



Chapter 4

Indonesia's Perspective

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1. Introduction

Economic relations between the Association of Southeast Asian Nations (ASEAN) and China are important not only because of their impact on the development of both parties but also on the regional and global economy. The first landmark of the economic relations was the signing of the ASEAN–China Free Trade Area (ACFTA) in 2003, which was preceded by the amendment of ASEAN's Treaty of Amity and Cooperation in Southeast Asia to include China. The ACFTA is phenomenal because it is the first regional free trade agreement (FTA) that ASEAN secured and the first China FTA with neighbouring countries. Given China's status as the strongest emerging power in the global economy and politics in the post-Cold War era, a study on the ACFTA is vital to understand its impacts on China and ASEAN Member States (AMS) as well as the regional and global economy. This is particularly pertinent because (i) China has been the second largest economy in the world since 2010; (ii) ASEAN and China, together with Japan, the Republic of Korea (henceforth, Korea), Australia, and New Zealand, signed a mega FTA – the Regional Comprehensive Economic Partnership – in 2021; and (iii) China has been embroiled in economic tensions with the United States (US) and its allies.

The ACFTA has played a significant role in deepening economic relations between ASEAN and China by enhancing two-way trade in goods and services and by facilitating China's foreign direct investment (FDI) in AMS. Bilateral trade has increased 85 times since 1991. In 2020, total bilateral merchandise trade reached US\$516.9 billion. Regarding FDI, China has evolved from a destination of ASEAN capital in the 1980s and 1990s to an FDI source country since 2010. The Belt and Road Initiative (BRI), introduced by the Chinese government in 2013, has intensified China's investment in infrastructure projects in AMS in the last decade. Chinese companies are now amongst the top three investors in AMS.

However, challenges to the ACFTA derive from three levels: internal issues within AMS, ASEAN–China relations, and the external environment. Within AMS, disappointments and criticisms regarding the ACFTA emerged after the FTA became effective in the 2010s because of ASEAN's increasing trade deficit with China. In addition, the ACFTA generated concerns about ASEAN–China relations, mainly due to China's duality of policy towards Southeast Asian countries: deepening economic cooperation on the one hand and strengthening its territorial claims in the South China Sea on the other. Moreover, the external environment of ASEAN–China relations has been dynamic, not only because of increasing tensions between China and the US but also because of other important emerging phenomena. These include the coronavirus disease (COVID-19) pandemic and changes in the global economic landscape such as the adoption of technology-based trade facilitation measures, disruptions and shifts in global and regional supply chains, expansion of the digital economy, and the urgency of sustainable economic development.

Therefore, a careful review of the ACFTA is imperative to understand its impacts on China and AMS and to ensure that it remains relevant and responsive to the needs of regional economic development.

This study aims to identify potential areas for improvement and further cooperation between ASEAN and China in the ACFTA. It has three objectives: (i) to assess the economic consequences of the ACFTA on AMS and identify potential areas for improvement; (ii) to assess the potential benefits and identify cooperation measures between ASEAN and China in new and emerging areas; and (iii) to identify trends and challenges facing ASEAN–China economic relations and make recommendations on how to address these challenges.

In terms of methodology, both quantitative and qualitative research methods are applied to achieve the objectives outlined above. The study will:

- (i) assess trade and investment relations in the context of the ACFTA;
- (ii) conduct business and stakeholder sentiment analysis;
- (iii) assess the potential benefits and identify cooperation measures between ASEAN and China; and
- (iv) identify trends and challenges facing ASEAN–China economic relations and make recommendations on how to address these challenges.

Data for this study are collected from a variety of sources, including government data, industry reports, academic literature, and focus group discussions with businesses and other stakeholders. Quantitative data are analysed using statistical software, while qualitative data are analysed using content and thematic analysis.

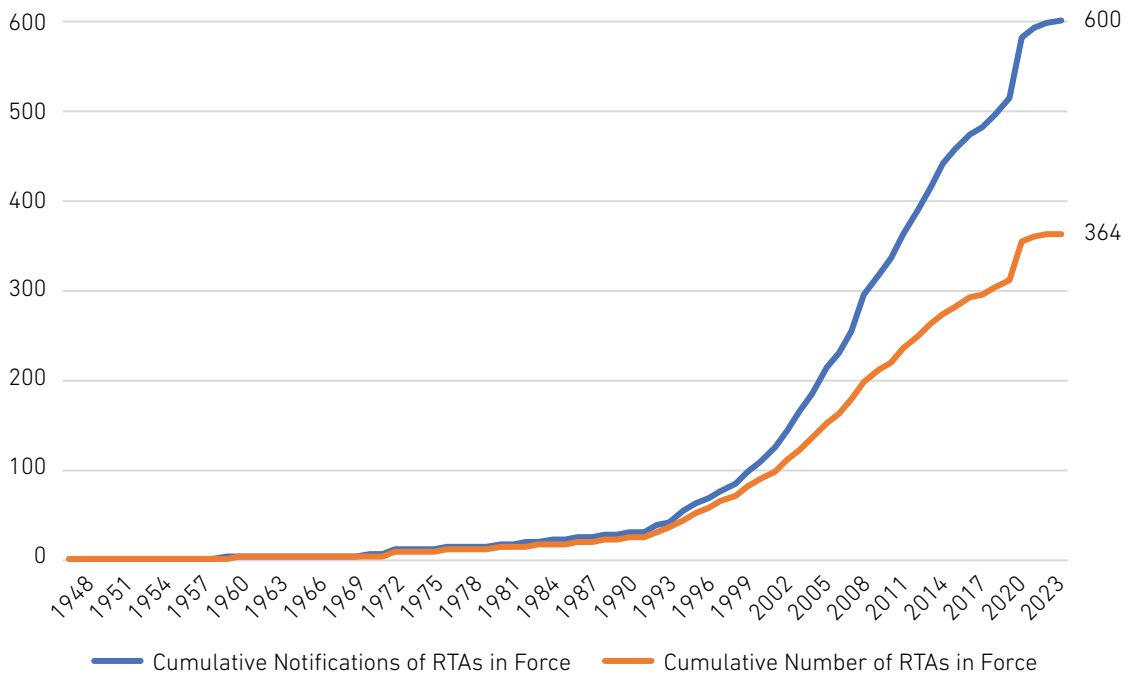
To conduct the quantitative analysis for this study, econometric methods are applied to estimate the economic impact of the ACFTA on ASEAN economies. The qualitative analysis involves collecting and analysing data on the perceptions and experiences of businesses, key persons, and other stakeholders in the region to identify key elements of success and obstacles to the ACFTA and ASEAN–China economic relations.

The rest of this study is organised into seven sections. Section 2 reviews the development of the ACFTA since its establishment in 2003. Section 3 assesses the impacts of the ACFTA on ASEAN–China relations by applying both quantitative and qualitative research methods. Section 4 analyses the lessons learned from the ACFTA and ACFTA Update. Section 5 delineates the policies of AMS towards China and examines the emerging issues and trends in the region and global context. Section 6 makes recommendations on how to address these issues to strengthen ASEAN–China economic relations. Section 7 concludes by highlighting the key findings and recommendations.

2. Development of the ACFTA, 2003–2022

Since the 1990s, the global community has made remarkable advancements in the realm of regional economic integration. According to the World Trade Organization (WTO), 364 regional trade agreements (RTAs) had entered into force by the end of 2023 (Figure 4.1). These data underscore the growing prominence of bilateral and regional trade liberalisation, making it imperative to comprehend the ramifications for world trade.

Figure 4.1 Evolution of Regional Trade Agreements (RTAs), 1948–2023



Source: WTO (n.d.), Regional Trade Agreements Information System (RTA-IS).

https://www.wto.org/english/tratop_e/region_e/region_e.htm (accessed 28 February 2024).

Over the past 2 decades, Asian economies have embarked upon a diverse range of market activities, earning them the reputation of ‘world factory’. Since the 1997–1998 Asian financial crisis, Asia has continued its journey towards regional economic integration, characterised by a proliferation of bilateral FTAs and the formation of monetary institutions in cooperation with neighbouring nations. This progression is manifest in the heightened interconnectivity between Northeast and Southeast Asian countries through collaboration and integration, which has significantly enhanced the efficiency of economic endeavours in the region (Yang and Martinez-Zarzoso, 2014).

As one of the world's fastest-growing economies, China has been the key actor in promoting Asian economic integration in the last 3 decades. Given China's reliance on international trade, it has consistently sought to bolster cooperation and economic integration with various nations across the globe. In 1990, China became an official member of Asia-Pacific Economic Cooperation (APEC), and in November 2001 proposed an initial regional trade agreement with ASEAN (Zhao, Malouche, and Newfarmer, 2008). The choice of the ASEAN region was due to its vast market potential and the substantial population of several AMS (Santoso and Fahruriza, 2013). A more thorough examination of the history and evolution of the ACFTA is in Table 4.1.

Table 4.1 History and Development of the ACFTA

Year	Milestones
1991	China attended the 24th AMM in 1991.
1996	China participated in the 29th AMM in 1996.
1997	China became a member of ASEAN+3 in December 1997.
2000	Chinese Prime Minister Zhu Rongji proposed the establishment of the ACFTA at the ASEAN–China Summit in November 2000.
2001	China became a member of the World Trade Organization (WTO) on 11 December 2001.
2002	ASEAN and China signed the Framework Agreement on Comprehensive Economic Cooperation on 4 November 2002.
	The ACFTA Framework Agreement protocol was amended twice.
2003–2006	The first protocol change was signed on 6 October 2003.
	The second amendment was signed on 8 December 2006.
	The Agreement on Trade in Goods was signed on 29 November 2004.
2004–2009	The Agreement on Trade in Services was signed on 14 January 2007 at the 12th ASEAN Summit.
	The Agreement on Investment was signed on 15 August 2009 at the 41st ASEAN Economic Ministers' Meeting.
2010	Implementation of the ACFTA on 1 January 2010.
	The ACFTA took full effect on 1 January 2015.
2015	The Protocol to Amend the Framework Agreement on Comprehensive Economic Cooperation (ACFTA Upgrade Protocol) was signed on 21 November 2015.
2016	The ACFTA Upgrade Protocol entered into force on 1 July 2016.

ACFTA = ASEAN–China Free Trade Area, AMM = ASEAN Foreign Ministers' Meeting, ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, WTO = World Trade Organization.

Source: Authors, based on Pradina (2018).

The ACFTA consists of three agreements: (i) the Trade in Goods Agreement, (ii) the Trade in Services Agreement, and (iii) the Investment Agreement. The cooperation agreement reflects the commitment of AMS and China to fortify their economic cooperation. The formation of this partnership had several well-defined objectives (Wahyudi, 2014), including (i) fortifying and enhancing economic, trade, and investment cooperation between the two parties; (ii) liberalising trade in goods, services, and investment; (iii) exploring and developing new avenues of mutually beneficial economic cooperation; and (iv) facilitating more seamless economic integration of the new AMS and bridging any existing disparities on both sides. In addition to these efforts, both parties also agreed to bolster and enhance economic cooperation through measures such as (i) eliminating tariff and non-tariff barriers to trade in goods, (ii) gradually liberalising trade in services, and (iii) constructing a competitive and open investment regime within the framework of the ASEAN–China FTA (Wahyudi, 2014).

The benefits, opportunities, and challenges related to the ACFTA have been well documented (Tongzon, 2005). One of the most significant benefits of the ACFTA is the increase in trade and investment flows between ASEAN and China. The agreement has resulted in the elimination of tariffs on many goods traded between the two parties, making them more competitive in each other's markets. The increased competition has resulted in lower prices for consumers in both ASEAN and China, leading to increased demand for goods and services. This has facilitated the growth of bilateral trade, which has resulted in an increase in investment flows. According to Wang (2018), the elimination of tariffs on trade between ASEAN and China has led to significant growth in exports from both regions. The authors found that Malaysia and Thailand have seen significant growth in their exports to China since the implementation of the ACFTA. This has helped spur economic growth in these countries, particularly in those sectors that are heavily reliant on exports. Additionally, the increased investment flows have facilitated the growth of new industries and the expansion of existing ones, which has created new employment opportunities and contributed to economic growth (Wang, 2018).

Another significant benefit of the ACFTA is job creation. The increased trade and investment flows resulting from the ACFTA have led to the development of new industries and the expansion of existing ones. This has created new employment opportunities, particularly in the manufacturing sector. According to Ceglowski and Golub (2012), the agreement has led to the creation of about 500,000 jobs in AMS since its implementation. This has helped reduce unemployment and poverty levels in these countries.

Furthermore, the ACFTA presents many opportunities and benefits to consumers and businesses of both parties. These include access to a broader spectrum of cheaper products for consumers (Tongzon, 2005) and easier access to the vast and rapidly growing Chinese market for ASEAN companies. The elimination of tariffs also enables smoother flow of intermediary goods between ASEAN and China, to the advantage of producers throughout the production process, and the promotion of deeper regional economic integration (Sheng, Tang, and Xu, 2014).

But the ACFTA is not without challenges. The biggest challenge is that ASEAN economies must be able to compete in China's market. As indicated in Table 2.1, the ACFTA was officially instituted in 2010. That year, about 8,000 tariff lines posted on China–ASEAN goods and services were zero. This zero-tariff imposition was applied to the manufacturing, agriculture, and mining industries, fostering free competition amongst products that adhered to the agreement from China and AMS, including Indonesia (Ministry of Transportation, 2010). Another significant challenge posed by the ACFTA is the potential for intensifying competition amongst AMS. The increased competition resulting from the ACFTA could negatively impact some industries and regions within ASEAN, leading to significant job losses and a reduction in social welfare if trade diversion effects supersede trade creation (Chia, 2005). Consequently, it would widen the income gap and increase inequality within AMS. Some countries, such as Viet Nam and Cambodia, may be more negatively impacted by the increased competition from China, as they are less developed and have fewer resources to compete.

The statement on the challenges mentioned above has a counterargument, as can be shown from a study conducted by the ASEAN Secretariat predicting that the agreement would increase exports from ASEAN to China by 48% and from China to ASEAN by 55% (Cordenillo, 2005). Tariff and non-tariff barriers were established on 1 July 2005 for selected products specified in the Harmonized System (HS) code 9-97, resulting in a 19% increase in bilateral trade between China and AMS, from around US\$49 billion in the first half of 2005 to nearly US\$59 billion in the second half of the same year. This trend has continued, with total bilateral trade reaching US\$329 billion in 2006, reflecting 47% growth from US\$223 billion in 2004, intensifying to US\$975 billion in 2022 (Chit, 2008).

However, the ACFTA is not merely about trade but also investment. The investment agreement establishes important safeguards to ensure non-discriminatory, fair, and equitable treatment of investors. It also includes provisions allowing for the transfer and repatriation of profits in freely usable currency, providing investors with the opportunity to seek arbitration to resolve disputes between investors and states.

Trade between China and ASEAN is increasing rapidly compared with other trading partners. This is partly due to rapidly growing bilateral investment (Ohashi, 2006). AMS invested about \$3 billion per year in China from 1992, and by the end of 2005, cumulative real investment in China was \$38.5 billion. Chinese companies were steadily increasing their investment in AMS as well. By the end of 2005, China and AMS had signed labour contracts with a total estimated value of \$23.2 billion (Zhao, Malouche, and Newfarmer, 2008).

As is often the case with FTAs, the parties to the agreement that led to the creation of the ACFTA cited the positive impacts of FTAs on trade and FDI as desirable goals. The agreement referred to the wish of participating countries to increase intra-regional trade and investment (Li, Scollay, and Maani, 2016). As part of their strategy to attract FDI, many AMS offer investment incentives and tariff reductions on imported materials and components. FDI is defined as an investment by a foreign direct investor resident in one economy that reflects the continuing interest and control of a company (foreign subsidiary) in another economy.

According to ASEANstats (n.d.), China has become the fourth largest source of FDI amongst ASEAN's eight Dialogue Partners. China's FDI flows to ASEAN reached US\$9 billion in 2019, accounting for 5.7% of the total FDI flows to the region. In 2021, FDI flows from China to ASEAN were US\$13.6 billion, almost double the US\$7 billion in 2020, accounting for 7.8% of ASEAN's total FDI inflows. Currently, more than 7,000 types of goods are eligible for duty-free treatment, and the upgrade of the ACFTA will provide a strong boost to the liberalisation and facilitation of trade and investment between ASEAN and China, and to the development of an integrated regional economy.

Given the fact that ASEAN and China have been particularly entangled since the ACFTA, Lakatos and Walmsley (2012) found that China and the other AMS have increased their capital holdings in Indonesia, the Philippines, Thailand, and Viet Nam. Yeyati, Stein, and Daude (2012) estimated that joining an FTA can increase FDI by about 30%.

The trade-creating effects of FTAs may result in welfare-enhancing investments if investors find it viable to move production to more efficient locations within the FTA. On the other hand, if the trade diversion effects of an FTA promote FDI in inefficient locations within the FTA, welfare-reducing investment diversion may occur (Balasubramanyam, Sapsford, and Griffiths, 2002). It is important for the ACFTA's trade creation to outweigh its trade diversion, creating optimism that investment creation outweighs investment diversion. However, as some trade diversion remains, the possibility of related investment diversion is not ruled out. The potential for increased intra-FTA trade stimulated by the ACFTA is far from being realised under existing ACFTA provisions, and the potential for further development of the ACFTA may also lead to more increases in FDI (Yang and Martinez-Zarzoso, 2014).

As the Chinese economy continues to grow and AMS see more investment opportunities in the region, China could be a good source of FDI for AMS. On the other hand, AMS can benefit from China's huge domestic market and growth potential by shifting some of their investment to China. Some AMS have already benefited from China's opening up, and ACFTA upgrades can further facilitate investment between these countries.

To see whether China and ASEAN trade are becoming more entangled, the Trade Complementary Index (TCI)¹ can be employed. The TCI serves as a crucial indicator to assess the extent of trade complementarity existing between two economies. It sheds light on whether the export and import structures of two countries engaged in trade complement each other (Retnosari and Nasrudin, 2018).

$$^1 \quad TCI_{cgr} = 1 - \left\{ \frac{\sum_a abs \left[\frac{M_{rg}}{M_r} - \frac{X_{cg}}{X_c} \right]}{2} \right\}$$

We compute the index using several variables: M_{rg} refers to a given country's overall imports of a particular commodity, while M_r denotes that country's total imports across all commodities. Similarly, X_{cg} denotes a given country's total exports for a specific commodity, whereas X_c pertains to that country's total exports across all commodities.

In this study, the focus centres on country *c*, which assumes the role of an exporter, and country *r*, which acts as an importing country. The TCI value, which can range from 0 to 1, serves as the cornerstone of the study's findings. A TCI value of 0 implies that there is no correspondence between the exported and imported goods of both countries, whereas a TCI value of 1 signifies a flawless match of trade patterns.

Table 4.2 elucidates the outcomes of the TCI computations on the ACFTA. A cursory glance at the table reveals that China and the Philippines are amongst the countries with a TCI score of 1, indicating an impeccable alignment of their trade patterns. Meanwhile, Cambodia, the Lao People's Democratic Republic (Lao PDR), Malaysia, and Viet Nam have attained a TCI score of 1 but only during certain intervals. In essence, a TCI score of 1 is synonymous with a perfect match of trade patterns. Nevertheless, the ACFTA's TCI value has an average value above 0.5, signifying a decent degree of trade complementarity. Conversely, Brunei's TCI average value is the lowest, posing a challenge for the government in discerning viable export items.

Table 4.2 Trade Complementary Index of the ACFTA

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Average
Brunei	0,7	0,6		0,6	0,5	0,4	0,5	0,7	0,7	0,5	0,5	0,5	0,6	0,7	0,7	0,2	0,6	0,6	-0,1	0,5
China	1,0	1,0	1,0	1,0	1,0	1,1	1,0	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1
Indonesia	1,2	1,2	1,2	1,1	1,1	0,9	0,8	0,8	0,8	0,8	0,8	0,8	0,8	0,8	0,8	0,7	0,7	0,7	0,7	0,9
Cambodia	0,8	0,7	0,9	1,0	0,9	0,7	1,1	1,1	1,1	1,0	0,8	0,6	0,9	0,8	0,9	1,0	0,9	0,6	1,0	0,9
Lao PDR								0,9	1,1	1,1	0,8	0,7	0,7	0,7	0,6	0,7	0,7	0,6	0,7	0,8
Myanmar								0,5	0,7	0,6	0,5	0,6	0,5	0,6	0,7	0,7	0,7	0,7	0,7	0,6
Malaysia	1,0	1,0	1,0	1,0	1,0	0,9	1,0	1,0	1,0	1,0	1,0	1,0	0,9	0,9	0,9	0,9	1,0	1,0	1,0	1,0
Philippines	1,2	1,2	1,3	1,2	1,2	1,3	1,3	0,8	1,1	1,2	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,1	1,2	1,2
Singapore	0,9	0,9	1,0	0,9	0,9	0,9	1,0	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,8	0,9	0,9	0,9	0,9
Thailand	0,9	0,9	1,0	0,9	0,9	0,9	0,9	0,9	0,8	0,8	0,8	0,8	0,9	0,9	0,9	0,8	0,8	0,8	0,8	0,9
Viet Nam	0,7	0,8	0,7	0,7	0,7	0,7	0,7	0,8	0,8	0,8	0,8	0,8	0,9	0,9	1,0	1,0	1,0	1,0	1,0	0,8

ACFTA = ASEAN–China Free Trade Area, ASEAN = Association of Southeast Asian Nations

Source: Authors' calculations.

Hastiadi (2016) showed that China, Japan, and Korea share a common goal to achieve sound regional economic growth in East Asia, and the partnership with ASEAN will ensure sustainable market growth in the future. The results of a pay-off matrix reveal that the ACFTA, followed by the Japan–ASEAN and Korea–ASEAN FTAs, could yield a more positive outcome – i.e. the ACFTA had broader regional impacts than that of bilateral relations between China and ASEAN.

3. Economic Consequences of ACFTA for ASEAN–China Relations

This section focuses on the effects of the ACFTA on AMS and ASEAN–China relations. The study uses both quantitative and qualitative research methods to achieve its research objectives. This includes the following four tasks:

- (i) **Assessing trade and investment relations in the context of the ACFTA** – a quantitative descriptive analysis of ASEAN–China economic relations since the establishment of the ACFTA; and an examination of developments in the digital economy, global value chains, and sustainable development.
- (ii) **Conducting business and stakeholder sentiment analysis** – collecting and analysing data on the perceptions and experiences of businesses and other stakeholders in the region, to identify key elements of success and possible barriers to doing business in the region.
- (iii) **Assessing potential benefits and identifying measures of cooperation between ASEAN and China** – examining the opportunities and challenges presented by new and emerging areas of cooperation between ASEAN and China, and identifying measures that can be taken to maximise the benefits of these areas for both sides.
- (iv) **Identifying trends and challenges facing ASEAN–China economic relations** –examining the trends and challenges facing ASEAN–China economic relations, and making recommendations on how to address these challenges.

Data for this study are collected from a variety of sources, including government data, industry reports, academic literature, and surveys of businesses and other stakeholders. Quantitative data are analysed using statistical software, while qualitative data are analysed using content and thematic analysis. To conduct the quantitative analysis for this study, we use econometric methods to estimate the economic impact of the ACFTA on ASEAN economies. We use panel data regression analysis to estimate the effects of the ACFTA on trade and investment between ASEAN and China. In addition, we analyse the impacts of the ACFTA on the manufacturing sector. This involves creating a panel data set containing time series data for a sample of AMS and China, and estimating regression models that control for various economic and trade-related variables. The use of econometric methods allows us to quantitatively assess the economic impact of the ACFTA on ASEAN economies and provide a rigorous and objective analysis of the agreement's performance.

3.1. Quantitative Method

3.1.1. The model

We use a trade gravity model to estimate the impact of the ACFTA on trade flows between ASEAN and China. The model will also be used to explore the impact of the ACFTA on trade in the manufacturing sector. A trade gravity model is a type of econometric model that estimates the effect of economic size, distance, and other factors on trade flows between countries. This model was first constructed by Tinbergen and Pöyhönen to describe patterns of international trade between two countries (A and B). Their research showed that the volume of trade between two countries is proportional to the size of their economies, mainly represented by gross domestic product (GDP) and population, and reverse proportional to the geographic distance amongst the two countries. This model has been widely used in international trade studies. By estimating the effect of the ACFTA on trade flows using trade gravity models, we will be able to better understand the key drivers of trade between ASEAN and China, and assess the extent to which the ACFTA has contributed to growth in manufactures and investment.

The basic model of this gravitational approach can be described as follows:

$$\ln Export_{ij} = \beta_0 + \beta_1 \ln GDP_i + \beta_2 \ln GDP_j + \beta_3 \ln Dist_{ij} + \epsilon_{ij} \quad (1)$$

Where \ln denotes the form of natural logs; $Export_{ij}$ denotes exports from country i to country j , GDP_i and GDP_j are the income variables of countries i and country j , $Dist_{ij}$ is the distance from country i to country j , and ϵ_{ij} is the error term.

The basic version of the gravity equation can be expanded into the analysis on the implications for FDI perspectives (Li, Scollay, and Maani, 2016). This study also seeks to look at the impact of the ACFTA on investment. Therefore, the following equations have been developed based on the basic model of gravity. This model will be used to analyse three things: (i) the impact of the ACFTA on total trade, (ii) the impact of the ACFTA on manufactures, and (iii) the impact of the ACFTA on investment.

$$\ln Y_{ijt} = \beta_0 + \beta_1 \ln GDP_{it} + \beta_2 \ln GDP_{jt} + \beta_3 POP_{it} + \beta_4 Dist_{ij} + \beta_5 \ln POP_{jt} + \beta_6 \ln X_{rit} + \beta_7 \ln X_{rjt} + \beta_8 Comlang_{ij} + \beta_9 Comcol_{ij} + \beta_{10} ACFTA_{ijt} + \epsilon_{ijt} \quad (2)$$

Where $\ln Y_{ijt}$ is a dependent variable, denoting total trade, manufactures, or investment; i denotes the exporting country and j denotes the importer; GDP denotes GDP per capita; POP denotes population; Xr denotes real exchange rate; and $ACFTA$ is a dummy variable with a value of 1 after 2010 and 0 before 2010. We use 2010 since the ACFTA has been enforced since the beginning of 2010.

Although the application of econometric methods in gravity models is flexible, the fixed effects model tends to provide better results than the random effects model and is preferred in most studies (Kepaptsoglou, Karlaftis, and Tsamboulas, 2010).

The fixed effects model comes at the cost of not being able to estimate the impact of time-invariant bilateral determinants, such as distance, common language, and common colonies. Therefore, *Distij*, *Comlangij*, and *Comcolij* will be eliminated from the estimation because they are fixed over time. The model is specified as:

$$\text{LnYijt} = \beta_0 + \beta_1 \text{LnGDPit} + \beta_2 \text{LnGDPjt} + \beta_4 \text{POPit} + \beta_5 \text{LnPOPjt} + \beta_6 \text{LnXrit} + \beta_7 \text{LnXrjt} + \beta_{10} \text{ACFTAijt} + \varepsilon_{ijt} \quad (3)$$

In conducting data analysis in this study, gravitational models were transformed in the form of natural logarithms. As with the results of previous studies, the authors hypothesise that the ACFTA has a positive impact on investment growth, manufactures, and trade flows.

3.1.2. The data

The data used in this study are quantitative data through secondary data. The data in this study were obtained from the World Integrated Trade Solution (WITS), Penn World Table (PWT), and Centre d'Études Prospectives et d'Informations Internationales (CEPII). The sample contains data from 2003 to 2019 for ACFTA members, based on the data availability of the PWT database.

3.1.3. Dependent variables

The study uses the total value of bilateral trade and that of trade of manufacturing goods as the dependent variables. The HS code system is used for product classification in this study (Table 4.3).

Table 4.3 Dependent Variables Summary

No.	Variable	Code	Definition	Unit	Data source	Reference
1.	Total trade	Lntrade_ij	Total value of trade all commodities	US\$	WITS	(Alleyne, Zhang, and Mu, 2020; Devadason and Chandran, 2019; Li, Scollay, and Maani, 2016; Sheng, Tang, and Xu, 2014; Sun and Li, 2018; Yang and Martinez-Zarzoso, 2014)
2.	Total manufacturing	Lnmanufacture_ij	Total value of trade in manufactures	US\$	WITS	(Alleyne, Zhang, and Mu, 2020; Devadason and Chandran, 2019; Li, Scollay, and Maani, 2016; Sheng, Tang, and Xu, 2014; Sun and Li, 2018; Yang and Martinez-Zarzoso, 2014)

WITS = World Integrated Trade Solution.

Source: Authors.

3.1.4. Independent variables

The independent variables used in this study are based on the theory of the gravity model of international trade. By modelling the standard of trade gravity, the two basic factors that can affect trade amongst countries are the size of the economy and the distance between the countries. However, this study expands the basic model to include dummy variables of the ACFTA, distance, exchange rate, population, language, and historical similarities (Table 4.4).

Table 4.4 Independent Variables Summary

No.	Variable	Code	Definition	Unit	Data source	Reference
1.	ACFTA membership	ACFTA	Exporting and importing countries are included in the ACFTA members	Dummy variables with values of 1 if a country has joined the ACFTA and 0 if a country has not joined the ACFTA	ACFTA	(Alleyne, Zhang, and Mu, 2020; Devadason and Chandran, 2019; Li, Scollay, and Maani, 2016; Paladini and Cheng, 2015; Sheng, Tang, and Xu, 2014; Yang and Martinez-Zarzoso, 2014)
2.	GDP	LnGDPi and LnGDPj	GDP x PPP	US\$/year	PWT	(Alleyne, Zhang, and Mu, 2020; Devadason and Chandran, 2019; Li, Scollay, and Maani, 2016; Paladini and Cheng, 2015; Sheng, Tang, and Xu, 2014; Yang and Martinez-Zarzoso, 2014)
3.	Population	LnPopi and LnPopj	Total population	Total (million)	PWT	(Alleyne, Zhang, and Mu, 2020; Devadason and Chandran, 2019; Li, Scollay, and Maani, 2016; Paladini and Cheng, 2015; Sheng, Tang, and Xu, 2014; Yang and Martinez-Zarzoso, 2014)
4.	Exchange rate	LnEXi and LnEXj	Real exchange rate	Country currencies of trading partners	PWT	(Devadason and Chandran, 2019; Paladini and Cheng, 2015)

ACFTA = ASEAN–China Free Trade Area, ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product, PPP = purchasing power parity, PWT = Penn World Table.

Source: Authors.

3.2. Qualitative Method

The qualitative analysis involves collecting and analysing data on the perceptions and experiences of businesses and other stakeholders in the region, to identify key elements of success and possible barriers to doing business in the region. We qualitatively discuss in some detail the various economic and non-economic criteria that impinge on the prospects of the ACFTA's success. We complement and broaden the existing literature, which focuses on providing quantitative estimates of the effects of the ACFTA. Data from the results of the research analysis using this qualitative method support the main findings using quantitative methods.

3.3. The results

Tables 4.5 and 4.6 present the results of the estimation of the fixed effects model on total trade. The estimation results use a panel data model.

Table 4.5 Estimated Results on Total Trade

	(1) lnexp_ij	(2) lnexp_ij
lnrgdp~i_1	1.021*** (11.03)	0.632*** (6.09)
lnpop_i_1	0.582 (1.04)	-0.470 (-0.75)
lnxr_i_1	0.230 (1.49)	0.567*** (3.27)
lnrgdp~j_1	0.237*** (2.70)	0.590*** (6.01)
lnpop_j_1	-1.750*** (-3.03)	-0.682 (-1.05)
lnxr_j_1	0.595*** (4.19)	0.582*** (3.65)
ACFTA_ij	0.240*** (3.42)	0.237*** (3.01)
_cons	-3.700** (-2.16)	-4.234** (-2.21)
N	1876	1876

t statistics in parentheses

* p<0.10, ** p<0.05, *** p<0.01

Source: Authors.

Table 4.6 Estimated Results on Manufacture Trade

	(1) lnm~xp_ij	(2) lnm~xp_ij
lnrgdp~i_1	2.885*** (10.14)	2.409*** (8.40)
lnpop_i_1	-0.849 (-0.50)	-2.011 (-1.16)
lnxr_i_1	-0.909* (-1.91)	-1.072** (3.27)
lnrgdp~j_1	1.479*** (5.50)	2.266*** (8.35)
lnpop_j_1	1.201 (0.68)	0.290 (0.16)
lnxr_j_1	0.301 (0.69)	0.251 (0.57)
ACFTA_ij	-1.239*** (-5.75)	-1.180*** (-5.43)
_cons	-38.91*** (-7.40)	-33.77*** (-6.37)
N	1876	1876

t statistics in parentheses

* p<0.10, ** p<0.05, *** p<0.01

Table 4.5 presents the results of the estimated total trade between China and ASEAN in terms of exports and imports. The figure indicates that a substantial number of variables have a significant impact on both exports and imports. The primary variable under examination in this study, the ACFTA, exhibits diverse positive and negative effects on exports and imports.

The coefficients of dummy variables in the model were analysed in a semi-log fashion by using Equation (3). The ACFTA variable has a positive impact on total trade in terms of exports and imports, leading to a 27.1% increase in exports and a 26.7% rise in imports. Conversely, in the manufacturing sector, the ACFTA trade agreement has an adverse effect on exports and imports (Table 4.6). The ACFTA trade agreement leads to a 71% reduction in the value of exports and a 69.3% decrease in the value of imports in manufacturing trade, which implies that the AMS possess a lower comparative advantage than China in manufacturing trade.

The GDP variable has a positive influence on both exports and imports. This indicates that the higher the GDP of an exporting country, the greater its ability to produce goods and services. Conversely, the value of GDP in the importing country illustrates the increasing purchasing power of the population (Jagdamba and Kannan, 2020). The population variable and real exchange rates have varying impacts on exports and imports.

4. Good Practices and Lessons Learned from the ACFTA and ACFTA Update

Implementation of the ACFTA and the ACFTA Update has provided invaluable experience not only in terms of economic engagement but also in social and cultural interaction. Good practices and lessons learned are identified below.

First, different levels of economic development across AMS have hindered full implementation of the ACFTA. The agreement provided many opportunities for economies that were competitive and quick to adapt in the region but resulted in economic as well as social problems in others. The Early Harvest Programme and the ACFTA Update may mitigate the negative consequences, but the impacted countries need to enhance economic competitiveness and gear up for more comprehensive and progressive industry–trade policies.

Second, the ACFTA has been successful in helping a developing country like Viet Nam (previously considered less competitive and grouped under Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV) countries) to be as competitive as (if not more competitive than) the other AMS. Viet Nam's openness to deeper economic relations with China through the ACFTA (despite a bitter history and geopolitical pressures) has resulted in productive and win–win economic relations. This phenomenon appears to contribute to stable relations between the two countries, providing another example that interdependence enables conflict prevention in the region (Copeland, 2015).

Third, top–down approaches in formulating and negotiating FTAs enhance the risk of rejection from domestic audiences in AMS. The governments of AMS need to be more attentive to concerns and inputs not only from business communities but also from scholars and civil society organisations.

Fourth, proximity (in terms of cultural similarities) places constraints on countries to exploit their comparative or location advantages (Alleyne, Zhang, and Mu, 2020). It would be beneficial for both countries if the trading partners were in the same region. In such a homogeneous environment, profits arising from comparative advantage, the production of superior items over other countries, can be suppressed. This fosters unsustainable long-term trade patterns and constrains structural improvements within the export sector of disadvantaged countries. Not only market power but also bargaining power can be enhanced through the formation of regional trade agreements. As Schiff and Winters (2002) pointed out, economies of scale and product differentiation should be seen not as comparative advantages, but as pro-competitive effects in the larger market.

Fifth, international trade has never been perceived as a zero-sum game. However, maximising profit while reducing the associated costs is the benchmark for measuring the value of a contract for the parties involved. It can effectively identify the sources of export growth, providing the country with the basis for improving existing comparative advantages, as well as trade conditions, and opening up new trade markets (Sun and Li, 2018). China's market liberalisation under the ACFTA brought promising economic opportunities to AMS. Preferential market access under the ACFTA enables ASEAN exporters to compete more effectively with developed country exporters, especially in industries where China has a comparative advantage in intermediate and capital goods. As suggested by Park, Park, and Estrada (2008), the ACFTA provided better market access for ASEAN exports in general. As for trade in manufacturing goods, the ACFTA has a negative impact on exports and imports. This implies that AMS possess a lower comparative advantage relative to China in the manufacturing trade. Moreover, with a gravity model approach, this study provides knowledge about how the influence of the ACFTA as an international trade instrument can impact the economies of AMS and China.

Sixth, based on the qualitative findings, we can see that the ACFTA has had mixed impacts on different industries and sectors. On the one hand, the reduction or elimination of tariffs on goods and services has benefited exporters and importers in both regions, leading to increased trade flows and economic growth. On the other, there are concerns that the agreement created negative consequences for some domestic industries, particularly in smaller, less developed countries in ASEAN.

Seventh, implementation of local content requirements or the TKDN, which is aimed at promoting domestic value-added production and increasing domestic participation in global production networks, is an issue in the context of the ACFTA. In Indonesia, the TKDN has become a major obstacle to participation in global production networks, as it has resulted in higher costs and reduced competitiveness for Indonesian firms. One of the main challenges faced by Indonesian firms in meeting TKDN requirements is the lack of domestic suppliers and supporting industries. Many components and materials needed for production must be imported, which can be expensive and time-consuming. As a result, Indonesian firms may struggle to meet the minimum threshold for local content and may

face additional costs and delays in trying to source local inputs. Another issue with the TKDN is that it can create a trade-off between domestic value added and global competitiveness. While the TKDN is intended to promote domestic value-added production and reduce dependence on imports, it can also make Indonesian firms less competitive in global markets. This is because higher local content requirements can lead to higher costs and reduced efficiency, which can make Indonesian products less competitive than products from other countries.

Overall, while the ACFTA has brought about benefits such as increased trade and economic growth, it has also created challenges for domestic industries in AMS. TKDN requirements have become a major obstacle to Indonesian participation in global production networks. It is important for policymakers to address these challenges by finding ways to promote domestic value-added production while ensuring that Indonesian firms remain competitive in global markets.

One potential solution is to focus on developing domestic supporting industries and suppliers, which could help reduce the reliance on imported inputs and make it easier for Indonesian firms to meet TKDN requirements. Another approach could be to provide incentives and support for Indonesian firms to upgrade their technology and production processes, which could help reduce costs and improve efficiency.

5. ACFTA and Geoeconomics of AMS

The ACFTA has become an important landmark of ASEAN–China relations. It was based not only on economic common interests but also on a level of trust and cooperative willingness. Arguably, the political aspect is as important as the economic one. But the fact that China accessed to the ASEAN Treaty of Amity and Cooperation in Southeast Asia before the ACFTA came into force indicates that both parties' willingness to reach an agreeable code of conduct in dispute settlement. Indeed, since the 1990s, the bilateral relations of AMS with China have depended on intertwined economic and political factors. However, the political and economic agreements do not automatically secure robust economic and political relations of both parties.

In the last 3 decades, three phenomena have added to the complexity of ASEAN–China relations and the implementation of the ACFTA. The first is the spate of conflicts in the South China Sea between China and the Philippines, Viet Nam, Malaysia, and Brunei, which has created one of the most dangerous hotspots in the world. Despite the necessity, AMS have not consolidated a common position in dealing with China regarding this geostrategic problem. Consequently, they have not been able to conclude a code of conduct in the South China Sea with China. The second issue is that the 10 AMS have unequal levels of economic development and ideology, which have hindered ASEAN economic integration and posed structural challenges to ASEAN's common economic position vis-à-vis China. The upgraded ACFTA addresses some of these cross-ASEAN economic diversities, but others remain. The third

phenomenon is China's new global policy of President Xi Jinping – the BRI – which has been executed in AMS individually since 2015. The BRI has created another layer of bilateral economic engagement between China and individual AMS, complicating the implementation of the regional economic scheme under the ACFTA.

Therefore, the implementation of the ACFTA and the development of economic relations between China and ASEAN have been shaped not only by economic factors and political dynamics, but also by intertwined bilateral and regional economic engagement with China. In addition, the geopolitical tensions between the US and China need to be considered since these countries have allies amongst AMS. As Baviera (1999) stated, Southeast Asian countries have no unified economic policy towards China. It is imperative to consider the bilateral relations of each AMS with China, since they differ from one country to another. The geoeconomics of individual AMS shape their behaviour towards the ACFTA and towards ASEAN relations with China.

This section focuses on the evolution of AMS policies towards China and the impacts of the ACFTA on individual AMS to understand challenges to the ACFTA and ASEAN–China relations.

5.1. Evolution of Indonesian Policies Towards China

Relations between Indonesia and China fluctuated from 1949 to 1990 but have grown significantly since the downfall of the Suharto Government in 1998. The period of close relations between Jakarta and Beijing under President Sukarno was changed drastically in 1967 when President Suharto treated China as a threat to Indonesia due to China's support for the Indonesian Communist Party. After more than 3 decades of antagonistic relations, the two countries signed an agreement to normalise their diplomatic relations in 1990, indicating fundamental changes in Indonesian perceptions towards China, from a national threat to a potential partner (Fitriani, 2018). President Abdurrahman Wahid took major steps in building closer relations with China, and President Susilo Bambang Yudhoyono signed the Strategic Partnership Agreement with President Hu Jintao on 25 April 2005. Despite domestic criticism (Hadi 2012; Fitriani 2021), Yudhoyono joined other ASEAN leaders to support the implementation of the ACFTA in 2010. He also enhanced the cooperation by signing a bilateral agreement on the Indonesia–China Comprehensive Strategic Partnership with President Xi Jinping on 2 October 2013, which expanded the cooperation more broadly to political–security and social–cultural dimensions. Indonesian attitudes towards China were shaped by domestic politics (Fitriani, 2021), economic interests (of the government and business community), Chinese attitudes in the South China Sea, and issues of Chinese descendants in Indonesia (anti-China sentiment and Chinese Indonesian roles in economic relations).

At the beginning, the ACFTA was not widely discussed in Indonesia, and did not include the participation of government officials, the business community, and the public in its preparation. It was no surprise that the announcement of ACFTA full implementation prior to 1 January 2010 created public shock within the country that immediately provoked strong criticism and even rejection from scholars and the public. This created the momentum for Indonesian scholars to pay more attention to ACFTA documents and undertake research on its implementation. While economic relations with China opened business opportunities for Indonesia, the country's scholars and the public have perceived the ACFTA negatively due to the influx of Chinese products. The basic problem is that Indonesian products seem to lack competitiveness in the Chinese market (Hadi, 2012; Fitriani, 2018). Chinese investment in Indonesia, which has increased since 2005, has also created concern because it was followed by an influx of Chinese workers, especially after Indonesia engaged in China's BRI (Rakhmat and Tarahita, 2020; Fitriani, 2021). In the last decades, close political relations and enormous economic interests between Indonesia and China have maintained steadily increasing economic engagement between the two countries (Fitriani, 2021). In addition, social-cultural relations between Indonesians and Chinese have developed through increasing exchanges of tourists and scholars. The Chinese government has also tried to approach Islamic communities by providing scholarships. It seems that the Chinese government has combined implementation of the ACFTA with BRI projects and a bilateral approach to Indonesia. Thus, the ACFTA has been perceived as both a challenge and an opportunity by Indonesians.

5.2. Philippines

The Philippines' relations with China have been shaped by its position as a US ally, conflicts in the South China Sea, economic interests, and domestic politics. As a close US ally in the region, which has experienced severe conflict with China in the South China Sea, the Philippines has had strained relations with China. However, almost all Philippine presidents since Marcos have tried to maintain good relations with China due to its enormous economic size. Indeed, the Philippines have had a close – if not dependent – economic relationship with China. In 2000, Philippine President Joseph Estrada signed a Framework of Bilateral Cooperation in the Twenty-First Century with Chinese President Jiang Zemin. The Philippines also joined AMS in signing the Framework Agreement on Comprehensive Economic Cooperation between China and AMS (ACFTA) on 4 November 2002.

However, the signing of the ACFTA was not without opposition in the Philippines. The underlying factor behind the Philippine opposition to the ACFTA was the fear of the dominance of Chinese products in the domestic market and export destinations (Hongfang, 2006). Like Indonesian Chinese, Filipino-Chinese merchants enjoy close economic relations with China, but the Filipino Chinese Chambers of Commerce opposed the ACFTA due to fear of anti-Chinese sentiment in the Philippines (Hongfang, 2006: 275–76). President Arroyo's government raised import taxes on 464 product lines (including pharmaceutical products, cosmetic products, garments, and shoes) due to pressure from Philippine business associations while other AMS started benefiting from the Early Harvest Programme under the ACFTA (Hongfang, 2006).

Nevertheless, the Philippines' attitude towards the ACFTA changed because of the opportunities offered by the agreement. Economic relations between the two countries grew until 2009, when China became the fourth largest trading partner for the Philippines (Baviera, 2012). In 2006, the Philippines enhanced its relations with China by signing 12 cooperation documents and initiatives including economic sectors (trade, finance, and infrastructure) as well as security (to counter traditional and non-traditional security threats) and maritime. The bilateral cooperation also included the development of Philippine telecommunications infrastructure (the National Broadband Network or NBN–ZTE Project), funded by loans from the Export–Import Bank of China, which were cancelled in 2007 due to strong public criticism (Baviera, 2012). Despite the Philippines' enhanced economic relations with China under President Duterte (2016–2022), the implementation of the ACFTA in the Philippines has been hindered by conflicts over the Spratly Islands and domestic criticism.

The Philippines has perceived China as a threat to its territorial integrity since 1995 when the Chinese started claiming the ownership of the Mischief Reef in Kalayaan (Baviera, 1999). Viet Nam and the Philippines were the two most vocal parties against China regarding the hotspots in contention. Some tensions escalated in 2011 when a Chinese patrol vessel approached a Philippine oil exploration vessel in the region. The Philippines took the territorial claim to the Permanent Court of Arbitration, which issued a ruling in 2016 in the Philippines' favour. Due to long-term security considerations and economic tensions, relations between the Philippines and China remained strained up to 2021.

However, geopolitical pressures have exacerbated tensions between the two countries since 2022 due to the US–China decoupling as well as the worsening conflicts in the South China Sea and the Taiwan Strait. The US and the Philippines strengthened their security pact in the form of the Enhanced Defense Cooperation Agreement in 2014. Under the Biden Administration and President Ferdinand Marcos, Jr, the two countries have intensified their security cooperation, including the Philippines providing 10 sites for US military bases, which placed increased strain on bilateral relations that could significantly impact the implementation of the ACFTA in the Philippines.

6. The Way Forward

The ACFTA was established in 2010 with the goal of eliminating tariffs on goods traded between AMS and China. Since then, the agreement has contributed to significant increases in trade and investment flows between the two parties. However, there is still much room for further economic integration between ASEAN and China, particularly in areas such as services trade and investment.

One area where ASEAN and China can work to deepen economic integration is in services trade. Services account for a significant portion of the economy in both ASEAN and China, but trade in services between the two parties remains limited. This is partly due to regulatory barriers that restrict the ability of firms to provide services across borders. To address this issue, ASEAN and China could work to negotiate a comprehensive agreement on trade in services that removes regulatory barriers and promotes greater cross-border trade in services.

Another area where ASEAN and China can deepen economic integration is in investment. While investment flows between the two regions have grown significantly in recent years, there is still a significant gap between the level of investment in China and the level of investment in AMS. To address this issue, ASEAN and China could work to promote greater investment flows between the two parties by reducing barriers to investment and promoting greater investment protection.

One way to promote greater investment flows between ASEAN and China is through the negotiation of a comprehensive investment agreement. Such an agreement could provide greater protection for foreign investors in ASEAN and China, reduce barriers to investment, and promote greater transparency and predictability in investment rules and regulations.

Another way to promote greater investment flows is through the promotion of investment facilitation. This could involve the establishment of investment promotion agencies in both ASEAN and China that work to attract foreign investment and provide support to investors looking to invest in the region. Additionally, ASEAN and China could work to promote greater investment in infrastructure projects in the region, which could help create new investment opportunities and promote greater economic integration.

In addition to trade and investment, ASEAN and China can work to promote greater connectivity and infrastructure development in the region. This could help improve the physical and institutional infrastructure that supports economic activity, such as transportation networks, telecommunications systems, and regulatory frameworks. This could help reduce the costs of doing business in the region and make it more attractive for firms to invest and trade in the region.

One way to encourage greater connectivity and infrastructure development is through the promotion of public–private partnerships in the region. Public–private partnerships involve collaboration between the public and private sectors to finance and implement infrastructure projects. This can help reduce the burden on public budgets and promote greater efficiency and innovation in infrastructure development.

Another way to relate connectivity and infrastructure development with the ACFTA is by establishing synergies with China's BRI and Global Development Initiative. This strategy could also be used to enhance Chinese involvement in sustainable connectivity and green infrastructure development in AMS. In the short term, this strategy would help AMS finance climate change mitigation. In the long term, it would maintain close relations between AMS and China despite geopolitical tensions in the region.

Moreover, ASEAN and China could explore ways to deepen financial integration and promote the use of local currencies in trade and investment transactions. This could help reduce reliance on the US dollar and promote greater financial stability in the region. The establishment of a regional currency swap arrangement and the promotion of cross-border payment and settlement systems could also help facilitate trade and investment flows.

Another area that could be explored to promote deeper economic integration is to improve infrastructure connectivity and promote economic cooperation across Asia and beyond via promoting China's BRI. This could serve as a platform for investment cooperation between ASEAN and China. The BRI has already invested heavily in infrastructure projects in AMS, including ports, railways, and highways, and there is potential for deeper investment cooperation in areas such as energy, manufacturing, and tourism.

Furthermore, ASEAN and China could explore ways to promote digital integration. The COVID-19 pandemic has accelerated the adoption of digital technologies, and ASEAN and China could work together to promote digital trade, e-commerce, and digital connectivity. This could involve initiatives such as harmonising digital regulations, promoting cross-border data flows, and building digital infrastructure. Achievements of the Group of Twenty (G20) in the digital economy and in combating cyber fraud could be used by AMS and China to deepen their cooperation in developing regional digital norms.

ASEAN and China could also work towards deeper institutional integration. This could involve strengthening existing institutions such as the ACFTA and the ASEAN–China Centre, as well as exploring the possibility of new institutions to promote deeper economic integration. One example could be a regional investment agreement that would provide a framework for investment cooperation between ASEAN and China.

Another potential area for deeper institutional integration is dispute resolution. Disputes between ASEAN and China have arisen in the South China Sea, and a more effective dispute resolution mechanism could help prevent conflicts from escalating. The existing Declaration on the Conduct of Parties in the South China Sea is a positive step, but it is not legally binding and has no enforcement mechanisms. ASEAN and China could explore the possibility of a more robust dispute resolution mechanism, such as a binding code of conduct.

ASEAN and China could also work together to promote greater regional integration in other areas, such as education and human capital development, to promote student exchange programmes and joint research initiatives. Social–cultural approaches have long been underplayed in ASEAN–China relations, which have focused heavily on economic issues.

In conclusion, the ACFTA has brought about significant benefits for both China and AMS. It has promoted trade, investment, and economic cooperation, creating new opportunities and driving economic growth in the region. However, the agreement also faces several challenges and criticisms, including trade imbalances, industrial relocation, and non-tariff barriers. These challenges require continuous efforts from both parties to address and overcome them, and to ensure that the benefits of the ACFTA are shared more widely and sustainably across the region. Although the ACFTA has been

a successful example of regional economic integration, there is potential for deeper integration to promote more inclusive and sustainable economic growth. ASEAN and China could work together to promote trade and investment, digital integration, and deeper institutional integration. By doing so, they could create a more integrated and prosperous region that benefits all parties. Indeed, as the ACFTA gives ASEAN more leverage and benefits to engage in global production networks, the agreement helps strengthen the position of both ASEAN and China in the global economy. The agreement has also been an important channel for political partnership and cooperation between AMS and China amid growing geopolitical pressures in the region. The economic importance of the agreement demands the maintenance of healthy diplomatic relations and an environment that is conducive to maintaining regional and global stability.

7. Conclusion

This study has assessed the implementation of the ACFTA and its consequences for ASEAN–China relations.

7.1. Key Findings

- The ACFTA is not only about economic engagement between AMS and China but has also developed as a political modality and security instrument to maintain regional stability.
- Amid geopolitical tensions stemming from the US–China trade war and conflicts in the South China Sea, the ACFTA provides cooperative platforms that serve common economic interests for AMS and China.
- Trade and FDI between China and ASEAN are increasing rapidly compared with other trading partners.
- The ACFTA can be beneficial for both parties, especially if they share cultural similarities and belong to the same region. This can help foster sustainable long-term trade patterns, enhancing bargaining power and promoting economies of scale and product differentiation.
- To improve their export performance, countries need to focus on identifying and improving their comparative advantage. This can help open up new trade markets and create opportunities for growth.
- It is important to consider the sectoral impacts of trade agreements. For instance, while the ACFTA has positive effects on total trade, it has negative impacts on the manufacturing sector, suggesting that AMS have a lower comparative advantage in this area compared with China. Policymakers and businesses should take this into account when designing trade policies and strategies.
- The findings of this study highlight that a top–down approach in developing FTAs creates greater social risks for governments of AMS, for which a more inclusive process is needed.

- The ACFTA provides enormous opportunities for ASEAN to take advantage of China's economic and technological development while increasing their economic and political bargaining positions towards the US and its allies.
- Overall, the ACFTA needs to be upgraded to better suit the new economic environment and to respond to contemporary political reality.

7.2. Recommendations:

- The implementation of the ACFTA has resulted in many advantages for the economies of both China and ASEAN. Therefore, both parties should continue to promote the implementation and compliance of the agreement to enhance economic cooperation.
- Both parties should take advantage of the provisions in the investment agreement to ensure that investors receive fair and equitable treatment and that disputes are resolved through arbitration.
- China should continue to increase its investment in AMS to boost economic growth and development in the region.
- ASEAN should continue to offer investment incentives and tariff reductions on imported materials and components to attract more FDI from China and other countries.
- Both parties should focus on increasing intra-regional trade and investment to achieve the goals of the ACFTA.
- Emphasis on proximity: Countries should consider proximity, in terms of cultural similarities, when forming trade agreements. Trading partners from the same region can establish more sustainable and mutually beneficial trade relationships.
- Focus on comparative advantage: Countries should focus on identifying and improving existing comparative advantages to maximise their profits while reducing the associated costs. This can help improve trade conditions and open up new trade markets.
- Emphasis on the manufacturing sector: The study found that the ACFTA trade agreement has a negative impact on the manufacturing sector in some AMS, implying that ASEAN possess a lower comparative advantage than China in this sector. Thus, AMS should focus on improving their manufacturing capabilities and competitiveness to avoid losing out in this sector.
- Enhancing market access: Preferential market access under the ACFTA could enable ASEAN exporters to compete more effectively with developed country exporters, especially in industries where China has a comparative advantage in intermediate and capital goods. AMS should therefore focus on leveraging this market access to increase their exports to China.
- AMS need to maintain independent policies towards the major powers and to engage others beyond the US and China. Maintaining the economic and political relevance of the ACFTA is imperative for ASEAN amid geopolitical tensions in the region.

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