for electric vehicles to respond to climate change but applies them differentially by limiting geographical conditions for the final production of electric vehicles, production of electric vehicle batteries, and production of minerals and parts for electric vehicle batteries.

The European Chips Act became effective in 2023. It plans to increase the share of European production in the semiconductor market to 20% through public–private joint ventures. EU battery regulations adopted in December 2022 are strengthening environmental standards for sustainable battery production, such as raising the waste battery recovery rate target, strengthening the ratio of recycled raw materials, making carbon footprint labelling mandatory, and undertaking supply chain due diligence. The European Critical Raw Materials Act, which was accepted by the European Council in April 2024, consists of identifying key raw material dependence, improving access to raw materials through offshore cooperation, promoting environment-friendly investments, and developing alternative technologies.

China is providing massive subsidies for the localisation of key items and technologies in current and future supply chains through the DCP strategy and innovation-led growth policy. The DCP strategy sets the goal of strengthening internal supply chain capabilities through self-reliance on core technologies and the advancement of industrial structures. The innovation-led growth policy seeks to enhance China's own supply chain capabilities by fostering eight technologies and nine emerging industries.

### 3.5. Supply chain blocs

The era of nationalism dominated by geopolitics has put an end to the multilateralism and most favoured nation principles that lasted for about 70 years. The era of geopolitics centred on geographical location and the era of tech-politics centred on science and technology are beginning at the same time. In the future, the fragmentation of the global economy will become even more serious as it deteriorates into an era determined by the convergence of geo-economics and geopolitics. In traditional economic statecraft, official development assistance, trade, investment, and finance are used as economic means to achieve foreign policy goals. With the emphasis on economic security, the localisation of the supply chain is widely used as a tactic of international economic governance.

As major countries increase their interest in economic security, the strategic hegemony of resources and technology spreads and the global supply chain is being reorganised. To survive global competition, the importance of stabilising the supply chain is increasing for companies as well as countries. Rifkin (2022) stated that it has become an era in which adaptability becomes important in efficiency, in the transition from an era of progress to an era of resilience.

The global supply chain structure, which focused on efficient international division of labour, is being reorganised into regional production sharing for stable supply chains due to various reasons (e.g. COVID-19). Here, we see a phenomenon in which regional supply chains are strengthened through

regional value chains. Deglobalisation is changing the value chain structure. In the existing international division of labour, the phenomenon of localising the value chain is intensifying, and the transition to the domestic value chain is accelerating. Based on this trend, trade agreements amongst countries that share similar values are likely to increase in the future.

In this regard, Duong (2023) suggested that FTAs can help improve Viet Nam's participation in the global supply chain after COVID-19. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the RCEP are contributing to supply chain stability, and these agreements are expected to have significant implications on the upgrade of the ASEAN+1 FTAs (the ASEAN–Australia–New Zealand Free Trade Area, the ACFTA, the ASEAN–Korea Free Trade Area (AKFTA), etc.) that were signed long ago.

### **3.6. Developing a discourse for trade restoration**

It will be difficult for the WTO to normalise, but discourse on trade and investment restoration may increase in the future, centred on international organisations and countries. The World Economic Forum Annual Meeting 2023 at Davos, under the theme of 'Cooperation in a Fragmented World', warned of the losses that cracks in the world economy would bring. Concerns were raised about the declining trade and investment and consequent loss of global growth engines, while the need for international policy coordination for trade restoration was emphasised. At the forum, attendees criticised the industrial and subsidy policies of the US and China that violate the international trade order, and emphasised international solidarity to restore globalism and free trade. The direction of trade discourse is expected to be introspection on the imbalance of attitudes towards the light and shade of trade liberalisation, international cooperation measures for inclusive and sustainable trade, and the derivation of realistic measures for trade restoration under the constraints of security and values.

In the meantime, the international community's passive response to the side effects of trade liberalisation, combined with political populism amid the economic recession, are deepening the decline in trade. As the first step in discussions on trade restoration, it is time to systematically investigate how trade and openness are linked to income inequality, poverty, the deterioration of working conditions, and environmental destruction. It is necessary to form an international consensus on deriving an international trade system that accepts the side effects of trade liberalisation as part of the trade agenda and minimises the derived costs. The need for international public discussion on the concept and scope of security and value, and the impact of trade on the heterogeneity of security and value amongst countries, could also be raised.

## 4. To-Do List for ASEAN–China 3.0

ASEAN and China signed a bilateral FTA at a time when they lacked FTA experience and know-how. The ACFTA is poor, both structurally and in terms of content. China's FTAs with Australia and Korea are better than the ACFTA, but compared with the CPTPP and the US–Mexico–Canada Agreement, the market access scope is narrower and the trade rules are weaker. ASEAN has completed market integration within the ASEAN region through the AEC and is promoting various cooperative projects. Moreover, ASEAN and China are members of the RCEP, and the RCEP is better than the ACFTA. The RCEP also has many shortcomings in market access and trade rules, such as sanitary and phytosanitary measures and technical barriers to trade. The ACFTA revision should overcome the limitations of the RCEP. China has already expressed its intention to join the CPTPP. In addition, China needs to find a close partner for economic cooperation in the Asian region in response to the US containment policy. Considering this situation, ASEAN and China should upgrade the ACFTA as soon as possible.

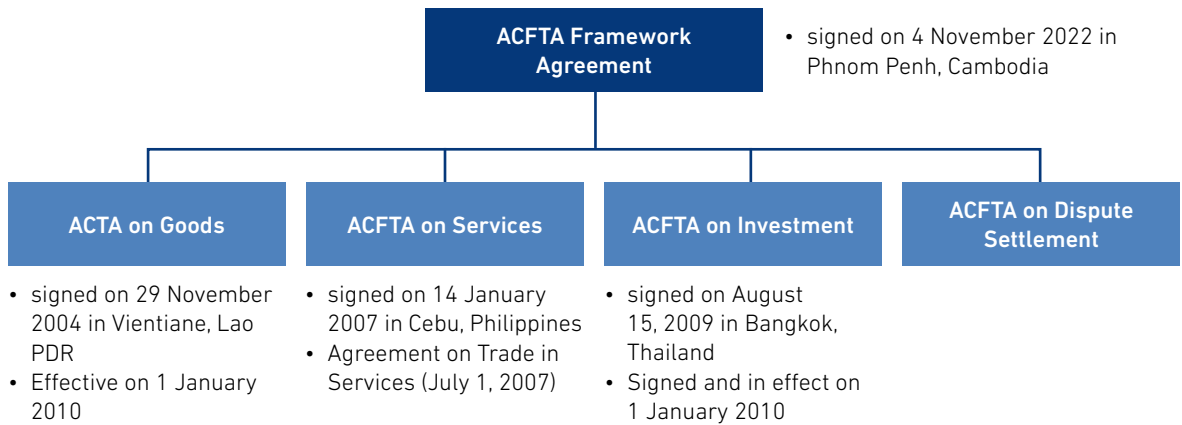
### 4.1. A single agreement

In 2002, ASEAN and China signed the Framework Agreement on China–ASEAN Comprehensive Economic Cooperation, which is regarded as the starting point of the ACFTA. At the time, Japan and Korea were negotiating a bilateral FTA, and China was pursuing trade agreements with Hong Kong, Macau, and ASEAN. It was the time when the wind for FTA regionalism in East Asia had just begun. In 2004, ASEAN and China concluded the Agreement on Trade in Goods, followed by the Agreement on Trade in Services in 2007 and the Agreement on Investment in 2009. When these four agreements are combined with the Agreement on Dispute Settlement Mechanism, a total of five individual FTAs constitute the ACFTA (Figures 3.2 and 3.3).

The agreement for goods organises the tariff elimination schedule of each member country in two annexes (I and II) according to their market opening sensitivity (normal, sensitive), and the rules of origin criteria for each item are presented in Annex III. In addition, specific commitments are written in separate files for service and investment liberalisation.

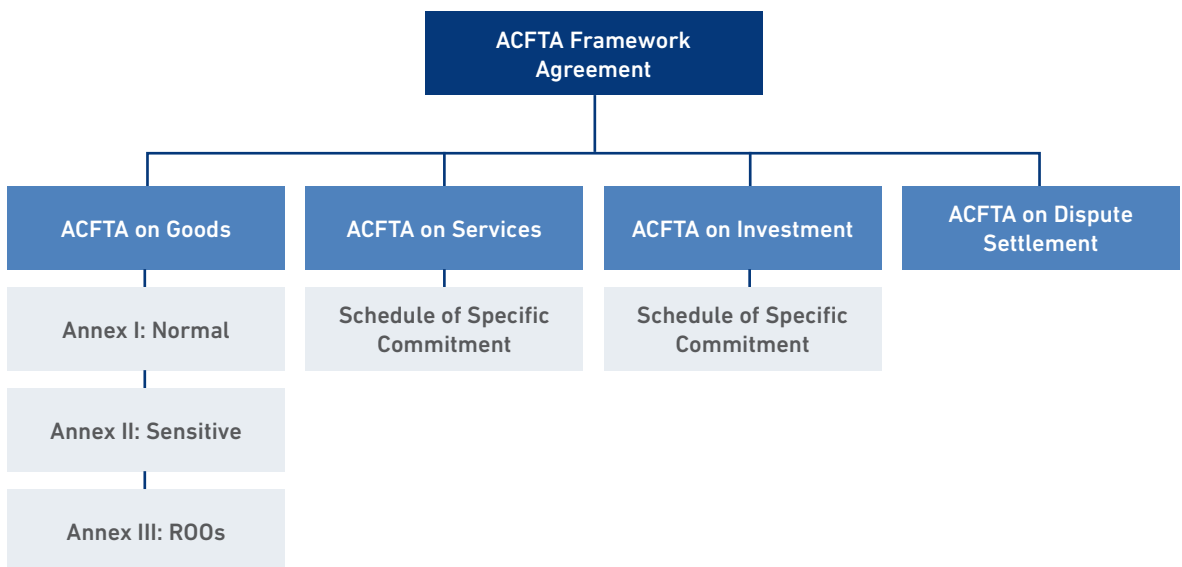


**Figure 3.2 Structure of the ACFTA**



ACFTA = ASEAN–China Free Trade Area, ASEAN = Association of Southeast Asian Nations.  
 Source: Authors.

**Figure 3.3 Annexes and Schedules of the ACFTA**



ACFTA = ASEAN–China Free Trade Area, ASEAN = Association of Southeast Asian Nations, ROO = rules of origin.  
 Source: Authors.

The ACFTA upgrades are necessary in several respects. First, it is necessary to transform these five separate agreements into one integrated agreement with expanded market access and global standard trade rules. In 2002, ASEAN and China, which lacked FTA experience and know-how, took a step-by-step approach to ease the burden of market opening. Although negotiations were conducted on goods, services, and investment for 7 years until 2009, the scope of market opening was relatively narrow and the level of opening is shallow compared with other FTAs, since both ASEAN and China were passive about market opening. In the end, a typical ‘South–South FTA’ was concluded.

## 4.2. Improve poor market access

The low utilisation of the ACFTA can be seen through the results of Viet Nam’s FTA utilisation survey. According to Duong (2023), the ACFTA has utilisation rates as low as 33.9% in Viet Nam. Cheong (2014) pointed out that the utilisation of the ACFTA is affected by many factors, but the scope and speed of tariff elimination are the most important determinants. Although there is no research on the reason for the low utilisation of the ACFTA, it is highly likely that poor market access due to the low level of tariff elimination and tariff preference are the background for the low utilisation of the FTA.

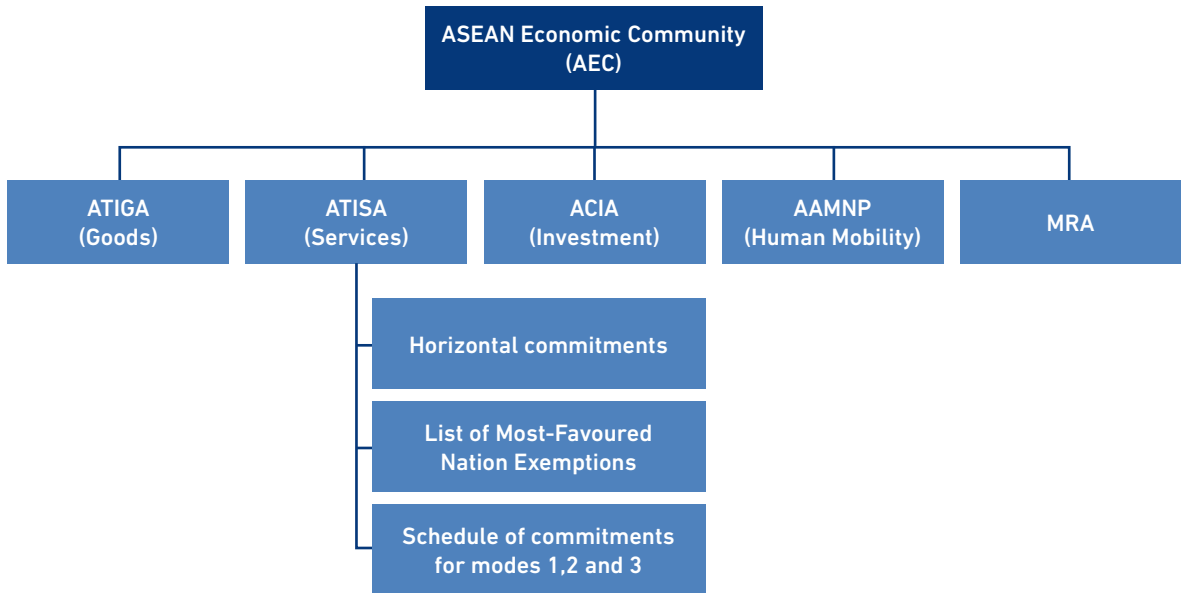
The scope of market opening and the tariff elimination schedule of the ACFTA should be advanced. An FTA cannot be described as ‘high-quality’ if the tariff elimination rate is not close to 100%. In addition, the extent of openness to services and investment should be expanded, and the protection of intellectual property rights (IPR) should be improved. Tariff elimination alone makes it difficult for FTAs to contribute to supply chain stability. The rules related to the goods–investment–services–IPR nexus should be defined at the global level so that multinational companies review their business in ASEAN and China.

## 4.3. Achieve AEC+ in the ACFTA 3.0

The AEC, launched on 31 December 2015, is a regional economic integration initiative aimed at creating a single market and production base amongst the 10 AMS (Figure 3.4). The AEC aims to promote the free flow of goods, services, investment, skilled labour, and capital amongst AMS, benchmarking the EU. It also aims to create a more competitive and dynamic region by promoting innovation, increasing productivity, and fostering a business-friendly environment.

To achieve these goals, the AEC has implemented various measures, including reducing trade barriers, harmonising standards and regulations, promoting the development of small and medium-sized enterprises, enhancing connectivity and infrastructure, and facilitating the mobility of skilled workers within the region. The AEC is expected to bring many benefits to the ASEAN region, such as increased trade and investment flows, greater efficiency and productivity, and improved competitiveness.

Figure 3.4 Structure of the AEC



AAMNP = ASEAN Agreement on the Movement of Natural Persons, ACIA = ASEAN Comprehensive Investment Agreement, AEC = ASEAN Economic Community, ASEAN = Association of Southeast Asian Nations, ATIGA = ASEAN Trade in Goods Agreement, ATISA = ASEAN Trade in Services Agreement, MRA = ASEAN Sectoral Mutual Recognition Arrangement.

Source: Authors.

The ASEAN Free Trade Area (AFTA) is a free trade area amongst the AMS. Under the AFTA, tariffs on goods traded amongst AMS are gradually being reduced to zero. As of 2021, the average tariff rate for intra-ASEAN trade was around 0.1%. This is a significant reduction from the average tariff rate of 6% in 1993 when the AFTA was established. The reduction in tariffs has been achieved through a series of tariff reduction schedules negotiated by AMS. Under these schedules, AMS have agreed to gradually reduce tariffs on goods traded amongst themselves, with the aim of achieving a tariff rate of zero by 2025 for most products. It is important to note that some sensitive products, such as certain agricultural products and automobiles, are still subject to higher tariff rates within ASEAN. However, AMS have also agreed to negotiate a reduction of these tariffs through the ASEAN Trade in Goods Agreement.

In upgrading the ACFTA, ASEAN and China should set market opening beyond the AEC as a negotiation goal. This applies to goods, services, and investment. In addition, both parties should benchmark the CPTPP for trade rules and IPR. There are concerns over spaghetti bowl effect losses as many FTAs have overlapped in Asia. When ASEAN and China agree on a high-level FTA suitable for the times, rather than creating another tedious FTA, the ACFTA could contribute to strengthening the supply chain between the two regions during a time of chaos in the world economy.

## References

- ASEANstats (n.d.), <http://www.aseanstats.org/> (accessed 16 April 2024).
- Blinken, A.J. (2022), 'The Administration's Approach to the People's Republic of China', Speech, The George Washington University, Washington, DC, 26 May. <https://www.state.gov/the-administrations-approach-to-the-peoples-republic-of-china/>
- Cheong, I. (2014), 'Korea's Policy Package for Enhancing Its FTA Utilization and Implications for Korea's Policy', *ERIA Discussion Paper Series*, No. DP-2014-11. Jakarta: Economic Research Institute for ASEAN and East Asia (ERIA).
- (2016), 'Analysis of the FTA Negotiation Between China and Korea', *Asian Economic Papers*, 15(3), pp.170–87.
- Duong, N.A. (2023), 'Engaging in Global Supply Chains in the New Context: A Vietnamese Perspective', Second Conference of the Asian Council of Economic Policy, Seoul, 5 April.
- Embassy of China in Brunei Darussalam (2022), 'Brief Status of China–ASEAN Economic and Trade Cooperation in 2021', 29 January. [http://bn.china-embassy.gov.cn/eng/zwxg/202201/t20220129\\_10636735.htm](http://bn.china-embassy.gov.cn/eng/zwxg/202201/t20220129_10636735.htm)
- Fung, D. (2022), 'The Growing China–ASEAN Economic Ties', HKTDC, 7 January. <https://research.hktdc.com/en/article/OTUxMzk0NDE0>
- Han, H. (2023), 'Challenges and Response of Supply Chain Disruptions in Korea', Second Conference of the Asian Council of Economic Policy, Seoul, 5 April.
- HSBC (2020), 'ASEAN Rises to Become China's Top Trading Partner, Great Prospect for China + ASEAN Strategy'. <https://www.business.hsbc.com.cn/en-gb/campaigns/belt-and-road/asean-story-1>
- IMF (2022), *World Economic Outlook: Countering the Cost-of-Living Crisis*. Washington, DC: International Monetary Fund.
- (2023), *World Economic Outlook Update: Near-Term Resilience, Persistent Challenges*. Washington, DC: International Monetary Fund.
- Medina, A.F. (2020), 'ASEAN Overtakes EU to Become China's Top Trading Partner in Q1 2020', ASEAN Briefing, 15 May. <https://www.aseanbriefing.com/news/asean-overtakes-eu-become-chinas-top-trading-partner-q1-2020/>
- Paterson, S. (2022), 'Supply Chains Are Trying to Diversify. Will ASEAN Step in?', Hinrich Foundation, 1 June.
- Rifkin, J. (2022), *The Era of Resilience: Reimagining Existence on a Rewilding Earth*. New York: St. Martin's Press.

- Ryu, Y. (2023), 'A Study on Countermeasures to Chinese Economic Coercion: From the Perspective of Economic Security', *Journal for International Trade*, 28(1), pp.1–23 (in Korean). [https://www.kci.go.kr/kciportal/landing/article.kci?arti\\_id=ART002942784](https://www.kci.go.kr/kciportal/landing/article.kci?arti_id=ART002942784)
- Sheng, Y., H.C. Tang, and X. Xu (2012), 'The Impact of ACFTA on People's Republic of China–ASEAN Trade: Estimates Based on an Extended Gravity Model for Component Trade', *ADB Working Paper Series on Regional Economic Integration*, No. 99. Manila: Asian Development Bank.