

Further ASEAN–China Cooperation for Joint Prosperity: Envisioning ACFTA 3.0 in the Digital Era

Edited by

Lurong Chen
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Foreword

ASEAN–China bilateral trade has seen exponential growth, increasing 85-fold since the establishment of dialogue relations in 1991. Today, ASEAN and China are each other’s largest trading partners, with total bilateral merchandise trade continuing to rise steadily despite challenging economic and geopolitical environments. Central to this robust economic relationship is the ASEAN–China Free Trade Area (ACFTA).

In the light of recent shifts in the global economic landscape, it is imperative for ASEAN and China to enhance the ACFTA to ensure its continued relevance and responsiveness to market demands. Key challenges include the dynamic changes in global and regional supply chains, the reverberating effects of the COVID-19 pandemic, the increasing importance of technical standards and regulations, transparency measures, the integration of technology-based trade facilitation measures such as electronic document exchange, and emerging trade issues like digital trade and sustainable economic development.

The research team led by Lurong Chen and Aladdin D. Rillo critically examines the economic impacts of the existing ACFTA, considering the evolving market conditions in the region. Drawing comparisons with other free trade agreements involving ASEAN and/or China, particularly the Regional Comprehensive Economic Partnership (RCEP), this ERIA work envisions ACFTA 3.0 as a vehicle to consolidate a business-friendly, trade-facilitative, and future-ready free trade area, promising mutual economic prosperity for both parties.

It is noteworthy that the policy recommendations presented in this report hold relevance beyond the scope of ASEAN–China relations, extending to many other ‘ASEAN-plus’ trade negotiations. This offers a continuous driving force for pan-regional market integration. As an international organisation, ERIA remains committed to conducting economic research in support of regional integration and development in ASEAN and East Asia.



Tetsuya Watanabe

President of ERIA

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ASEAN–China economic relations play a pivotal role in the Asian economy. The establishment of the ASEAN–China Free Trade Agreement (ACFTA) has solidified the foundation of the production sharing network in Asia, known as ‘Factory Asia.’ With technological advancements and shifts in the global economic landscape, it is imperative for ASEAN and China to enhance their bilateral relations in market integration and economic cooperation. This publication, a collaborative effort by experts from the region, outlines key policy issues for the upgrade of ACFTA and highlights its significance in promoting ASEAN–China cooperation.

We extend our sincere gratitude to all contributors for their unwavering enthusiasm and dedication to this research project and the ensuing policy dialogues. We also express our appreciation to Tetsuya Watanabe, President of ERIA, Koji Hachiyama, Chief Operating Officer of ERIA, and Le Quang Lan, Director of the Market Integration Directorate of the ASEAN Secretariat, for their trust and steadfast support, which were instrumental to the project’s success.

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Chapter 1

Further ASEAN–China Cooperation for Joint Prosperity: Envisioning the ACFTA 3.0

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1. Introduction

Relations between the Association of Southeast Asian Nations (ASEAN) and China are vital to regional stability and prosperity in Asia. Within 30 years, bilateral trade, investment, and cooperation ties were strengthened significantly following the conclusion of the Agreement on Trade in Goods of the China–ASEAN Free Trade Area (ACFTA) in 2004, followed by the agreements on services in 2007 and the agreement on investment in 2009. The ACFTA 1.0 was officially launched in January 2010. With the ACFTA 1.0, businesses in both ASEAN and China have found it easy to access each other's markets, as a broad range of export products enjoy duty-free or preferential tariff rates. China has been ASEAN's largest trading partner since 2009, while ASEAN has been China's second largest trading partner since 2019.

The upgrade of the agreement (ACFTA 2.0), which was signed in 2015 and entered into force in 2018, brought ASEAN–China economic relations to a new high. Over 90% of items traded between ASEAN and China are subject to zero tariffs. According to statistics published by Embassy of China in Brunei Darussalam, the total trade volume between China and ASEAN in 2021 was US\$878 billion, comprising US\$484 billion in Chinese exports to ASEAN and US\$395 billion in imports from ASEAN (Embassy of China to Brunei Darussalam, 2022). In 2022, these figures increased to US\$975 billion, US\$567 billion, and US\$408 billion, respectively.

With the ACFTA's provisions for investment protection and promotion, the confidence of investors on both sides has grown. Statistics published by ASEANstats (2022) have shown that China's foreign direct investment (FDI) in ASEAN increased from US\$6.57 billion in 2015 to US\$13.83 billion in 2021, and the top three sectors of Chinese FDI in ASEAN in 2021 were (i) manufacturing (25.4%), (ii) information and communication technology (ICT) (17.6%), and (iii) real estate activities (17%). In the ICT sector, one-third of ASEAN inward FDI in 2021 was from China. From the other side, the top three sectors of ASEAN FDI in China in 2020 were (i) manufacturing (27.4%), (ii) real estate (22.4%), and (iii) leasing and business services (18.5%) (Ministry of Commerce, 2022).

The implementation of the ACFTA (both 1.0 and 2.0), together with the ASEAN Economic Community (AEC) and many other free trade agreements (FTAs) signed by ASEAN and East Asian countries, built the foundation of the production sharing network in Asia (so called 'Factory Asia'). It opened the door for both parties to enhance economic cooperation, especially in trade facilitation, connectivity, energy, services and tourism, and capacity building. This is evident not only in the increasing intra-industry trade and specialisation within the region, but also in the region's increasing weight in global value chains (GVCs).

The implementation of the Regional Comprehensive Economic Partnership (RCEP) and the establishment of the ASEAN–China Comprehensive Strategic Partnership have consolidated the foundation for deeper cooperation and more efficient production sharing between ASEAN and China. The ACFTA 3.0 has the potential to level up the degree of bilateral cooperation, as well as that of market integration in East and Southeast Asia.

2. Changing Economic Conditions

For over 30 years, ASEAN–China cooperation has made steady progress and extended from the economic and technological domains to culture, the environment, and social development. When ASEAN and China launched the ACFTA 3.0 negotiations, the world economy was still recovering from the coronavirus disease (COVID-19) pandemic. The ASEAN–China Joint Statement on Cooperation in Support of the ASEAN Comprehensive Recovery Framework (ASEAN, 2021) highlighted five areas of bilateral cooperation: cooperation on public health, cooperation on social security, economic integration, digital transformation, and sustainable development. In addition to its long-term objectives, the ACFTA 3.0 should contribute to a faster recovery of the regional economy.

Both sides should fully consider significant changes in the global economic situation when negotiating the ACFTA 3.0. The digital economy, the green economy, and GVC restructuring are amongst the global trends that will be most influential for regional development in the coming decade. Additionally, both sides' achievements in development in the past 2 decades and the consequent changes in economic interests will affect the future direction of ASEAN–China relations.

2.1. The digital economy

The digital economy refers to an economy that is highly dependent on the application of digital technologies, data, and human–machine interaction. It encompasses all economic activities. Internationally, digitalisation can affect economic growth via its effect on reducing trade costs, similar to the effect of the industrial revolution in the 18th and 19th centuries, when the use of steamships and railways drove down the cost of mass transportation and created a boom in international trade; and that of the information revolution in the 20th century, when the application of ICT facilitated communications and set the stage for the birth of GVCs. The idea of economic liberalisation became widely accepted as the way a country could facilitate its involvement in GVCs to pursue economic prosperity and development (Kimura and Chen, 2018). Service links – especially those of business and financial services – were making great strides forward as well. As a result, the world economy became further interconnected via GVCs (Chen, 2021). ASEAN and China benefited from participating in GVCs and achieved fast economic growth.

The development of the digital economy in the 21st century extends the coverage of GVCs and increases their sophistication. It deepens the international division of labour from industry-wide to task-wise by lowering the cost of people-to-people connections, increasing information transparency of the GVCs operation, and blurring the boundaries between production and services. The related transformation will be a process marked by strong competition and conflicts between different values, cultures, and social systems, and the ongoing dispute between the United States (US) and China should be considered in this broader context. Asia will be the first to bear the brunt of the shocks resulting from their possible decoupling.

The digital economy has transformed various sectors, including retail, media, finance, and transportation. It has enabled new business models, increased efficiency, and expanded global reach. But it also presents challenges such as the digital divide, privacy concerns, cybersecurity risks, and job displacement. China–ASEAN bilateral cooperation in digital economy cooperation will be an important development issue highlighted in the ACFTA 3.0. Both sides could consider operationalising the Action Plan on Implementing the ASEAN–China Partnership on Digital Economy Cooperation (2021–2025) and strengthening cooperation under the ASEAN Digital Masterplan 2025.

2.2. The green economy and sustainability

Since the late 1990s, with the increasing awareness of the challenges posed by climate change, pollution, and global warming, the concept of a 'low-carbon green economy' has gradually filtered into the public's minds the significance of balancing economic development and sustainability. In 2015, the United Nations General Assembly created the 17 Sustainable Development Goals.

The transition to a low-carbon green economy is critical to many of these goals. It requires measures such as promoting cleaner and renewable energy,¹ reducing energy consumption and waste (energy efficiency), minimising carbon emissions from transportation (sustainable transportation), promoting infrastructure projects with environmental considerations (green infrastructure), and adopting a circular economy model. All these call for international collaboration, not only between governments but also involving society as a whole.

2.3. Value chain restructuring

The world economy entered an age of 'turbulence' during the 2008 global financial crisis, which was followed by a series of negative economic events such as the US–China trade tensions and the impacts of the COVID-19 pandemic. The process of US–China decoupling has accelerated, although the world economy is still recovering from the COVID-19 pandemic.

Economically, the network of regional production sharing that involves both the US and China has been the cornerstone of Asian development (Chen and Intal, 2017). Factory Asia functions well based on a multilayered network intertwined with intensive cross-border activities (Chen, De Lombaerde, and Cuyvers, 2017).

¹ Shifting from fossil fuels to renewable energy sources such as solar, wind, hydro, and geothermal power. This involves investing in clean energy infrastructure and technologies.

Close links with both the US and China have enabled ASEAN to benefit from capital inflows and technology diffusion, as well as access to both large markets. But distrust has risen between the US and China, especially in high-tech areas such as digital technologies. This has posed serious threats to the integrity of GVCs. To offset the consequent shocks to regional production sharing, ASEAN should ensure that both the US and China remain committed to the ASEAN market despite the increasing tensions between them (Chen, 2021). This would help increase the region's significance in the world economy by strengthening bilateral economic relations with China and participating in the US Indo-Pacific Economic Partnership for Prosperity.

2.4. 2003 versus 2022

Both ASEAN and China experienced substantial growth in their consumer markets before the ASEAN–China Agreement on Trade in Goods became effective. China, with its large population, has become one of the world's largest consumer markets. ASEAN, on the other hand, has witnessed a rising consumer base and increased purchasing power. Tables 1.1–1.3 show some changes in development conditions that both sides face today compared with 2 decades ago.

Table 1.1 Changes in Economic Sizes

Indicator	2003			2021		
	ACFA	ASEAN	China	ACFA	ASEAN	China
GDP (US\$ billion)	4,950	1,346	3,604	18,915	3,064	15,851
GDP per capita (US\$)	2,697	2,461	2,797	9,066	4,546	11,223
Population (million)	1,835	547	1,288	2,086	674	1,412
Age 15–64 (million)	1,261	353	908	1,433	455	977
Exports to the world (US\$ million)	783,483	345,255	438,228	5,077,292	1,714,990	3,362,302
Imports from the world (US\$ million)	682,272	294,606	387,666	4,146,600	1,619,057	2,527,543
China exports to ASEAN (US\$ million)		30,927			483,530	
ASEAN exports to China (US\$ million)		47,328			395,154	

ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product.

Note: Totals may not be exact due to rounding.

Source: Raw data from World Bank (2023), World Development Indicators. <https://databank.worldbank.org/source/world-development-indicators> (23 August 2023).

Table 1.2 Changes in Market Motivation – Main Sectors of Bilateral Cooperation

Sector	2003	2021
Manufacturing and industrial cooperation	AMS were known for their manufacturing and industrial strengths, while China had a growing export-oriented manufacturing sector, which led to increased trade in intermediate goods and manufacturing parts and components.	Manufacturing and industrial cooperation between ASEAN and China had deepened, with increased integration of supply chains and production networks.
Resources and energy trade	ASEAN is rich in natural resources, such as minerals, energy, and agricultural products, which were in demand in China's growing economy.	The resources and energy trade between ASEAN and China had expanded, with increased cooperation in areas such as oil and gas, minerals, and renewable energy.
Services and tourism	Chinese tourists were increasingly visiting AMS, contributing to the growth of the services sector.	The complementary trade structure in services and tourism had strengthened, with AMS benefiting from Chinese tourists' spending and Chinese companies expanding their presence in ASEAN service sectors.
Agricultural trade	ASEAN and China have complementary agricultural sectors. AMS, with their diverse agricultural production, have been able to supply China with various food products.	Agricultural trade had continued to grow, with increased demand for high-quality agricultural products and cooperation in areas such as food security and agricultural technology.
Consumer market	China's large consumer market potential was expected to create opportunities for AMS to export their products.	The complementary trade structure had deepened, with AMS benefiting from increased exports of consumer goods, electronics, and other products to China

AMS = ASEAN Member State/s, ASEAN = Association of Southeast Asian Nations.

Source: Authors.

Table 1.3 Changes in Economic Policy Environment

Sector	2003	2021
General	<ul style="list-style-type: none"> • China's accession to the WTO • ASEAN's agreement to establish AEC • In recovery from the 1997 Asian financial crisis 	<ul style="list-style-type: none"> • US–China decoupling • In recovery from the COVID-19 pandemic • Establishment of the RCEP • ASEAN centrality
Global power dynamics	ASEAN and China were conscious of the need to balance influence within the region. The ACFTA served as an avenue for China to engage with AMS and strengthen its relationships.	China's economic rise and its growing role in global affairs triggered discussions on how to maintain a balance of power and ensure mutual benefits within the region.
Driving force	AMS sought to tap into China's economic growth and emerging markets. China, in turn, recognised the importance of engaging with ASEAN for its own economic interests and regional influence.	Mutual interests remained a driving force, with both sides seeking to deepen economic integration, expand trade relations, and promote sustainable development.
Importance of connectivity	ASEAN and China recognised the need for improved physical connectivity to enhance economic cooperation and regional integration.	Geopolitical considerations focusing on the impact of infrastructure development on regional connectivity, trade flows, and influence had increased.
ASEAN centrality	ASEAN's unity and its role as a driver of regional cooperation were emphasised.	ASEAN's centrality remained a cornerstone of geopolitical considerations, with ASEAN playing a key role in shaping the regional architecture and promoting dialogue platforms.

ACFTA = ASEAN–China Free Trade Area, AMS = ASEAN Member State/s, ASEAN = Association of Southeast Asian Nations, COVID-19 = coronavirus disease, RCEP = Regional Comprehensive Economic Partnership, US = United States, WTO = World Trade Organization.

Source: Authors.

3. Policy Recommendations for the ACFTA 3.0 Negotiations

To enrich the content of the ACFTA 3.0 and make the agreement relevant to the needs and challenges of the changing global economy, we recommend ASEAN and China to have an in-depth exploration of the following issues during the negotiations. They are either new issues that were not contemplated in the previous versions of the ACFTA or existing issues with new elements and emphases.

3.1. Bilateral rule-setting on digital trade

The rapid growth in digital trade and its rising importance in the world economy demand common international rules and norms to level the playing field. Through the ACFTA 3.0, ASEAN and China can work together on a bilateral regulatory framework on digital trade by applying multilateral rules and disciplines.

Given that the ACFTA was signed before the 'big bang' of e-commerce, and the available policy tools in the World Trade Organization (WTO) were designed in the pre-digital era,² the ACFTA 3.0 negotiations could cover the discussion on rule-setting for digital trade in favour of an open, reliable, and secure cyberspace that facilitates doing business online. New digital-enabled means of communication, such as social media, instant messages, and videotelephony, have extended the coverage of GVCs and enriched their content. The ACFTA 3.0's rules on digital trade should aim at governing the whole GVCs, including trade in intermediate products and service activities that weave through the production network.

Above all, the agreement should apply the disciplines of pre-establishment non-discrimination and national treatment; and include explicit provisions to ensure equal treatment of foreign supplies of goods, services, or items of intellectual property. These principles should cover cross-border data flows as well as payment, investment, and labour movement related to the internet of things.

For instance, Chinese e-commerce platforms should open up to ASEAN sellers and buyers; and ASEAN e-commerce platforms should open up to Chinese sellers and buyers as well. ASEAN users registered on Chinese e-commerce platforms have to obey the same regulations and enjoy the same privileges as Chinese users, and vice versa. The approach undertaken should be in line with both ASEAN and China's interests. Setting international standards and ensuring interoperability between digital systems and platforms will be vital for facilitating smooth cross-border digital trade.

² The General Agreement on Trade in Services (GATS) is considered to have the most significance to digital trade amongst the existing WTO set of rules (Wu, 2017; Nakatomi, 2019). When the GATS was negotiated and agreed in 1995, many digital products and services did not exist.

3.2. Cross-border e-commerce

ASEAN and China are amongst the world's fastest growing e-commerce markets. Setting international regulations that govern online transactions will facilitate bilateral digital trade and foster the development of the digital economy. The ACFTA 3.0 should help promote the alignment and mutual recognition of technical standards, quality control, and assessment procedures to facilitate bilateral trade and investment. The negotiations need to focus on specific features of cross-border electronic transactions, especially when touching upon provisions that address issues related to customs procedures, trade facilitation, consumer protection, and taxation.

For example, the number of low-value parcels in cross-border e-commerce is increasing, driven by the growth in international business-to-consumer activities. Exempting these low-value parcels from tariffs and possibly other taxes could help cross-border e-commerce transactions to expand, which could particularly benefit individuals and micro, small, and medium-sized enterprises to explore business opportunities in the regional market (Hufbauer and Wong, 2011).

It would also be beneficial for both sides to enshrine binding commitments in the ACFTA 3.0 on 'not imposing customs duties on electronic transmissions' based on the agreement in the 1998 Geneva Ministerial Declaration on Global Electronic Commerce and the 2019 moratorium.³ ASEAN and China could explore the possibility of setting unilateral binding provisions on the lowest ceiling of *de minimis*, with the flexibility to choose a higher amount voluntarily⁴ under the non-discrimination principle. The required amount could be indexed based on the stage of country development.

3.3. Trade in services

Digital trade includes trade in final products as well as trade in intermediate goods and services, which could be either the output of substage activities or service links that work on facilitating the fragmented pattern of production. Technological progress in ICT has driven down the cost of people-to-people communication, and it will keep doing so. With digitalisation, businesses and individuals utilise digital technologies to create, distribute, and consume goods and services. This includes activities such as e-commerce, online advertising, digital content creation and distribution, software development, cloud computing, and data analytics. In addition to its effect on enabling online trade and facilitating transactions, digitalisation has introduced new service activities and turned more non-tradable sectors to tradable.

³ With the Geneva Ministerial Declaration on Global Electronic Commerce (WT/MIN(98)/DEC/2) and the 1999 moratorium, member states promised not to impose customs duties on electronic transmissions and have continued this duty-free practice since then.

⁴ The higher the amount of *de minimis*, the more the consumers will gain.

Digital-armed service links – either digitally enabled or ‘born-digital’ – will improve the capacity of GVC coordination, facilitate network extension, and allow GVCs to evolve towards an ecosystem that is better connected (Chen, 2022). By introducing new sources of value added to business, digitalisation has sharpened the competitiveness of data-driven business models, especially servicification.

Broadly speaking, trade in services is of increasing importance for regional production sharing in the digital era, as are the related rules and commitments. FTAs are a useful complement to the General Agreement on Trade in Services (GATS) in promoting trade in services, as the GATS was written in 1995 but lacks updates thereafter. The ICT sector is making progress at a fast pace. But one of the biggest limits of multilateral governance on trade in services is the lack of adaptation to technological change (Nakatomi, 2019).

While the ACFTA 1.0 and 2.0 have facilitated trade in goods, the ACFTA 3.0 needs to focus on facilitating trade in services, with emphasis on service-related rules and commitments that accommodate continuing adoption of digitalisation in economic activities, such as financial services, telecommunications, tourism, and professional services. The design of digital trade rules on services in the ACFTA 3.0 could refer to the progress of the negotiation of the ASEAN Trade in Services Agreement (ATISA). For instance, it could adopt the negative list approach, with broader liberalisation commitments and better clarification of general exceptions and security exceptions, especially for new products and services that even the latest agreements (e.g. the RCEP and ATISA) have not covered.

3.4. Digital-related NTMs

Non-tariff measures (NTMs) often come in the form of laws or red tape that hamper free trade or discriminate against foreign suppliers in terms of market access, such as discriminatory regulations or local content rules (Fefer, Akhtar, and Morrison, 2019). Variations in regulatory standards, technical requirements, and certification procedures can pose challenges for businesses. NTMs concerning traditional trade-related measures can extend to digital trade and lead to a discretionary pattern favouring certain local players (Wu, 2017).

Market access restrictions on international services and factor mobility, whether specific to digital trade or not, can create obstacles for foreign competitors entering the market. In this regard, the ACFTA 3.0 should consider including binding provisions that require countries to clarify their policy objectives, content, and scope when setting new laws or regulations related to digital trade.

It is worth noting that while digitalisation could help reduce existing NTMs,⁵ it may also enable new forms of NTMs that would probably hinder international trade and investment. For instance, when digital technologies are widely used in tradable goods and services, administrative measures on digital products or services, such as the technical standards of digital products and qualification inspection of digital services, could pose technical barriers that restrict market access and international trade.

The seven principles proposed by the 2018 Asia-Pacific Economic Cooperation (APEC) Ministerial Meeting are worth considering when the ACFTA 3.0 negotiations address these potential barriers and seek solutions to reduce unnecessary measures. First, information on NTMs, including the development processes, needs to be transparent. Second, the consequence of imposing NTMs should be predictable, coherent, and non-discriminatory. Third, NTMs should be non-discriminatory. Fourth, NTMs should be based on relevant international standards. Fifth, NTMs need to be consistent with members' WTO commitments and obligations. Sixth, the use of NTMs needs to be minimised and have a precise legitimate objective. Seventh, NTMs should not pose unwarranted barriers to technological progress and innovation.

3.5. Intellectual property rights

The digital economy fosters a culture of innovation and encourages the rapid adoption of new technologies. Digitalisation intensifies the cross-border exchange of intellectual property and increases the prominence of intellectual property rights (IPR) protection in endorsing cross-border technology transfer.⁶ Inadequate IPR protection in a country makes investors worry about their proprietary information, trade secrets, or copyright material being misused. This may discourage them from entering the market. From the host country's perspective, ensuring effective IPR protection is crucial for attracting FDI and fostering innovation. Indeed, protecting intellectual property has been part of the entry requirements for countries becoming involved in GVCs (Chen and Kimura, 2021).

As ASEAN and China work on deeper cooperation in GVCs, setting robust IPR standards should be accorded increasing importance. In the ACFTA 3.0, provisions related to IPR protection⁷ should aim for levels higher than those of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) requirements, coupled with effective enforcement mechanisms, to ensure that both producers and consumers can benefit and that such protection can subsequently contribute to technology transfer and innovation (Chen, 2022). In this regard, useful references for the ACFTA 3.0

⁵ For example, adopting modern trade facilitation measures could improve the efficiency of customs procedures.

⁶ On the one hand, digitalisation helps separate intellectual property ownership and the right to use it, allowing its owner and user to take different roles in the GVCs and share the value added generated by the intellectual property. On the other hand, digitalisation makes IPR infringement easy, especially in online marketplaces.

⁷ Such as patent protection, copyright, trademarks, and enforcement measures to combat intellectual property infringement.

negotiations on IPR protection are Chapter 11 of the RCEP and Chapter 18 of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Both introduced provisions that go beyond member countries' commitments in multilateralism and surpass the level under TRIPS ('TRIPS-plus'), as well as detailed obligations on enforcing TRIPS-plus protection.

The negotiations should on the one hand highlight equal treatment of online violations of copyright, trademarks, and other related rights with their offline equivalents; on the other hand, they should consider the development gaps in the 10 ASEAN Member States as well as country-specific schedules and technical assistance requests.⁸

3.6. Pivot for free flow of data with trust

The digital economy involves the transfer and storage of vast amounts of data. News, opinions, and speech disseminated via the internet and social media have increasing influence on real-life activities and decision-making. Rules and regulations on online behaviour, such as data flow, privacy, consumer protection, competition, and cybersecurity, are reshaping the cyber landscape and extending the current international order to cyberspace. Particularly, measures that hinder the free flow of data⁹ tend to increase costs and lower the efficiency of doing business across borders. For that reason, promoting the free flow of data is a high priority for trade liberalisation in the digital era.

The diversity of countries' attitudes towards the governance of cyberspace ('cyber-governance') and the consequent policies reflect differences in the economic and legal systems, institutions, social values, and even ideologies that are present amongst countries. Since cross-border data transfers are subject to different privacy and data regulations across countries, they raise concerns regarding the jurisdictions and legal frameworks governing data. The challenge lies in striking a balance between the need for data flow in facilitating digital trade and the legitimate concerns regarding data protection of individuals¹⁰ and nations.¹¹

It would be constructive for the ACFTA 3.0 to involve provisions that regulate cross-border data flows. Rule-setting on data governance could help reduce barriers to the free flow of data, which would then drive cross-border flows of goods, services, capital, and people. Moreover, bilateral cooperation on improving data security and privacy legislation would be an important step towards trust building amongst people and businesses in the region. Including the data-related issues in the negotiations would increase data-related policy transparency and accountability and build trust amongst ASEAN and China to pave the way for establishing harmonised regulatory frameworks and fostering international cooperation on data practice.

⁸ Taking this into account in the negotiations could facilitate implementation and smoothen the transition period of a country's domestic adjustments/reforms.

⁹ Measures such as requirements on data localisation, web filtering or blocking, cybertheft, and requirements for source code or algorithms disclosure.

¹⁰ For instance, concerns regarding the protection of personal information, privacy rights, and data security.

¹¹ Some countries limit cross-border data flows in the name of national security or data localisation requirements.

The provisions on data governance in the ACFTA 3.0 should cover (i) general provisions that can be applied to regulating data flows, (ii) specific provisions for certain types of data flows, and (iii) exceptional terms designed for exceptional circumstances.

3.7. Trade-related cybersecurity

The changes triggered by digitalisation could be wider, deeper, and less predictable than ever before, especially with the development and use of artificial intelligence, big data, and the internet of things. The advance of technologies in data storage, processing, transition, and monetisation could increase the likelihood of data being leaked, stolen, or misused. This has drawn increasing attention, especially as the advance of digital technologies is evaporating the boundaries between cyberspace and reality over time. For individuals, their virtual identity in the online world has to be mapped with their physical one; for countries, cyberspace, which was conceived as borderless, is becoming an ever more integral part of national sovereignty.

For that reason, cybersecurity has become one of the prime concerns in the digital economy. Cyberthreats can disrupt business operations and supply chains, particularly when cyberattacks are organised transnationally. According to *Cybercrime Magazine*, cybercrime¹² cost \$6 trillion economic loss globally in 2021, and this figure is expected to reach \$10.5 trillion in 2025 (Morgan, 2020).

Given the rising importance of cybersecurity in trade and investment, but the lack of international law in regulating transnational cybercrime and cyber fraud,¹³ ASEAN and China will see the inclusion of cybersecurity clauses in the ACFTA 3.0 as a useful approach to bilateral rule-setting in this field. Indeed, the ASEAN–China Strategic Partnership Vision 2030 has highlighted the importance of ASEAN–China cooperation on cybersecurity policy and digital connectivity.¹⁴ Both sides have agreed to ‘enhance digital governance and cyber security and continue to support the ASEAN–China Cyber Dialogue, and work together to expand practical cooperation on cyber security and digital governance...’ (ASEAN, 2021).

The ACFTA 3.0 could apply this strategy to the negotiations on security standards and compliance regarding the design, testing, and certification of digital products and services. In principle, ASEAN–China bilateral cooperation in cybersecurity should address the vulnerabilities of interconnected systems between countries to ensure network safety, reliability, and trustworthiness. In addition to the effort on strengthening bilateral collaboration in identifying and mitigating malicious intrusions and the dissemination of malicious code, the ACFTA 3.0 could also aim for (i) promoting the use of a risk-

¹² Cybercrime costs include productivity loss, revenue loss, disaster recovery, liability, and customer loss (Dübendorfer, Wagner, and Plattner, 2004).

¹³ Other than the Budapest Convention on Cybercrime (2001).

¹⁴ The Co-Chairs’ Statement on the 1st ASEAN–China Cyber Dialogue stated that ‘... cyber cooperation has played a more important role in spearheading all-round cooperation on innovation between ASEAN and China’ (Ministry of Foreign Affairs, 2020).

based approach in decision-making; (ii) facilitating the movement of cyber experts, including lawyers, engineers, researchers, students, and trainers; and (iii) supporting capacity building and sharing of best practices in incident response, disaster management, and increasing public awareness.

3.8. Regional cooperation on connectivity

Issues related to connectivity and trade facilitation should not be neglected. With new solutions to ease and increase the security of data exchange, trade facilitating measures, such as electronic certification, electronic authentication, and digital signatures, have been widely accepted by business. Upgrading the related technical standard could help increase interoperability across different national systems and provide a useful reference in the case of dispute settlement.

In Asia, development cooperation has been a key feature of ASEAN-plus FTAs since their inception. The ACFTA 3.0 should extend what the ACFTA 1.0 and 2.0 have achieved in streamlining customs procedures and harmonising related regulations to facilitate the adoption of digital technologies in trade facilitation measures, such as the ASEAN Single Window and electronic customs platforms, to reduce the administrative burden by simplifying documentation requirements for bilateral trade.

With the success of bilateral cooperation in infrastructure building in ASEAN ports, railways, and highways, the ACFTA 3.0 should support both sides in exploring opportunities for deeper cooperation in areas such as energy, manufacturing, and tourism. From China's perspective, this could establish synergies with its Belt and Road Initiative and Global Development Initiative and enhance Chinese involvement in sustainable connectivity and green infrastructure development in the region. From the ASEAN perspective, such development cooperation could improve the socio-economic infrastructure, incorporate trade and investment linkages to unleash market potential, and help address social issues such as financing climate change mitigation.

3.9. Bilateral dispute settlement mechanisms

Provisions on dispute settlement are important elements of FTAs to ensure compliance with the agreement and prevent the parties from violating the terms agreed. A dispute settlement mechanism, defined in the FTA, should adequately address and provide resolution processes for disputes that occur between countries, business to business, investor to state, or state to state.

Since the legal systems and approaches to international law differ significantly in ASEAN and China, it could be challenging to find common ground to resolve disputes based on different interpretations of legal norms. Moreover, despite the progress in bilateral relations for deeper cooperation and

partnership, disputes involving historical, legal, and geopolitical factors may hinder the implementation of the FTA. A cooperative approach to address these issues bilaterally could prevent escalation; manage tensions; help increase stability and accountability in doing business; and safeguard and deepen trade, investment, and economic cooperation.

Upgrading the ACFTA 3.0 should particularly focus on improving its effectiveness in dispute settlement to facilitate the implementation of the agreement, especially regarding the use of e-signatures, e-certificates, and e-invoices. It could consider (i) enhancing the binding enforcement mechanisms to ensure that all parties comply with rules agreed; (ii) balancing countries' interests and enabling even small countries to achieve favourable outcomes in disputes; (iii) improving the timing and efficiency of dispute settlement, (iv) increasing the transparency and public awareness of the process and results; and (v) harmonising countries' arbitration laws and providing guidance on alternative resolutions for disputes between sellers and consumers in different countries, which is of increasing importance as digital platforms can remove intermediaries in the value chain and enable direct connections between producers and consumers.

3.10. Green economy

Sustainable development has been a global trend. ASEAN and China have realised the importance of balancing economic growth with environmental sustainability. During the 25th ASEAN–China Summit in November 2022, both sides issued a joint statement on strengthening common sustainable development.

Incorporating provisions related to sustainable development, environmental protection, and related responsible business practices in the ACFTA 3.0 could facilitate bilateral cooperation in frontiers such as the low-carbon transition, knowledge sharing on renewable energy, and investment in the green economy. Promoting the development of the green economy should also encourage businesses to adopt socially responsible approaches to trade and investment that take into account issues such as labour rights, environmental impacts, and gender equality.

Basically, the ACFTA 3.0 could upgrade and extend environmental provisions that require the parties' commitments to uphold environmental laws, regulations, and standards. It will also be useful to provide a structured process of dispute resolution for parties to address alleged violations of environmental commitments. Furthermore, information disclosure requirements on environmental regulations and related decisions could help promote policy transparency. These efforts could contribute to the establishment of a bilateral cooperation framework on environmental matters, such as pollution control, natural resources management, biodiversity protection, and sustainable forestry and fisheries development.

Some priorities of ASEAN–China cooperation in this area include (i) encouraging trade and investment in eco-friendly goods and services by reducing tariffs or non-tariff barriers on these products, (ii) facilitating trade in renewable energy technologies and services to accelerate countries' transitions to cleaner energy sources, and (iii) promoting sustainable agricultural and fisheries by adhering to sustainable supply chain practices and through joint efforts on combating illegal fishing.

3.11. Capacity building and technical assistance

Capacity building initiatives and technical assistance programmes are useful in facilitating knowledge diffusion and technology transfer. Including clauses on capacity building in FTAs can help developing countries strengthen export capabilities, improve access to finance, and better understand international trade procedures and regulations. Originally, 'the Parties agree to implement capacity building programmes and technical assistance, particularly for the newer ASEAN Member States, in order to adjust their economic structure and expand their trade and investment with China' (ASEAN, 2002: Article 7, Item 4). The ACFTA 3.0 will go beyond this and contain initiatives addressing new trade issues.

For instance, capacity building will be necessary in supporting ASEAN and China's cooperation on e-commerce.¹⁵ Providing training, networking, and technical support for individuals and small and medium-sized enterprises, and improving their utilisation of e-commerce platforms, will be a practical way to help bridge the digital gap and foster inclusiveness.

In supporting the development of the green economy, the ACFTA 3.0 could include initiatives that support infrastructure building on renewable energy installations, waste management facilities, and sustainable transportation systems. The implementation of the FTA could include technical support that helps countries conduct environmental impact assessments on projects and prepare backup policies to mitigate the risks. This effort could complement the capacity building roadmap on energy investments and financing for ASEAN and accelerate ASEAN Member States' transformation towards cleaner energy.

Moreover, via capacity building and technical assistance, the ACFTA 3.0 could encourage businesses in both China and ASEAN to adopt socially responsible business practices in sustainable supply chains, thus reducing carbon emissions and minimising environmental harm.

¹⁵ Capacity building initiatives, endorsed during the 22nd ASEAN Economic Ministers–Ministry of Commerce of China Consultation on 21 August 2023, focus on boosting e-commerce collaboration between ASEAN and China.

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Annex: Summary of Background Papers

The report is supplemented with eight background papers. The first paper, Investment-Related Issues and Solutions for the Improvement of the ASEAN–China Free Trade Area, prepared by **Junji Nakagawa**, is a technical paper that attempts to elucidate the expected content of the new investment chapters in the ASEAN–China Free Trade Area (ACFTA) 3.0 based on a comparison of the related provisions in the five recent free trade agreements (FTAs) and bilateral investment treaties that involved the Association of Southeast Asian Nations (ASEAN) or/and China: (i) Chapter 10 of the Regional Comprehensive Economic Partnership (RCEP), (ii) the ASEAN Comprehensive Investment Agreement, (iii) the European Union (EU)–Viet Nam Investment Protection Agreement, (iv) the EU–China Comprehensive Agreement on Investment, and (v) the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) Investment Chapter.

The paper states that an enhanced chapter on investment liberalisation, clear and transparent provisions on investment protection, detailed rules on investment facilitation, as well as a transparent and timely investor–state dispute settlement (ISDS) mechanism would empower the ACFTA 3.0 to provide a reliable legal basis for businesses in response to challenges originating in dramatic shifts in supply chains, the impact of the coronavirus disease (COVID-19) pandemic, and the embrace of digital technologies in trade and investment.

First, for further investment liberalisation, the ACFTA 3.0 could refer to the RCEP as a baseline and include provisions on pre-establishment national treatment with a negative list, as well as a list of performance requirements that will be prohibited under the new agreement. Second, the inclusion of post-establishment national treatment and most favoured nation treatment and the linking of fair and equitable treatment to the customary international law minimum standard of treatment would maximise efforts on investment protection. Third, the ACFTA 3.0 may refer to the Agreement on Investment Facilitation for Development and add new provisions on investment facilitation. Fourth, if ASEAN and China decide to include an ISDS mechanism in the ACFTA 3.0, they may consider having detailed rules on ISDS, or the establishment of an investment court system or a forum for regional arbitration.

The second background paper, Issues on the ASEAN–China Free Trade Area, was prepared by **Inkyo Cheong** and **Yeri Ryu**. From the third-party aspect, it affirms the significance of the ACFTA in promoting East Asian regionalism and points out the necessity of updating the related terms of market access and trade rules as part of the regional response against growing geopolitical risks against globalisation in recent years.

Like many other countries, ASEAN Member States (AMS) have witnessed a substantial increase in trade with China in the past 2 decades. The regional economy relies heavily on inputs from China for production and consumption. The Chinese market has accounted for 15% of ASEAN's total exports annually. Between 2016 and 2020, ASEAN's exports to China surged by 51%, outpacing exports to the rest of the world. But both parties should realise that the initial ACFTA was developed at a time when both parties lacked experience and know-how in establishing FTAs. Despite the creation of the RCEP, it is acknowledged that it has shortcomings in market access and trade rules, including sanitary and phytosanitary measures and technical barriers to trade. The ACFTA 3.0 could address the limitations of the RCEP through advancing market openness for service and investment, tariff elimination, and benchmarking trade rules and intellectual property rights with the CPTPP.

When the trade tensions between China and the United States (US) drove an industrial relocation from China, ASEAN became a premier destination. Enhancing links with China will help ASEAN leverage the gains from this opportunity and smoothen the transfer of raw materials, intermediate goods, machinery, facilities, and technology from China. The experience of the Republic of Korea shows that FTA policies could effectively ease excessive regulations and improve the country's business environment. Given this, the focuses of the ACFTA 3.0 should include strengthening supply chain stability and resilience, reforming their legal and trade frameworks to improve the ease of doing business, and investing in infrastructure and sophisticated manufacturing capabilities.

ASEAN aims for a duty-free zone by 2025, following the launch of the ASEAN Economic Community (AEC) in 2015. The ACFTA 3.0 should consider providing 'AEC plus' provisions. Structurally, it would be beneficial to have one integrated agreement with global standard trade rules, rather than a framework with supplementary agreements like its predecessor. Content-wise, the new agreement must emphasise expanding the scope of market opening and the tariff elimination schedule.

The other six papers present viewpoints from a country's perspective. In **Evi Fitriani** and **Fithra Faisal Hastiadi**'s paper, Indonesia's Perspective on the ASEAN–China Free Trade Area 3.0, the two professors provide a thorough assessment of the ACFTA based on an investigation of its economic consequences on ASEAN and then identify key areas for further cooperation between the two parties, taking into consideration some main challenges facing ASEAN–China economic relations in recent years.

It is evident that the ACFTA has provided enormous opportunities for ASEAN to take advantage of China's economic and technological development. In the past 20 years, trade liberalisation between ASEAN and China has brought benefits as well as challenges for domestic industries in AMS. While the ACFTA has ushered in significant benefits from increasing bilateral trade and investment, and deepening economic cooperation, there are particular economic and political concerns on issues such as trade imbalances, industrial relocation, and the existence of non-tariff barriers.

Looking forward, ASEAN and China could explore ways to enhance financial integration, foster investment cooperation through the Belt and Road Initiative (BRI), promote digital integration, and strengthen institutional cooperation. This could generally increase the economic and political bargaining positions of AMS towards the US and its allies. This would require the ACFTA to be upgraded to better suit the new economic environment and to respond to contemporary political reality. When designing trade policies and strategies, policymakers need to understand the specific sectoral impacts of trade agreements and take these factors into consideration.

A priority of the ACFTA 3.0 is to ensure that investors from both parties receive fair and equitable treatment. On the one hand, it should facilitate China's continuous investment in ASEAN; on the other hand, it should reflect ASEAN's market openness for foreign investment and trade liberalisation, especially in trade in raw materials and components. Preferential market access under the ACFTA 3.0 could help strengthen ASEAN's export capacity, especially in the intermediate or substages of industries where China has global competitiveness. Extensively, the ACFTA 3.0 should be consistent with ASEAN's global strategy of maintaining an independent policy towards the major powers.

The next paper, Thailand's Perspective on the ASEAN–China Free Trade Area 3.0, was written by **Sineenat Sermcheep, Chayodom Sabhasri, June Charoenseang, and Danupon Ariyasajakorn**. It identifies impediments and potential areas for further cooperation between ASEAN and China based on an analysis of the existing ACFTA's economic impacts on ASEAN in general and Thailand in particular.

Since the establishment of the ACFTA, bilateral relations have been improving steadily – ASEAN–China bilateral trade increased tenfold within 2 decades. China is now ASEAN's most important trading partner. In the case of Thailand, the share of trade with China in Thailand's total trade increased from 13.4% in 2012 to 19.2% in 2021. More than 80% of Thailand–China bilateral trade has been either duty-free or with ACFTA-applied tariff rates, making the ACFTA one of Thailand's top utilised FTAs.

Nevertheless, some non-tariff measures, such as trademark issues, limited opening hours of cross-border customs and inspections, and certification on data sharing, still exist and hinder bilateral trade. The ACFTA 3.0 should therefore aim at further ASEAN–China collaboration in eliminating/reducing these barriers.

Moreover, given the existence of common challenges faced by ASEAN and China, such as the increasing risk of global recession, the acceleration of supply chain and value chain restructuring, the digital and green transformation, and the implementation of the United Nations' Sustainable Development Goals in 2030, the ACFTA 3.0 should aim for deepening ASEAN–China collaboration in (i) developing the digital economy and complementing ASEAN's ongoing process towards regional digital economy integration; (ii) providing technology and financial support for industry's adjustment to a green and sustainable mode of growth; (iii) generating resilient supply chains amongst ASEAN and China; and (iv) facilitating seamless cross-border e-commerce transactions via aligning product standards, data protection and privacy regulations, electronic signatures, and cybersecurity measures.

Nguyen Anh Duong and Vo Tri Thanh's paper on Viet Nam's Perspective on the ASEAN–China Free Trade Area 3.0 argues that the implementation of the ACFTA has contributed to the fast growth of trade and investment between Viet Nam and China since 2010. For instance, Viet Nam was the second largest exporter (following Singapore) to China and the largest importer of Chinese goods within ASEAN in 2021. By the end of 2022, China was Viet Nam's fourth largest source of foreign direct investment (FDI).

Viet Nam sees trade liberalisation and international economic cooperation as vital to its development strategy. This is evident in the country's membership of the CPTPP, the EU–Viet Nam FTA, and the RCEP.

From the Vietnamese perspective, the upgrade of the ACFTA should focus on strengthening bilateral cooperation in areas such as rules of origin (ROOs), trade facilitation, sanitary and phytosanitary and technical barriers to trade regulations, capacity building, and services liberalisation. The authors recommend that the ACFTA 3.0 preserve the harmonisation approach embodied in existing ASEAN FTAs, emphasise improving trade management and administration in Viet Nam, generate leverage effects to enhance the competitiveness of Vietnamese products, and promote Vietnamese firms' involvement in GVCs.

The paper prepared by **Juita Mohamad, Jazreen Jefri, and Low Zhen Ting**, Malaysia's Perspective on the ASEAN–China Free Trade Area 3.0, also hails the ACFTA as a significant step towards boosting economic ties between ASEAN and China, as is evident in Malaysian trade and investment. Malaysia is one of China's top trading partners in ASEAN. To Malaysia, China is the most significant export destination as well as a large source of imports. In 2021, Malaysian exports to China reached US\$41 billion, while imports from China amounted to US\$49 billion.

Malaysia sees China as an important development partner. The ACFTA 3.0 should provide the driving force for both parties to commit to higher standards of trade regulation, in addition to those to be applied under the RCEP. Malaysia is particularly concerned about how the ACFTA 3.0 could help promote FDI to accelerate technology transfer and industrialisation, strengthen international cooperation in e-commerce and environmental sustainability, and eliminate non-tariff measures for further trade liberalisation.

It will be in both Malaysia and China's interest to make the ACFTA 3.0 complement the BRI by ensuring the safety and transparency of bilateral investments. It is desirable to have the ACFTA 3.0 work on (i) simplifying ROOs and certificate of origin procedures, (ii) service sector liberalisation, (iii) investment promotion and facilitation, and (iv) capacity building for e-commerce development capabilities. To promote the development of the digital economy, both parties may consider prioritising rule-setting on taxation and personal data protection.

Chap Sotharith's paper, Cambodian Perspective on the ASEAN–China Free Trade Area 3.0, reveals the ACFTA's significant contributions to the increase in trade and investment between Cambodia and China. In 2021, total bilateral trade reached US\$11.2 billion. China remained Cambodia's largest source of FDI, mainly in the energy and infrastructure sector. In 2022, the Cambodian government approved US\$4.4 billion of FDI, of which more than half was from Chinese investors. Trade liberalisation has also facilitated the movement of people and bilateral economic cooperation. For instance, China is now Cambodia's largest source of development aid, and at its peak, over 2 million Chinese tourists visited Cambodia yearly.

Cambodia took the first move to liberalise bilateral trade with China by signing the Cambodia–China Free Trade Agreement in 2021. The implementation of that FTA extended tariff-free trade to over 340 products, such as seafood products, garlic, cashew nuts, and dried chilli. It further paved the way for bilateral cooperation under the BRI, especially in technology, e-commerce, and regulation.

The ACFTA 2.0 touched upon issues such as ROOs, customs procedures and trade facilitation, market access for services, as well as enhanced economic and technical cooperation. Cambodia sees the ACFTA 3.0 as another big step forward to enhance bilateral economic ties by reducing non-tariff barriers, improving product and service standardisation, and building trust. Negotiations on quarantine protocols to promote ASEAN's exports of food and fruit to China should effectively reduce the existing non-tariff barriers facing trade in agriculture products. Moreover, the higher 'quality' of the ACFTA 3.0 will help shape the direction of domestic reforms. This must be accompanied by technical assistance and capacity building for Cambodia, the Lao PDR, and Myanmar (the CLM countries), especially in the digital economy, the green economy, and research and development activities.

The background paper titled *China's Perspective on the ASEAN–China Free Trade Area 3.0*, which was written by **Jianping Zhang**, reviews good practices and draws lessons in utilising ACFTA terms since its establishment. It points out that the ACFTA (2002) was China's first FTA, and since then has been widely seen as another significant step to open the Chinese market after its accession to the World Trade Organization. The total trade volume between China and ASEAN increased from US\$55 billion in 2002 to US\$975 billion in 2021. China is now ASEAN's largest trading partner, and vice versa. Amongst the emerging markets, ASEAN has been the largest destination of Chinese FDI. By the end of 2021, the cumulative amount of bilateral investment between China and ASEAN exceeded US\$280 billion. For China, ASEAN is an important market for overseas project contracting and labour service cooperation. Nearly one-quarter of China's signed project contracts in 2021 were in ASEAN. China also sees the ACFTA as an opportunity to expand its global influence.

The ACFTA 3.0 needs to address not only economic elements related to (i) the digital economy and cross-border e-commerce, (ii) global value chains and East Asian production networks, and (iii) the low-carbon green economy and sustainable development, but also economic elements that could threaten China–ASEAN value chains in the context of increasing China–US trade tensions. Bearing this in mind, the negotiations for the ACFTA 3.0 will aim for a higher level of institutional arrangements for economic and trade cooperation and contribute to the multilevel dialogue mechanism on coordinating China–ASEAN macroeconomic policies by improving the business environment and facilitating trade, investment, and the movement of skilled labour between ASEAN and China.





Chapter 2

Investment-Related Issues and Solutions for Improving the ASEAN–China Free Trade Area

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1. Introduction

On 13 November 2022, the leaders of the Association of Southeast Asian Nations (ASEAN) and China announced the launch of negotiations for the upgrade of the ASEAN–China Free Trade Area (ACFTA) (ASEAN, 2022). This paper analyses investment-related issues and solutions that should be dealt with for the upgrade of the ACFTA. ASEAN and China concluded the Agreement on Investment of the Framework on Comprehensive Cooperation in 2009.¹ Recent changes to the global economic landscape necessitate a careful reflection and review of the investment agreement to ensure that it remains relevant and responsive to the needs of businesses. Challenges that need to be addressed include the dramatic shifts in global and regional supply chains, the impact of the coronavirus disease (COVID-19) pandemic, and the adoption of advanced technologies in trade and investment facilitation. Taking these issues into account, there is a need to review the provisions of the investment agreement in light of other agreements involving ASEAN and China, including Chapter 10 of the Regional Comprehensive Economic Partnership (RCEP),² and other ASEAN and non-ASEAN free trade agreements (FTAs) and bilateral investment treaties (BITs), including the ASEAN Comprehensive Investment Agreement (ACIA)³ and the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP).⁴ This paper will elucidate the expected content of the new ASEAN–China Investment Agreement, which should build on these agreements.

¹ The Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, signed on 15 August 2009, entered into force on 1 January 2010 (ASEAN, 2009a).

² The RCEP agreement, signed on 15 November 2020, entered into force on 1 January 2022.

³ The ACIA, signed on 26 February 2009, entered into force on 29 March 2012 (ASEAN, 2009b).

⁴ The CPTPP, signed on 8 March 2018, entered into force on 30 December 2018 for Australia, Canada, Japan, Mexico, New Zealand, and Singapore; on 14 January 2019 for Viet Nam; on 19 September 2021 for Peru; on 29 September 2022 for Malaysia; and on 22 February 2023 for Chile.

2. The 2009 ASEAN–China Investment Agreement

2.1. The 2009 ASEAN–China Investment Agreement as the last element of the ACFTA

On 15 August 2009, ASEAN and China signed the Agreement on Investment, which was the last of the agreements constituting the ACFTA. The other agreements are the Framework Agreement,⁵ the Agreement on Trade in Goods,⁶ the Agreement on Trade in Services,⁷ and the Agreement on Dispute Settlement Mechanism.⁸

The Framework Agreement set out the objective, amongst others, to create a transparent, liberal, and facilitative investment regime (Art. 1(b)). To achieve this objective, the parties agreed to (i) enter into negotiations to progressively liberalise the investment regime; (ii) strengthen cooperation in investment, facilitate investment, and improve the transparency of investment rules and regulations; and (c) provide for the protection of investments (Art. 5). Therefore, the investment regime should contain rules in three areas: investment liberalisation, investment facilitation, and investment protection. The provisions of the investment agreement will be reviewed to examine their contribution to these goals.

2.2. Investment protection and investment liberalisation

The ASEAN–China Agreement on Investment provides for national treatment, most favoured nation treatment (MFN), and fair and equitable treatment (FET).

⁵ The Framework Agreement on Comprehensive Economic Cooperation Between ASEAN and China, signed on 4 November 2002, entered into force in July 2005 (ASEAN, 2002).

⁶ The Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China, signed on 29 November 2004, entered into force July 2005 (ASEAN, 2004b).

⁷ The Agreement on Trade in Services of the Framework Agreement on Comprehensive Economic Co-operation Between ASEAN and China, signed on 14 January 2007, entered into force on 1 July 2007 (ASEAN, 2007).

⁸ The Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-operation Between ASEAN and China, signed on 29 November 2004, entered into force on 1 January 2005 (ASEAN, 2004a).

In the investment agreement, national treatment is granted to foreign investors and their investments ‘with respect to management, conduct, operation, maintenance, use, sale, liquidation, or other forms of disposal of such investments’ (Art. 4). Hence, national treatment applies to the post-entry stage only. Due to the absence of pre-entry national treatment, there is no obligation of investment liberalisation. Although ASEAN Member States (AMS) insisted on investment liberalisation, China was not prepared to undertake investment liberalisation obligations in the agreement. As Xiao stated, the investment agreement represents ‘old wine in the new bottle’ (Xiao, 2010: 2).⁹

China’s hesitant attitude towards investment liberalisation reflected its overall policy at the time. China had concluded well over 100 BITs by the time it concluded the investment agreement, but it had never agreed on investment liberalisation.¹⁰

The MFN clause of the investment agreement applies not only to the post-entry stage, but also to the pre-entry stage, as the MFN is accorded to the ‘admission, establishment, acquisition, expansion’ of investments as well (Art. 5.1). Besides, the investment agreement expressly excludes dispute resolution procedures from the scope of the MFN clause (Art. 5.4).

However, national treatment and MFN treatment are substantially derogated by Article 6.1, which provides that the obligations shall not apply to any existing or new nonconforming measures maintained or adopted by a party. It allows a party to withdraw the non-discriminatory treatment of foreign investors in the future without violating its national treatment or MFN obligations. The investment protection granted by Articles 4 and 5 would be undermined to a great degree (Xiao, 2010: 10).

The investment agreement provides for FET as well as full protection and security in Article 7.1. It sets two restrictions on the application of FET. First, FET refers to the obligation not to deny justice only (Art. 7(a)). Second, a breach of another provision of the agreement does not amount to a breach of FET (Art. 7.3). The language resembles Article 11 of the ACIA. It may be concluded that the ACIA was utilised as a reference when the FET clause of the ASEAN–China investment agreement was negotiated.

On the transfer and repatriation of profits, Article 10.1 of the investment agreement provides that each party shall allow all transfers in respect of investment in any freely usable currency. On the other hand, the investment agreement provides a number of exceptions to this principle, including the right to impose capital controls in the case of a serious balance-of-payments crisis, which is consistent with the Articles of Agreement of the International Monetary Fund (IMF) (Art. 11.1).

In sum, with respect to investment protection, though the common standards of treatment are provided for by the investment agreement, their application is substantially restrained due to several restrictions.

⁹ See also Berger (2013: 22–23).

¹⁰ In 2013, Berger categorised three generations of Chinese BITs since its first BIT in 1982. Even the latest third-generation BITs provide for post-establishment national treatment (Berger, 2013: 8).

2.3. Transparency, promotion, and facilitation of investment

To facilitate investment and improve transparency, the investment agreement provides for obligations of transparency (Art. 19), promotion of investment (Art. 20), and facilitation of investment (Art. 21). These include the publication and notification of laws and policies affecting investment (Art. 19.1(a)), establishing enquiry point (Art. 19.1(c)) and one-stop investment centres in the respective host parties (Art. 21(d)), and various forms of cooperation amongst parties to promote and facilitate investment.

2.4. Investor–state dispute settlement

China's early BITs provided either no investor–state dispute settlement (ISDS) provisions or a narrowly constructed ISDS clause that only admits the amount of compensation for expropriation to arbitration (Li and Bian, 2020: 505). According to Li and Bian, the second-generation Chinese BITs signed from 1998 to 2011 allow for the admission of legal disputes to arbitration (Li and Bian, 2020: 505). The investment agreement belongs to this generation. Article 14 on ISDS applies to disputes concerning an alleged breach of substantive obligations under Articles 4, 5, and 7 (standards of treatment); 8 (expropriation); 9 (compensation for losses); and 10 (transfer of profits).

After a cooling-off period of 6 months, the dispute may be submitted at the choice of the investor to one of four international arbitration procedures¹¹ or to the domestic courts of the host state (Art. 14.4(a)). This so-called fork-in-the-road rule is mitigated to the benefit of the investor, as the investor may submit the dispute to an international arbitration procedure even if it has been submitted to a competent domestic court, provided that the investor has withdrawn its case from the domestic court before a final judgement has been reached in the case (Art. 14.5).

If the investor wants to submit a dispute to arbitration, they have to meet other conditions, including: (i) the submission of the dispute must be within 3 years of the time at which the investor became aware of a breach of an obligation under the agreement; and (ii) prior to submitting the claim to arbitration, the investor has to give 90 days advance written notice to the host state, and the host state may require the use of domestic administrative review procedures (Art. 14.6).

¹¹ These are procedures under the International Centre for Settlement of Investment Disputes (ICSID) Convention, under the ICSID Additional Facility Rules, under the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, or under any other arbitration rules agreed upon by the disputing parties. See Art. 14.4.

2.5. Exceptions

The investment agreement provides for three types of exceptions: (i) measures to safeguard the balance of payments (Art. 11); (ii) general exceptions (Art. 16); and (iii) self-judging security exceptions (Art. 17). Article 17 enumerates cases in which the clause may be invoked: policies concerning the non-proliferation of nuclear weapons; trafficking in arms; protecting critical public infrastructure from attack; and war or other emergency in domestic or international relations (Art. 17.(b)). These cases are normally deemed to be situations where some kind of military threat is at stake. However, as Article 17 uses the phrase 'including but not limited to', it clarifies that the enumeration is not exhaustive. Therefore, the security exception may be invoked also under situations that are not explicitly mentioned, including the economic crisis (Xiao, 2010: 12).

3. Provisions of the RCEP Relating to Investment

As ASEAN and China are parties to the RCEP, its provisions on investment are also relevant when we consider the expected content of the new ASEAN–China Investment Agreement. Chapter 10 of the RCEP covers the four pillars of promotion, protection, facilitation, and liberalisation (ASEAN, 2012). The RCEP is the first FTA in which China has made commitments on investment liberalisation.

3.1. Investment liberalisation

In contrast to the ASEAN–China investment agreement, the RCEP provides for investment liberalisation through pre-establishment national treatment with a negative list. Article 10.3 provides for national treatment with respect to 'the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments'. Annex III, List A enumerates existing nonconforming measures that are maintained by a party, and an amendment to such measures is allowed to the extent that it does not decrease the conformity of the measure as it existed immediately before the amendment (ratcheting requirement) (Art. 10.8.1).¹² Annex III, List B enumerates nonconforming

¹² The requirement is applied to Australia, Brunei, China, Japan, the Republic of Korea (henceforth, Korea), Malaysia, New Zealand, Singapore, Thailand, and Viet Nam. See Art. 10.8.1(c)(ii). For Cambodia, Indonesia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and the Philippines, an amendment is allowed to the extent that it does not decrease the conformity of the measure as it existed at the date of entry into force of the RCEP (standstill requirement). See Art. 10.8.1(c)(i).

measures that a party adopts or maintains after the entry into force of the RCEP (Art. 10.8.2). For these measures, therefore, a party does not assume a ratcheting requirement and has the autonomy to adopt or maintain any nonconforming measures after the entry into force of the RCEP. For instance, Annex III, List A of China has 12 items, including the exploration and ore dressing of rare earth and rare minerals, the manufacture of ground reception facilities for satellite television and broadcast, and processing of traditional Chinese medical materials. Annex III, List B of China has 11 items, including atomic energy, measures that grant rights or preference to ethnic minorities and ethnic minority areas, and any measure with respect to new sectors and industries.

With respect to trade in services, the RCEP employs a hybrid approach. Eight parties¹³ used positive list scheduling under Annex II, and seven parties¹⁴ adopted the negative list approach by including their nonconforming measures in Annex III. For instance, China's Annex II provides that the establishment of branches by foreign-owned enterprises is unbound, unless otherwise indicated in specific subsectors.¹⁵ According to Article 8.12, however, RCEP parties that initially adopted the positive list approach are required to transition to negative list scheduling within 3 years after the entry into force of the RCEP.¹⁶

Why could China make commitments for investment liberalisation under the RCEP? The pre-establishment national treatment and negative list initially arose as China's BIT policy in the context of the China–United States (US) BIT negotiations (Zhang, 2022: 1054–55). In 2013, China agreed to negotiate a BIT based on pre-establishment national treatment with a negative list with the US (Ministry of Commerce, China, 2013). This policy was implemented on a trial basis in the Pilot Free Trade Zones and promoted nationwide in 2018, before it was enacted in the Foreign Investment Law in March 2019.¹⁷ In sum, China was ready to make commitments for investment liberalisation under the RCEP as it had agreed to such commitments during the negotiation of the China–US BIT.

The RCEP provides for additional discipline for investment liberalisation by systematically prohibiting performance requirements, which is not provided for under the ASEAN–China investment agreement. Article 10.6.1 prohibits the imposition or enforcement of the following requirements as a condition for the establishment, acquisition, management, conduct, operation, or sale or other disposition of an investment: (i) to export a given level or percentage of goods; (ii) to achieve a given level or percentage of domestic content; (iii) to purchase, use, or accord a preference to goods produced in its territory;

¹³ Cambodia, China, the Lao PDR, Myanmar, New Zealand, the Philippines, Thailand, and Viet Nam.

¹⁴ Australia, Brunei, Indonesia, Japan, Korea, Malaysia, and Singapore.

¹⁵ RCEP, Annex II – China – 3.

¹⁶ For Cambodia, the Lao PDR, and Myanmar, the transition period is 12 years after the entry into force of the RCEP. See Art. 8.12.1.

¹⁷ Article 4 of the Foreign Investment Law provides that 'The State implements the management scheme of pre-establishment national treatment plus negative list with respect to foreign investment'. See Zhang (2022: 1055, 1058).

(iv) to relate the volume or value of imports to the volume or value of exports; (v) to restrict sales of goods in its territory that such investments produce by relating such sales to the volume or value of its exports or foreign exchange earnings; (vi) to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory;¹⁸ (vii) to supply exclusively from the territory of the party the goods that such investments produce to a specific regional market or to the world market; or (viii) to adopt a given rate or amount of royalty under a licence contract (footnote 42).

Although some of these requirements are allowed as a condition for granting an advantage to investors, the following requirements are prohibited even in such cases: (i) to achieve a given level or percentage of domestic content; (ii) to purchase, use, or accord a preference to goods produced in its territory; (iii) to relate the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with investments of that investor; or (iv) to restrict sales of goods in its territory that such investments produce by relating such sales to the volume or value of its exports or foreign exchange earnings (Art. 10.6.2). The RCEP, therefore, prohibits several World Trade Organization (WTO) Agreement on Trade-Related Investment Measures (TRIMs)-plus performance requirements,¹⁹ so that a foreign investor may enjoy a wide range of discretion in making decisions relating to their investment.

3.2. Investment protection

The MFN clause of the RCEP is quite similar to that of the investment agreement, including the exclusion of the clause regarding any international dispute resolution procedures or mechanisms under other existing or future international agreements (Art. 10.4.3). It must be noted, however, that this clause does not apply to Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, or Viet Nam. Furthermore, MFN treatment shall not be accorded to investors from these countries.²⁰

The FET clause of the RCEP also resembles that of the investment agreement, as it covers FET and full protection and security. However, in contrast to that of the investment agreement, the FET clause of the RCEP refers to the customary international law minimum standard of treatment of aliens (Art. 10.5.1). Besides this, it has two provisions that restrict the coverage of the FET clause: (i) FET refers to the obligation not to deny justice (Art. 10.5.2(a)); and (ii) a breach of another provision of the agreement does not amount to a breach of FET (Art. 10.5.3).

On transfers, Article 10.9.1 of the RCEP provides that each party shall allow all transfers relating to a covered investment to be made freely and without delay into and out of its territory. It also provides for a number of exceptions which are similar to those of the ASEAN–China Agreement on Investment, including the rights of a party under the IMF Articles of Agreement (Art. 10.9.4).

¹⁸ This does not apply to Cambodia, the Lao PDR, or Myanmar. See Art. 10.6.1.

¹⁹ TRIMs provide for the prohibition of requirements that violate Articles III.4 (national treatment) and XI (prohibition of quantitative restrictions).

²⁰ RCEP, Chapter 10, footnote 18.

3.3. Investment facilitation

The RCEP provides for the promotion of investment (Art. 10.16) and the facilitation of investment (Art. 10.17). The former includes best efforts obligations to organise joint investment promotion activities, promote business matching events, and organise various briefings and seminars on investment opportunities. The latter includes best efforts obligations to (i) simplify procedures for investment applications and approvals; (ii) promote the dissemination of investment information; and (iii) establish or maintain contact points, one-stop investment centres, focal points to provide assistance, and advisory services to investors (Art. 10.17.1). As an elaboration of the best efforts obligation (iii) above, Article 10.17.2 provides for a best efforts obligation to assist investors and covered investments to amicably resolve complaints or grievances with government bodies which have arisen during their investment activities. This is an ASEAN–China investment agreement plus component of the RCEP.

3.4. Omission of ISDS

The RCEP contains no ISDS. It leaves the ISDS mechanism for negotiations within 2 years after the entry into force of the agreement (Art. 10.15.1(a)). The negotiations are to be concluded within 3 years from the date of commencement of the negotiations (Art. 10.15.2). Although Japan and the Republic of Korea (henceforth, Korea) pushed for detailed ISDS rules during RCEP negotiations, the changing stances of other countries prompted the RCEP to omit ISDS (Hsieh, 2022: 89–90). In particular, New Zealand's new government declared its refusal to include ISDS in any FTAs in 2018 (Government of New Zealand, 2017: 1).

3.5. Exceptions

The RCEP provides for three types of exceptions – balance-of-payments exceptions, general exceptions, and security exceptions. On balance-of-payments exceptions, Article 17.15 provides that, where a party is in serious balance-of-payments difficulties, it may adopt or maintain restrictions on payments or transfers related to covered investments.

Chapter 10 of the RCEP does not provide for general exceptions. Instead, Article 17.12 provides for the incorporation of Article XX of the General Agreement on Tariffs and Trade (GATT) to Chapter 10 (investment), *mutatis mutandis*.

On security exceptions, in addition to Article 17.13 (security exceptions), which provides for general security exceptions, Article 10.15 provides that nothing in Chapter 10 shall be construed to preclude a party from applying measures that it considers necessary for (i) the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or (ii) the protection of its own essential security interests.

4. Other FTAs/BITs That Should Be Referenced

The new ASEAN–China Investment Agreement should build on Chapter 10 of the RCEP, as it is a recently concluded agreement involving both ASEAN and China. However, other ASEAN and non-ASEAN FTAs and BITs should also be referred to in considering the expected content of the new ASEAN–China Investment Agreement insofar as they represent the desirable content of a contemporary investment agreement between ASEAN and China. We refer to four such agreements: (i) the ACIA, as it represents a common policy stance of the AMS; (ii) the European Union (EU)–Viet Nam Investment Protection Agreement,²¹ as a recent BIT concluded by an AMS and the EU; (iii) the EU–China Comprehensive Agreement on Investment, negotiations on which were concluded in principle in December 2020 (European Commission, 2020a); and (iv) the CPTPP investment chapter, as China applied for its accession.

4.1. ACIA

The ACIA aims at investment liberalisation, protection, investment promotion, and facilitation (Art. 2(a)).

4.1.1. Investment liberalisation

The ACIA conducts investment liberalisation by providing pre-establishment national treatment plus negative lists. Article 5.1 provides that each AMS shall accord to investors national treatment with respect to 'the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments'. Article 9 provides that Article 5 shall not apply to any existing measure that is maintained by an AMS, as set out in its reservations list in the Schedule (Art. 9.1).²² The ACIA provides for the progressive liberalisation of investment, as each AMS commits to reduce or eliminate the reservation list in accordance with a blueprint created to facilitate the development of the ASEAN Economic Community (AEC) (Art. 9.4).

²¹ The EU–Vietnam Investment Protection Agreement, signed on 30 June 2019, will enter into force after it has been ratified by all EU member countries (European Commission, 2020b).

²² For the schedule of reservations of each AMS, please visit the ACIA database (ASEAN, n.d.).

At the same time, the ACIA provides two avenues of escape from these commitments. First, for a period of 12 months after the date of submission of each AMS reservation list, an AMS may adopt any measures or modify any of its reservations for prospective applications to investors, provided that such measures or modifications shall not adversely affect any existing investors (Art. 10.1). Secondly, after the expiration of the 12-month period, an AMS may, by negotiation and agreement with any other AMS, adopt any measure, or modify or withdraw such reservations, provided that such measure, modification, or withdrawal shall not adversely affect any existing investors (Art. 10.2).

4.1.2. Investment protection

Article 6 of the ACIA provides that a host state must provide MFN treatment to investors and their covered investment either at the pre-establishment or post-establishment stage (Art. 6.1 and 6.2). As in the case of the ASEAN–China investment agreement and the RCEP, MFN treatment shall not apply to ISDS procedures that are available in other agreements to which AMS are party.²³

The FET clause of the ACIA resembles that of the ASEAN–China investment agreement. It provides for FET and full protection and security (Art. 11.1). FET requires not to deny justice in any legal or administrative proceedings (Art. 11.2(a)). A breach of another provision of the ACIA does not amount to a breach of FET (Art. 11.3).

On transfers, Article 13.1 of the ACIA provides that each AMS shall allow all transfers relating to a covered investment to be made freely and without delay into and out of its territory. It also provides for a number of exceptions which are similar to those of the ASEAN–China investment agreement and the RCEP, including the rights of a party under the IMF Articles of Agreement (Art. 13.3 and 4). Besides, the ACIA provides for the right of an AMS to adopt or maintain a restriction on payments or transfers related to investments in the event of serious balance-of-payments and external financial difficulties or the threat thereof, provided that the restrictions are consistent with the Articles of Agreement of the IMF (Art. 14.1 and 2(a)).

4.1.3. Investment promotion and facilitation

The ACIA provides for the promotion of investment (Article 24) and the facilitation of investment (Article 25). The former includes cooperation obligations through encouraging the growth and development of ASEAN small and medium-sized enterprises; organising investment missions; and organising briefings and seminars on investment opportunities and on investment law, regulations, and policies. The latter provides for best efforts obligations to (i) create the necessary environment for all forms

²³ See ACIA, footnote 4(a).

of investments, (ii) streamline and simplify procedures for investment applications and approvals, (iii) promote the dissemination of investment information, (iv) establish one-stop investment centres, (v) strengthen databases on investments for policy formulation, (vi) undertake consultation with the business community on investment matters, and (vii) provide advisory services to the business community of the other AMS. These are similar to those of the RCEP, but the ACIA provides for a few activities that are not listed under the RCEP, such as (vi) and (vii) above.

4.1.4. ISDS

The ACIA provides detailed rules for ISDS. Under Article 32, if an investment dispute has not been resolved within 180 days of receipt of a request for consultations by a disputing AMS, the disputing investor may submit a claim under the ISDS mechanism. The subject matter of such disputes is an alleged breach of Articles 5 (national treatment), 6 (MFN treatment), 8 (senior management and board of directors), 11 (treatment of investment), 12 (compensation in cases of strife), 13 (transfers), and 14 (expropriation and compensation) relating to the management, conduct, operation, or sale or other disposition of a covered investment (Art. 32(a)).²⁴

The disputing investors may use the following forums to submit their claims: (i) courts or administrative tribunals of the disputing AMS; (ii) arbitration under the International Centre for Settlement of Investment Disputes (ICSID) Convention or the ICSID Rules of Procedure for Arbitration Proceedings; (iii) arbitration under the ICSID Additional Facility Rules; (iv) arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules; (v) the Kuala Lumpur Regional Centre for Arbitration or any other regional centre for arbitration in ASEAN; or (vi) any other arbitration institution, subject to the agreement of the parties (Art. 33). As in the case of ISDS under the ASEAN–China investment agreement, if the investor wants to submit a dispute to arbitration, he has to meet other conditions, including: (i) the submission of the dispute must be within 3 years of the time at which the investor became aware of a breach of an obligation under the agreement; and (ii) prior to submitting the claim to arbitration, the investor has to give 90 days advance written notice to the host state (Art. 34(a) and (b)).

The ACIA provides detailed rules for the ISDS procedure, including the formation of an arbitral tribunal and the selection of arbitrators (Article 35), the conduct of the arbitration (Article 36), the consolidation of arbitration (Article 37), expert reports (Article 38), the transparency of arbitral proceedings (Article 39), the governing law (Article 40), and arbitral awards (Article 41).²⁵

²⁴ This means that an alleged violation of pre-establishment national treatment does not fall within the coverage of ISDS.

²⁵ For details of the ISDS procedure under the ACIA, see Chaisse and Jusoh (2016: 166–73).

4.1.5. Exceptions

The ACIA provides for balance-of-payment exceptions, general exceptions, and security exceptions. On balance-of-payments exceptions, Article 16 provides that an AMS may adopt or maintain restrictions on payments or transfers related to investments in the event of serious balance-of-payments difficulties.

The ACIA provides for general exceptions under Article 17. Based upon the chapeau of Article XX of the GATT, measures enacted to address certain public policy purposes cannot be claimed as violating the ACIA, provided that the measures are not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination (Art. 17.1). The exceptional public policy purposes include measures (i) necessary to protect public morals or to maintain public order; (ii) necessary to protect human, animal, or plant life or health; (iii) necessary to secure compliance with laws or regulations which are not inconsistent with the agreement; (iv) aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of investments or investors; (v) imposed for the protection of national treasures of artistic, historic, or archaeological value; and (vi) relating to the conservation of exhaustible natural resources.²⁶

Article 18 of the ACIA provides for security exceptions. It adopts a self-judging approach whereby an AMS may take any action which it considers contrary to its essential security interests, including but not limited to:

- (i) actions relating to fissionable and fusionable materials or the materials from which they derived;
- (ii) actions relating to the trafficking of arms, ammunition, and implements of war and to trafficking of other goods and materials for the purpose of supplying a military establishment;
- (iii) actions taken in time of war or other emergency in domestic or international relations; and
- (iv) actions taken to protect critical public infrastructure from attempts to disable or degrade them (Art. 18(b)).

4.2. EU–Viet Nam Investment Protection Agreement/FTA

The EU–Viet Nam Investment Protection Agreement, signed in October 2018, is analysed here as a recent investment agreement concluded by an AMS and the EU.

²⁶ Similar wording of Article XX of the GATT may allow us to refer to GATT/WTO dispute settlement cases when we interpret Article 17 of the ACIA. See Chaisse and Jusoh (2016: 142–49).

4.2.1. Investment liberalisation

As its title reflects, the EU–Viet Nam Investment Protection Agreement (IPA) provides for investment protection and does not provide for investment liberalisation. Article 2.3 provides for national treatment with respect to ‘the operation, management, conduct, maintenance, use, enjoyment and sale or other disposal of’ investments, and it does not cover the establishment of investments. On the other hand, the EU–Viet Nam Free Trade Agreement, signed on the same day, provides for investment liberalisation. It adopts a positive list approach. Its Appendix 8-B provides for Viet Nam’s liberalisation commitments in services sectors (Section A) and liberalisation commitments of investment in non-services sectors (Section B). This split of an investment-related agreement into two (IPA and FTA) was based on Opinion 2/15 of the Court of Justice of the European Union (CJEU), which ruled that most aspects of the FTA are within the EU’s exclusive competence, but provisions on portfolio investment and ISDS fall outside the common commercial policy and hence involve the shared competence between the EU and its member countries.²⁷

4.2.2. Investment protection

Chapter 2 of the EU–Viet Nam IPA provides for investment protection. It provides for national treatment (Art. 2.3), MFN treatment (Art. 2.4), and FET (Art. 2.5). On national treatment, it provides that each party shall accord national treatment to investors with respect to the operation of the covered investments (Art. 2.3.1). On MFN treatment, it provides that each party shall accord MFN treatment to investors with respect to the operation of the covered investments (Art. 2.4.1).

At the same time, it provides for certain carveouts of these treatments. On national treatment, Viet Nam may adopt or maintain any measure with respect to the operation of a covered investment, provided that such measure is not inconsistent with Appendix 8B, where such measure is (i) a measure that is adopted on or before the entry into force of the agreement; (ii) a measure referred to in (i) that is being continued, replaced, or amended after the entry into force of the agreement, provided that the measure is no less consistent with Article 2.3.1 after it is continued, replaced, or amended than the measure as it existed prior to its continuation, replacement, or amendment; or (iii) a measure not falling within (i) or (ii) provided that it is not applied in respect of, or in a way that causes loss or damage to, investments made before the entry into force of the agreement (Art. 2.3.2). In addition, Annex 2 of the EU–Viet Nam IPA provides for exemptions for Viet Nam on national treatment including, amongst others, (i) newspapers and news-gathering agencies, printing, publishing, radio, and television broadcasting; (ii) production and distribution of cultural products; (iii) production, distribution, and projection of television programmes and cinematographic works; and (iv) investigation and security, provided that such measure is not inconsistent with Annex 8-B.

²⁷ Opinion 2/15 of the CJEU dated 16 May 2017.

On MFN treatment, it does not apply to the following sectors: (i) communication services, except postal services and telecommunication services; (ii) recreational, cultural, and sporting services; (iii) fishery and aquaculture; (iv) forestry and hunting; and (v) mining, including oil and gas. As in the case of the ASEAN–China investment agreement, the RCEP, and the ACIA, the MFN treatment does not include dispute resolution procedures or mechanisms provided for in any other agreements (Art. 2.4.5).

On FET, the EU–Viet Nam IPA provides that each party shall accord FET and full protection and security to investors (Art. 2.5.1). FET requires not denying justice, amongst others (Art. 2.5.2). A breach of another provision of the agreement does not amount to a breach of FET (Art. 2.5.7).

4.2.3. Investment promotion and facilitation

The EU–Viet Nam IPA does not provide for investment promotion and facilitation.

4.2.4. ISDS

The EU–Viet Nam IPA provides detailed rules for the settlement of investment disputes. Instead of an ordinary ISDS procedure, it provides for a permanent investment court system (ICS), consisting of a tribunal (Art. 3.38) and an appeal tribunal (Art. 3.39). The EU has been trying to adopt the ICS in its FTAs, and the ICS was adopted in the Canada–EU Comprehensive Economic and Trade Agreement (CETA)^{28 29} and the EU–Singapore IPA.³⁰ The EU–Viet Nam IPA is the third EU agreement that adopts the ICS.³¹

There are a few differences in the structure of the ICS in these three agreements. While the tribunal in all three agreements shall hear cases in divisions consisting of three members of the tribunal, the number of the members differs – 15 in the case of the CETA (Art. 8.27.2), six in the case of the EU–Singapore IPA (Art. 3.9.2), and nine in the case of the EU–Viet Nam IPA (Art. 3.38.2). On the appointment of members of the tribunal, while the EU–Singapore IPA allows parties to directly appoint two members each (Art. 3.9.2), the CETA and the EU–Viet Nam IPA only permits the joint committees to appoint members.³²

²⁸ The CETA, signed on 30 October 2016, provisionally entered into force on 21 September 2017 (European Commission, 2016: Chapter 8, Section F, Art. 8.18–8.45).

²⁹ According to Opinion 2/15 of the CJEU, the part of the CETA relating to investment protection and the ICS has not entered into force, as it must be ratified by all EU member countries. See Kleimann and Küber (2018: 31).

³⁰ The EU–Singapore IPA, signed on 15 October 2018, will enter into force when it has been ratified by all EU member countries (European Commission, 2019: Art. 3.1–3.24).

³¹ The agreement in principle of the EU–Mexico Trade Agreement, dated 21 April 2018, also provides for the ICS. See European Commission (2018: Section [X]).

³² Art. 8.27.2 of the CETA; Art. 3.38.2 of the EU–Viet Nam IPA.

It is premature to conclude that the ICS will become a new normal for settling investment disputes. As Hsieh pointed out, Asian states have viewed the EU proposal as another ISDS-plus scheme, and could not agree to appreciate the added value of the ICS in comparison with existing ISDS rules under Asian agreements such as the ACIA and ASEAN Plus One FTAs (Hsieh, 2022: 49). The EU declared that ISDS is dead for the EU while negotiating with Japan. However, Japan declined to accept the ICS, so the EU–Japan IPA will be subject to ongoing talks despite the entry into force of the EU–Japan Economic Partnership Agreement in 2019 (Hsieh, 2022: 150).³³

4.2.5. Exceptions

The EU–Viet Nam IPA provides for a number of exceptions. It provides for taxation carveout (Art. 4.4), prudential carveout (Art. 4.5), general exceptions (Art. 4.6), and security exceptions (Art. 4.8). The taxation carveout allows parties to implement taxation agreements (Art. 4.4.1) and to implement any measure to prevent double taxation (Art. 4.4.3), amongst others. The prudential carveout allows parties to adopt or maintain measures for prudential reasons, such as protection of investors or depositors, and ensuring the integrity and stability of the financial system (Art. 4.5.1).

On general exceptions, Article 4.6 adheres to Article XX of the GATT. First, its chapeau requires that the measures listed as general exceptions be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised protection on covered investment. Secondly, it lists the objectives of such measures that are allowed even if they violate Article 2.3 (national treatment) or Article 2.4 (MFN treatment), including those (i) necessary to protect public security or public morals or to maintain public order; (ii) necessary to protect human, animal, or plant life or health; (iii) relating to the conservation of exhaustible natural resources; (iv) necessary for the protection of national treasures of artistic, historical, or archaeological value; and (v) necessary to secure compliance with law or regulations which are not inconsistent with Articles 2.3 and 2.4.

Security exceptions of the EU–Viet Nam investment agreement adopt a self-judging approach whereby a member state may take any action which it considers contrary to its essential security interests, including but not limited to:

- (i) actions connected with the production of or trade in arms, munitions, and war materials and relating to traffic in other goods and materials and to economic activities carried out directly or indirectly for the purpose of provisioning a military establishment;
- (ii) actions relating to the supply of services carried out directly or indirectly for the purpose of provisioning a military establishment;
- (iii) actions relating to fissionable and fusionable materials or the materials from which they are derived; or
- (iv) actions taken in time of war or other emergency in international relations (Art. 4.8(b)).

³³ See also Clifford Chance (2018: 3).

4.3. EU–China Comprehensive Agreement on Investment

The EU and China reached an agreement in principle for the EU–China Comprehensive Agreement on Investment (CAI) in December 2020. It provides for investment liberalisation (Section II), investment facilitation (Section III), investment and sustainable development (Section IV), and state-to-state dispute settlement (Section V). It does not provide for investment protection or ISDS. The EU and China agreed to negotiate these matters and endeavour to complete the negotiation within 2 years of the signature of the EU–China CAI (Section VI, Subsection 2: Final provisions, Art. 3). We will analyse its content on investment liberalisation, investment facilitation, investment and sustainable development, and exceptions.

4.3.1. Investment liberalisation

The EU–China CAI adopts a negative list approach. Section II of the agreement provides for general obligations on the prohibition of performance requirements (Art. 3), pre-establishment national treatment (Art. 4) and MFN treatment (Art. 5), and senior management and boards of directors (Art. 6); it also provides a reservation list of the nonconforming measures of each party in its annexes. Annex I lists nonconforming measures and their amendments to the extent that they do not decrease the conformity of the measures as they existed immediately before the amendment (Art. 7.1(c)). Annex II lists nonconforming measures that the parties adopt or maintain either before or after the entry into force of the agreement (Art. 7.2). China's Annex I has 36 entries, and its Annex II has 17 entries.

On the prohibition of performance requirements, Article 3 lists a few TRIMs-plus performance requirements, including (f) to transfer technology, and (i) to achieve a given percentage or value of research and development in its territory (Art. 3.1). A performance requirement of transferring technology is also prohibited as a condition for an advantage in connection with the establishment or operation of investment (Art. 3.2(f)).

4.3.2. Investment facilitation

The EU–China CAI provides detailed rules for investment facilitation. Section III, Subsection III-1 of the agreement provides rules on the conditions for licensing and qualification (Art. 2) and licensing and qualification procedures (Art. 3). Subsection III-2 provides for general transparency obligations (Art. 2), the publication of laws and regulations (Art. 3), contact points and provision of information (Art. 4), administrative proceedings (Art. 5), and review and appeal (Art. 6). It also provides for the participation of covered investors in the development of standards by central government bodies (Art. 7) and the transparency of subsidies (Art. 8).

These contents largely adhere to the negotiating text of the WTO structured discussions on investment facilitation for development (WTO, 2023), as both the EU and China are parties to the negotiations. It should be noted that the following AMS are also parties to the negotiations: Cambodia, Indonesia, the Lao PDR, Malaysia, Myanmar, the Philippines, and Singapore.³⁴

4.3.3. Investment and sustainable development

Section IV of the EU–China CAI provides for investment and sustainable development. It consists of four subsections. Subsection 1 provides the context and objectives, Subsection 2 provides for investment and environment, Subsection 3 provides for investment and labour, and Subsection 4 provides for a mechanism to address differences. Subsection 1 lists relevant international documents including the Agenda 21 on Environment and Development (1992) and the United Nations Agenda for Sustainable Development and its Sustainable Development Goals (2015) (Art. 1.1).

Subsection 2 recognises the right of each party to determine its sustainable development policies (Art. 1), provides for best efforts obligations of each party to ensure that its laws and policies provide for high levels of environmental protection (Art. 2.1), and provides that it is inappropriate to encourage investment by weakening or reducing the levels of environmental protection (Art. 2.2). It also provides for a general agreement to dialogue and cooperate on investment-related environmental issues (Art. 3), the commitment of effectively implementing multilateral environmental agreements (Art. 4), and the commitment of enhancing the contribution of investment to the goal of sustainable development (Art. 5). On investment and climate change, Article 6 provides that the parties shall promote and facilitate investment of relevance for climate change mitigation and adaptation.

Subsection 3 reiterates the right of each party to determine its sustainable development policies (Art. 1), provides for best efforts obligations of each party to ensure that its laws and policies provide for high levels of labour protection (Art. 2.1), and reiterates that it is inappropriate to encourage investment weakening or reducing the levels of labour protection (Art. 2.2). It also provides for a general agreement to dialogue and cooperate on investment-related labour issues (Art. 3), the commitment of effectively implementing the International Labour Organization (ILO) Conventions that they have ratified (Art. 4), and the agreement to promote investment policies which further the objectives of the Decent Work Agenda (Art. 5).

Subsection 4 provides for a mechanism to address differences. It consists of consultations (Art. 1), a panel of experts (Art. 3), reports of the panel, and follow-up consultations (Art. 4).

³⁴ See WTO (n.d.-a, n.d.-b).

4.3.4. Exceptions

Section VI, Subsection 2 of the EU–China CAI provides for exceptions. Article 9 provides for restrictions in case of balance of payments difficulties. Article 4 provides for general exceptions. It provides that Article XX of the GATT is incorporated in the agreement, *mutatis mutandis*, for the purpose of Section II, Subsection 1 (investment liberalisation), and Section III (regulatory framework). Article 10 provides for self-judging security exceptions. It provides that nothing in the agreement shall be construed to prevent a party from taking an action which it considers necessary for the protection of its essential security interests:

- (i) connected to the production of or traffic in arms, ammunition, and implements of war;
- (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
or
- (iii) taken in time of war or other emergency in international relations.

4.4. CPTPP investment chapter

The investment chapter of the CPTPP is relevant to our analysis because, first, several AMS³⁵ are parties to the CPTPP, and second, China has applied for membership. It provides for investment liberalisation, investment protection, ISDS, and exceptions. It does not provide for investment facilitation.

4.4.1. Investment liberalisation

The CPTPP adopts a negative list approach on investment liberalisation. It provides for pre-establishment national treatment (Trans-Pacific Partnership (TPP) Agreement, Art. 9.4.1)³⁶ and MFN treatment (Art. 9.5.1), general prohibition of performance requirements (Art. 9.10.1 and 9.10.2), and senior management and boards of directors (Art. 9.11), as well as a reservation list of the nonconforming measures of each party in the annexes. Annex I lists nonconforming measures and their amendments to the extent that they do not decrease the conformity of the measures as they existed immediately before the amendment (Art. 9.12.1). Annex II lists nonconforming measures that the parties adopt or maintain either before or after the entry into force of the agreement (Art. 9.12.2).

On the general prohibition of performance requirements, the CPTPP provides for a few TRIMs-plus performance requirements, including (f) to transfer a technology, and (i) to adopt a given rate or amount of royalty under a licence contract or a given duration of the term of a licence contract (Art. 9.10.1).

³⁵ Brunei, Malaysia, Singapore, and Viet Nam.

³⁶ The TPP, signed on 4 February 2016, as incorporated in the CPTPP (Cabinet Secretariat, Japan, n.d.).

4.4.2. Investment protection

On investment protection, the CPTPP provides for national treatment (Art. 9.4), MFN treatment (Art. 9.5), and FET (Art. 9.6). On national treatment, the CPTPP provides that each party shall accord to investors and covered investments national treatment with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments (Art. 9.4.1 and 9.4.2). Likewise, on MFN treatment, the CPTPP provides that each party shall accord to investors and covered investments MFN treatment with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments (Art. 9.5.1 and 9.5.2). The MFN treatment does not cover international dispute resolution procedures, such as ISDS (Art. 9.5.3).

On FET, the CPTPP provides that each party shall accord to covered investments treatment in accordance with customary international law principles, including FET and full protection and security (Art. 9.6.1). FET includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process (Art. 9.6.2(a)). A breach of another provision of the agreement does not amount to a breach of FET (Art. 9.6.3).

4.4.3. ISDS

Chapter 9, Section B of the TPP provides detailed rules on ISDS. If an investment dispute has not been resolved within 6 months of receipt by the respondent of a request for consultations, the claimant may submit the claim to arbitration under one of the following alternatives: (i) the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, (ii) the ICSID Additional Facility Rules, (iii) the UNCITRAL Arbitration Rules, or (iv) any other arbitral institution if the claimant and the respondent agree (Art. 9.19.4). No claim shall be submitted to arbitration if more than 3 years and 6 months have elapsed from the date on which the claimant first acquired knowledge of the breach (Art. 9.21.1). It has a fork-in-the-road provision, and the claimant's notice of arbitration is accompanied by his written waiver of any right to initiate or continue before any court or administrative tribunal under the law of the respondent (Art. 9.21.2(b)).

Chapter 9, Section B of the TPP provides detailed rules on ISDS regarding the submission of a claim to arbitration (Art. 9.19), selection of arbitrators (Art. 9.22), conduct of the arbitration (Art. 9.23), transparency of arbitral proceedings (Art. 9.24), governing law (Art. 9.25), consolidation (Art. 9.28), awards (Art. 9.29), and service of documents (Art. 9.30). At the same time, it must be noted that the coverage of the arbitration proceedings was narrowed down by the CPTPP. The annex to the CPTPP suspended the application of several provisions of Article 9.19 on the subject matter of arbitration to exclude claims that the respondent has breached an investment authorisation (Art. 9.19.1(a)(i)B) and 9.19.1(b)(i)(B)) or an investment agreement (Art. 9.19.1(a)(i)(C) and 9.19.1(b)(i)(C)) from arbitration.

4.4.4. Exceptions

Article 29.3 of the TPP provides for balance-of-payments carveouts. Chapter 9 of the TPP does not provide for general exceptions. However, footnote 14 of Chapter 9 provides that whether treatment is accorded in 'like circumstances' under Articles 9.4 (national treatment) and 9.5 (MFN treatment) depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.³⁷ Article 9.10.3(d) provides for exceptions to the prohibition of performance requirements that largely adhere to the general exceptions under Article XX of the GATT. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, the prohibition of performance requirements shall not be construed to prevent a party from adopting or maintaining measures, including environmental measures:

- (i) necessary to secure compliance with laws and regulations that are not inconsistent with this agreement;
- (ii) necessary to protect human, animal, or plant life or health; or
- (iii) related to the conservation of exhaustible natural resources.

Chapter 9 of the TPP does not provide for security exceptions. Instead, a general provision on self-judgement security exceptions is applicable to Chapter 9. Article 29.2 provides that nothing in this agreement shall be construed to preclude a party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

We analysed the content of six FTAs/BITs that are relevant to considering the desirable content of the new ASEAN–China Agreement on Investment. Table 2.1 is the synthesis of the analysis that compares the content of these six FTAs/BITs.

Table 2.1 Comparison of the Contents of Six FTAs/BITs

FTAs/BITs	Investment liberalisation	Investment protection	Investment facilitation	ISDS	Exceptions
ASEAN–China Agreement on Investment	N	Y	Y	Y	Y
RCEP	Y	Y	Y	Y	Y
ACIA	Y	Y	Y	Y	Y
EU–Viet Nam IPA	Y	Y	N	Y	Y
EU–China CAI	Y	Y	Y	Y	Y
CPTPP	Y	Y	N	Y	Y

Note:

N: the treaty does not include related provisions

Y: the treaty contains related provisions

³⁷ It does not elucidate what are the legitimate public welfare objectives.

Table 2.1a The Contents of Investment liberalisation

FTAs/BITs	Investment liberalisation
ASEAN–China Agreement on Investment	None
RCEP	<ul style="list-style-type: none"> • Pre-establishment national treatment with a negative list • hybrid approach on services liberalisation (China: positive list)
ACIA	<ul style="list-style-type: none"> • Pre-establishment national treatment with a negative list • progressive liberalisation in accordance with an AEC Blueprint • each AMS may modify its reservation list, provided that such modification shall not adversely affect any existing investors
EU–Viet Nam IPA	Positive list approach (Appendix 8-B of the EU–Viet Nam Free Trade Agreement provides for Viet Nam’s liberalisation commitments in services sectors (Section A) and investment in non-services sectors (Section B))
EU–China CAI	Negative list approach (reservation list of nonconforming measures (pre-establishment national treatment and MFN treatment, performance requirements, senior management, and boards of directors) in Annexes I and II)
CPTPP	Negative list approach (reservation list of nonconforming measures (pre-establishment national treatment and MFN treatment, performance requirements, senior management, and boards of directors) in Annexes I and II)

Table 2.1b The Contents of Investment protection

FTAs/BITs	Investment protection
ASEAN–China Agreement on Investment	<ul style="list-style-type: none"> • Post-establishment national treatment and MFN treatment (derogated by new measures) • MFN treatment not applicable to dispute settlement • FET (independent) • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET
RCEP	<ul style="list-style-type: none"> • Post-establishment national treatment and MFN treatment • MFN treatment not applicable to dispute settlement • FET (customary international law standard of minimum standard of treatment of aliens) • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET
ACIA	<ul style="list-style-type: none"> • Post-establishment national treatment and MFN treatment • MFN treatment not applicable to dispute settlement • FET (independent) • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET

FTAs/BITs	Investment protection
EU–Viet Nam IPA	<ul style="list-style-type: none"> • Post-establishment national treatment and MFN treatment • carveouts of national treatment (mass media and cultural sectors, investigation and security) • carveouts of MFN treatment (communications services, recreational, cultural and sporting services, fishery and aquaculture, forestry and hunting, and mining) • MFN treatment not applicable to dispute settlement • FET (independent) • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET
EU–China CAI	None (EU and China agree to complete the negotiation on investment protection within 2 years of the signature of the EU–China CAI)
CPTPP	<ul style="list-style-type: none"> • Post-establishment national treatment and MFN treatment • MFN treatment not applicable to dispute settlement • FET (customary international law standard minimum standard of treatment of aliens) • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET

Table 2.1c The Contents of Investment facilitation

FTAs/BITs	Investment facilitation
ASEAN–China Agreement on Investment	<ul style="list-style-type: none"> • Publication of investment laws/policies • enquiry points and one-stop investment centres
RCEP	<ul style="list-style-type: none"> • Investment promotion (organise joint investment promotion activities, promote business matching events) • investment facilitation (simplify investment application/approval procedures; promote the dissemination of investment information; contact points, one-stop investment centres; amicably resolve complaints)
ACIA	<ul style="list-style-type: none"> • Investment promotion (organising investment mission, briefings and seminars on investment opportunities, and investment laws and policies) • investment facilitation (streamline and simplify procedures for investment applications and approvals, one-stop investment centres, strengthen databases on investments for policy formulation, undertake consultation with the business community, and provide advisory services to the business community)
EU–Viet Nam IPA	None
EU–China CAI	Detailed rules for investment facilitation (conditions and procedures for licensing and qualification, publication of laws/regulations, contact point, administrative proceedings, review and appeal, participation of covered investors in the development of standards by central government bodies, and transparency of subsidies)
CPTPP	None

Table 2.1d The Contents of ISDS

FTAs/BITs	ISDS
ASEAN–China Agreement on Investment	<ul style="list-style-type: none"> • Arbitration concerning breach of substantive obligations • 6-month cooling-off period • 90 days advance notice • fork-in-the-road • 3-year limit
RCEP	Omitted (start negotiation on ISDS within 2 years after the entry into force of the agreement; negotiation shall be concluded within 3 years)
ACIA	<ul style="list-style-type: none"> • Arbitration concerning breach of substantive obligations • 6-month consultation period • 90 days advance notice • fork-in-the-road • 3-year limit
EU–Viet Nam IPA	Investment court system, consisting of tribunal, and appeal tribunal
EU–China CAI	None (EU and China agree to complete the negotiation on resolution of investment disputes within 2 years of the signature of the EU–China CAI)
CPTPP	<ul style="list-style-type: none"> • Detailed rules on ISDS • 6-month consultation period • 90 days advance notice • fork-in-the-road • 3 years 6 months limit • CPTPP excludes disputes arising from investment authorisations and investment agreement from the ISDS coverage

Table 2.1e The Contents of Exception

FTAs/BITs	Exception
ASEAN–China Agreement on Investment	<ul style="list-style-type: none"> • Measures to safeguard the balance of payments • general exceptions • self-judging security exceptions
RCEP	<ul style="list-style-type: none"> • Measures to safeguard the balance of payments • general exceptions (incorporate Article XX of the GATT, mutatis mutandis) • self-judging security exceptions
ACIA	<ul style="list-style-type: none"> • measures to safeguard the balance of payments • general exceptions (adhering to Article XX of the GATT) • self-judging security exceptions
EU–Viet Nam IPA	<ul style="list-style-type: none"> • Taxation (Art. 4.4); prudential carveouts (Art. 4.5) • general exceptions (Art. 4.6, adhering to Article XX of the GATT) • monetary policy/exchange rate policy carveout (Art. 4.7) • self-judging security exceptions (Art. 4.8)
EU–China CAI	<ul style="list-style-type: none"> • Measures to safeguard the balance of payments • general exceptions (incorporate Article XX of the GATT, mutatis mutandis) • self-judging security exceptions
CPTPP	<ul style="list-style-type: none"> • Measures to safeguard the balance of payments • legitimate public welfare policy carveout for national treatment and MFN treatment • exceptions to the prohibition of performance requirements (adhering to Article XX of the GATT) • self-judging general security exceptions (Art. 29.2)

ACIA = ASEAN Comprehensive Investment Agreement, AEC = ASEAN Economic Community, AMS = ASEAN Member State/s, ASEAN = Association of Southeast Asian Nations, BIT = bilateral investment treaty, CAI = Comprehensive Agreement on Investment, CPTPP = Comprehensive and Progressive Agreement for the Trans-Pacific Partnership, EU = European Union, FET = fair and equitable treatment, FTA = free trade agreement, GATT = General Agreement on Tariffs and Trade, IPA = Investment Protection Agreement, ISDS = investor–state dispute settlement, MFN = most favoured nation, RCEP = Regional Comprehensive Economic Partnership.

Source: Author.

5. Desirable content of the new ASEAN–China Investment Agreement

The new ASEAN–China Investment Agreement should build on the five recent FTAs and BITs involving ASEAN and China, as they reflect the policies of AMS and China on investment liberalisation, protection, and facilitation. This section explores the desirable content of the new ASEAN–China Investment Agreement in terms of five components: investment liberalisation, investment protection, investment facilitation, ISDS, and exceptions.

5.1. Investment liberalisation

The ASEAN–China investment agreement does not provide for investment liberalisation, as China did not agree to make commitments on investment liberalisation. However, China later changed this stance and agreed to make investment liberalisation commitments. The RCEP and the EU–China CAI provide for pre-establishment national treatment with a negative list. The new ASEAN–China Investment Agreement should, therefore, provide for pre-establishment national treatment with a negative list. The AMS and China should negotiate the contents of the negative lists as annexed to the new ASEAN–China Investment Agreement.

They should also negotiate the list of performance requirements prohibited under the new ASEAN–China Investment Agreement, as this accords foreign investors a wide range of discretion in making decisions in the operation of investments. Here again, the RCEP should be referred to as a baseline of negotiation, as both AMS and China are parties to it. Whether to add some RCEP-plus items to the list will be a matter of negotiation. Candidates can be found in the CPTPP, as it has a long list of the prohibition of performance requirements. Candidates include (i) a requirement to purchase, use, or accord a preference to technology of the party or of a person of the party (TPP, Art. 9.10.1(h)(i)); (ii) a requirement that prevents the purchase or use of, or according of a preference to, a particular technology (TPP, Art. 9.10.1(h)(ii)); and (iii) a requirement to adopt a given duration of the term of a licence contract (Art. 9.10.1(i)(ii)). Under the RCEP, a couple of TRIMs-plus requirements shall not apply to Cambodia, the Lao PDR, and Myanmar (RCEP, Art. 10.6.1). Whether to accord the same treatment to these three AMS under the new ASEAN–China Investment Agreement might be a matter of negotiation.

5.2. Investment protection

The five agreements analysed in this paper, except the EU–China CAI,³⁸ have similar provisions on investment protection. They provide for post-establishment national treatment, MFN treatment, and FET. They provide that MFN treatment shall not be applied to dispute settlement, including ISDS. They also provide that FET refers to the obligation not to deny justice, and that a breach of the agreement does not amount to a breach of FET. The new ASEAN–China Investment Agreement should follow these precedents for investment protection.

A difference exists as to whether to link FET to the customary international law minimum standard of treatment of aliens. While the RCEP and the CPTPP adopt this approach, the ACIA, the EU–Viet Nam IPA, and the EU–China CAI do not, characterising FET as a stand-alone standard of treatment. The intention of the former is to clarify that FET does not require treatment beyond what is required by the customary international law minimum standard of treatment of aliens. The new ASEAN–China Investment Agreement should follow this approach, so that it may exclude the possibility that FET requires treatment beyond what is required by the customary international law minimum standard of treatment of aliens.

5.3. Investment facilitation

Investment facilitation is a relatively new topic in international investment law. While the ASEAN–China investment agreement has a few simple provisions on investment facilitation, the RCEP, the ACIA, and the EU–China CAI provide detailed rules on investment facilitation. The new ASEAN–China Investment Agreement should follow the latter approach, all the more because the plurilateral negotiation on investment facilitation for development recently reached agreement in principle (WTO, 2023). Although Brunei, Thailand, and Viet Nam are not participating in the negotiations, they should think of joining them.

The WTO Investment Facilitation for Development Agreement consists of Section I: Scope and General Principles; Section II: Transparency of Investment Measures; Section III: Streamlining and Speeding Up Administrative Procedures; Section IV: Focal Points, Domestic Regulatory Coherence, and Cross-Border Cooperation; Section V: Special and Differential Treatment for Developing and Least-Developed Country Members; Section VI: Sustainable Investment; and Section VII: Institutional Arrangements and Final Provisions.³⁹ The new ASEAN–China Investment Agreement may incorporate the whole agreement by referring to it in the new ASEAN–China Investment Agreement.

³⁸ The EU–China CAI lacks provisions on investment protection. Article 3, Subsection 2 of Section VI provides that the parties agree to continue negotiations on investment protection.

³⁹ See WTO. (n.d.-a). The draft Agreement on Investment Facilitation for Development has not yet been published. WTO (2021) is an earlier version of the draft agreement.

5.4. ISDS

The new ASEAN–China Investment Agreement may have three options on ISDS: no provision, detailed rules on ISDS, or the ICS. The third option is adopted under the EU–Viet Nam IPA (Section 4.2.4) and the EU–Singapore IPA. As this option reflects the policy of the EU, it is not likely that the new ASEAN–China investment agreement will adopt it. It is more likely that the new ASEAN–China investment agreement will adopt the second option – detailed rules on ISDS. The ACIA and the CPTPP will be referred to, as the former represents the common policy of AMS and because China applied for accession to the latter. The two agreements have similar provisions on ISDS, including the 6-month consultation period, 90-day advance notice, fork-in-the-road provision on forum choice between domestic court and arbitration, and 3-year (and 6 months) limit for resorting to ISDS. A major difference is the subject matter coverage of ISDS, as the CPTPP excludes disputes arising from investment authorisations and investment agreements from the coverage of ISDS (Section 4.4.3 above). Judging from the provisions of the ACIA on ISDS (Section 4.1.4 above), AMS will support wider coverage of ISDS, comprising disputes arising from an alleged breach of national treatment, MFN treatment, and FET. China will also support it, as it supports ISDS with wide coverage in its recent BITs.⁴⁰

Another issue for consideration with respect to ISDS under the new ASEAN–China Investment Agreement will be the choice of forum for arbitration. The ACIA provides that the disputing investors may use the following forums to submit their claims to arbitration: (i) arbitration under the ICSID Convention or the ICSID Rules of Procedure for Arbitration Proceedings; (ii) arbitration under the ICSID Additional Facility Rules; (iii) arbitration under the UNCITRAL Arbitration Rules; (iv) the Kuala Lumpur Regional Centre for Arbitration or any other regional centre for arbitration in ASEAN; or (v) any other arbitration institution, subject to agreement of the parties (ACIA, Art. 33). To decide on the forum for arbitration under the new ASEAN–China Investment Agreement, the parties should agree on (iv) above, as China has a number of arbitration institutions.⁴¹ Although these institutions are primarily aimed at private commercial arbitration, some accept claims for ISDS.⁴² Whether to add these Chinese arbitration institutions to the list of regional arbitration centres in ASEAN will be the subject of negotiation.

⁴⁰ Li and Bian (2020: 519) characterise the ‘Third Generation Chinese BITs (Circa. 2007–2013)’ as ‘gravitated towards the US model that is more comprehensive and elaborate’.

⁴¹ China International Commercial Court (2022) lists 10 third-party arbitration institutions in China.

⁴² For instance, Beijing Arbitration Commission adopted arbitral rules governing investor–state arbitration proceedings on 4 July 2019, which entered into force on 1 October 2019. See Aceris Law (2021).

5.5. Exceptions

The ASEAN–China investment agreement provides for three categories of exceptions: (i) measures to safeguard the balance of payments, (ii) general exceptions, and (iii) security exceptions (Section 2.5). These three categories of exceptions are common to the five agreements that are analysed in this paper. It is therefore likely that the new ASEAN–China Investment Agreement will provide for these three categories of exceptions.

On general exceptions, it is common to the five agreements that they either incorporate, *mutatis mutandis*,⁴³ or modify⁴⁴ Article XX of the GATT. The new ASEAN–China Investment Agreement may take either approach, as there is no practical difference between them.

On security exceptions, it is common to the six agreements – including the ASEAN–China investment agreement – that they adopt self-judging security exceptions, allowing a wide range of discretion of the parties. It is also likely that the new ASEAN–China Investment Agreement will adopt the same approach.

Table 2.2 compiles the suggested content of the new ASEAN–China Investment Agreement.

Table 2.2 Suggested Content of the New ASEAN–China Investment Agreement

Issues	Suggested provisions
Investment liberalisation	<ul style="list-style-type: none"> • Pre-establishment national • treatment with a negative list • contents of the list subject to negotiation • RCEP-plus prohibition of performance requirements subject to negotiation • carveouts to Cambodia, the Lao PDR, and Myanmar subject to negotiation
Investment protection	<ul style="list-style-type: none"> • Post-establishment national treatment • MFN treatment and FET • MFT treatment not applicable to dispute settlement including ISDS • FET refers to the obligation not to deny justice • a breach of the agreement does not amount to a breach of FET • FET refers to the customary international law minimum standard of treatment of aliens
Investment facilitation	<ul style="list-style-type: none"> • Detailed rules on investment facilitation • the WTO Agreement on Investment Facilitation for Development may be incorporated when it is adopted

⁴³ The RCEP and the EU–China CAI adopt this approach. See Sections 3.5 and 4.3.4.

⁴⁴ The ACIA, EU–Viet Nam IPA, and CPTPP adopt this approach. See Sections 4.1.5, 4.2.5, and 4.4.4.

Issues	Suggested provisions
ISDS	<ul style="list-style-type: none"> • Detailed rules on ISDS; 6 month consultation period • 90 days advance notice • fork-in-the-road provision on forum choice between domestic court and arbitration • 3 years (and 6 months) limit for resorting to ISDS • whether to include regional and domestic arbitration institutions subject to negotiation
Exceptions	<ul style="list-style-type: none"> • Measure to safeguard the balance of payments • general exceptions (either incorporating, mutatis mutandis, or modifying Article XX of the GATT) • self-judging security exceptions

FET = fair and equitable treatment, GATT = General Agreement on Tariffs and Trade, ISDS = investor–state dispute settlement, MFN = most favoured nation, RCEP = Regional Comprehensive Economic Partnership, WTO = World Trade Organization.

Source: Author.

6. Conclusion

The ASEAN–China investment agreement, concluded in 2009, should be updated to reflect the recent challenges in the world, including the dramatic shifts in global and regional supply chains, the impact of the COVID-19 pandemic, and the adoption of advanced technologies in trade and investment facilitation. The new ASEAN–China Investment Agreement should take these challenges into account and provide a reliable legal basis for businesses. Enhanced investment liberalisation, clear and transparent provisions on investment protection, and detailed rules on investment facilitation are the three principal components. Detailed rules on ISDS will support investors of the contracting parties to settle investment disputes in a transparent and timely manner. On the other hand, each contracting party should be able to implement policies to pursue legitimate public welfare objectives, such as public health, financial stability, and national security. The expected content of the new ASEAN–China Investment Agreement satisfies these requirements and will become a reliable legal platform for businesses in ASEAN and China.

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Chapter 3

Issues on the ASEAN–China Free Trade Area

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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).

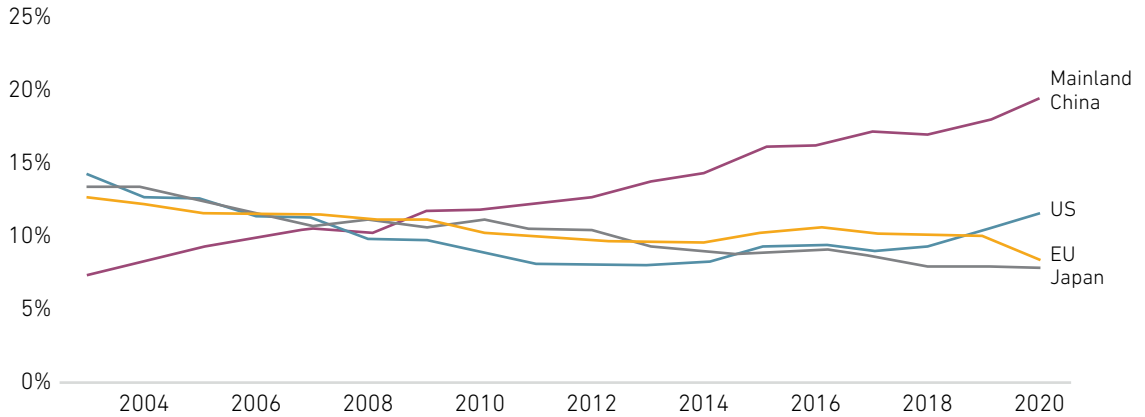
Logistics infrastructure is one of the prerequisites for foreign investors. AMS must continue to increase infrastructure investment to catch up with other countries.

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

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.¹ 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.

¹ 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

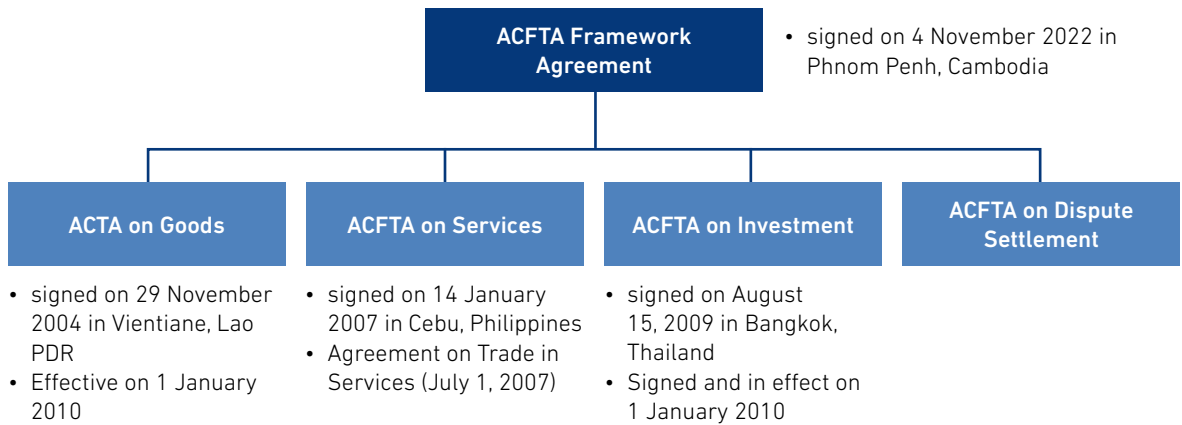
ASEAN and China signed a bilateral FTA at a time when they lacked FTA experience and know-how. The ACFTA is poor, both structurally and in terms of content. China's FTAs with Australia and Korea are better than the ACFTA, but compared with the CPTPP and the US–Mexico–Canada Agreement, the market access 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).

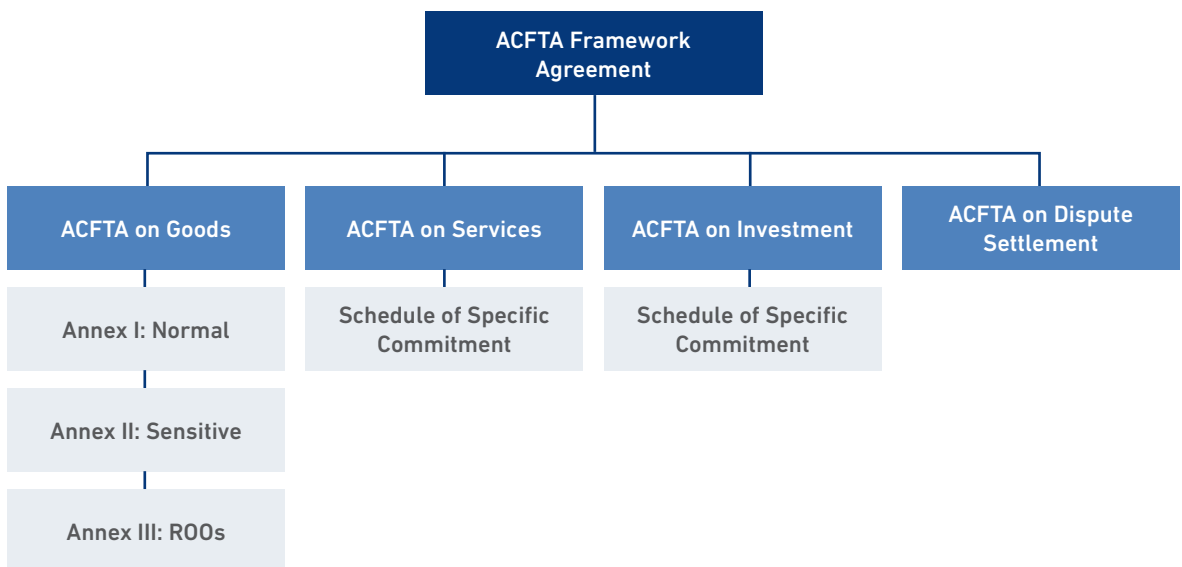
The agreement for goods organises the tariff elimination schedule of each member country in two annexes (I and II) according to their market opening sensitivity (normal, sensitive), and the rules of origin criteria for each item are presented in Annex III. In addition, specific commitments are written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

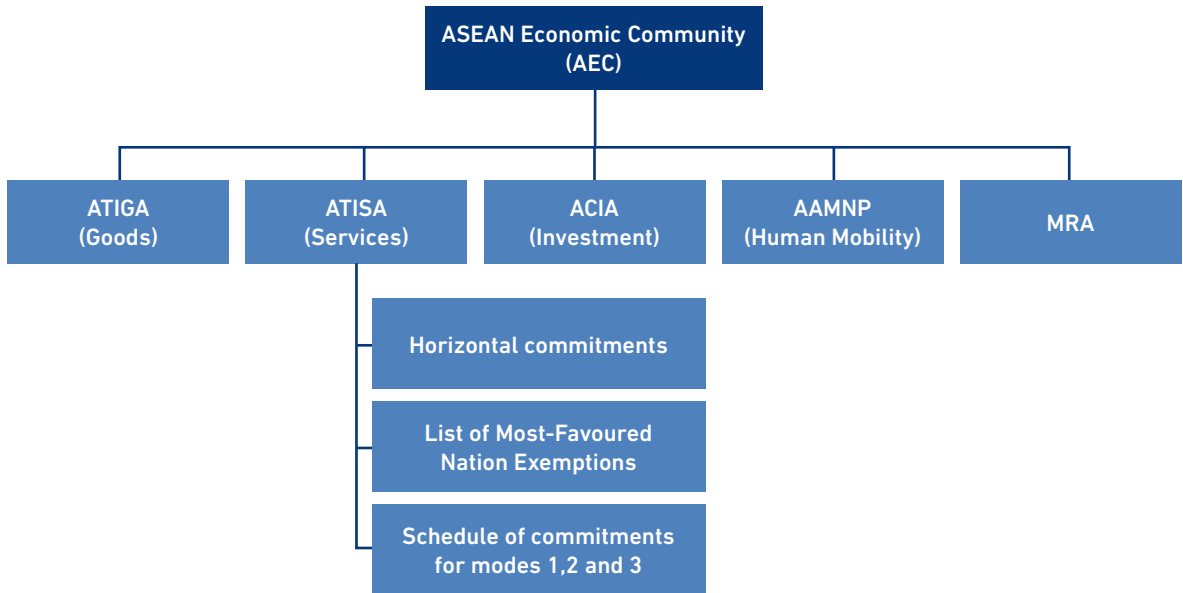
The scope of market opening and the tariff elimination schedule of the ACFTA should be advanced. An FTA cannot be described as ‘high-quality’ if the tariff elimination rate is not close to 100%. In addition, the extent of openness to services and investment should be expanded, and the protection of intellectual 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.

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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.

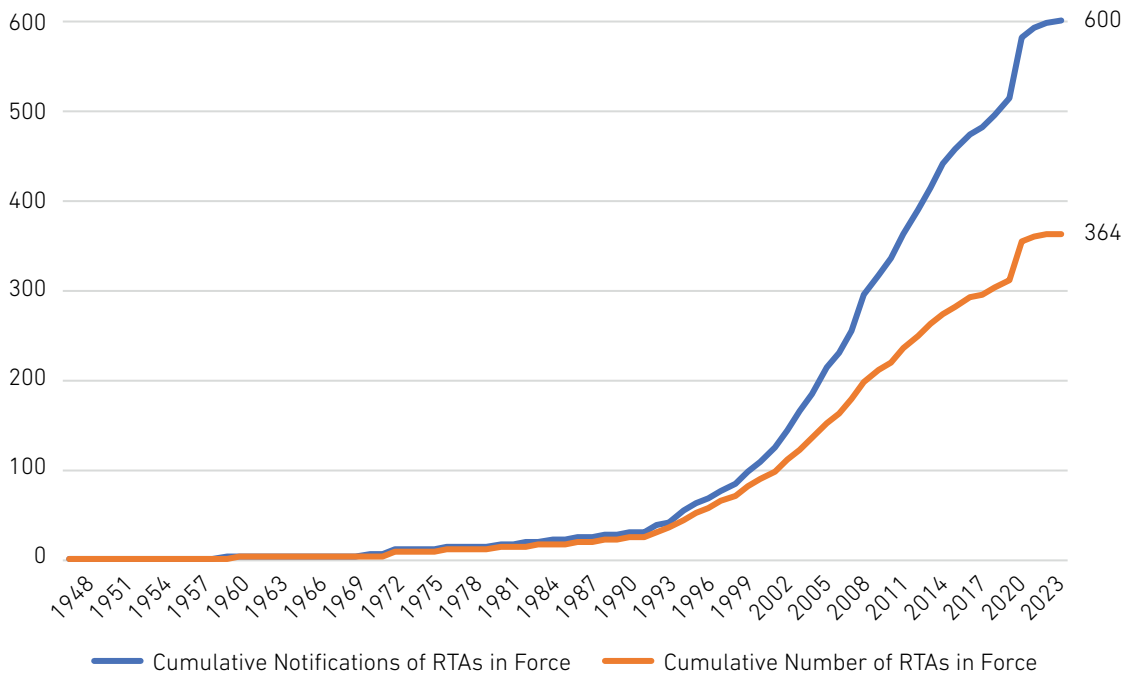
To conduct the quantitative analysis for this study, econometric methods are applied to estimate the economic impact of the ACFTA on ASEAN economies. The qualitative analysis involves collecting and analysing data on the perceptions and experiences of businesses, key persons, and other stakeholders in 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	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	0,7	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	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	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	0,7	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	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	1,1	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	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	0,8	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	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:

$$\ln \text{Export}_{ij} = \beta_0 + \beta_1 \ln \text{GDP}_i + \beta_2 \ln \text{GDP}_j + \beta_3 \ln \text{Dist}_{ij} + \varepsilon_{ij} \quad (1)$$

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.

$$\ln Y_{ijt} = \beta_0 + \beta_1 \ln \text{GDP}_{it} + \beta_2 \ln \text{GDP}_{jt} + \beta_3 \text{POP}_{it} + \beta_4 \text{Dist}_{ij} + \beta_5 \ln \text{POP}_{jt} + \beta_6 \ln \text{Xr}_{it} + \beta_7 \ln \text{Xr}_{jt} + \beta_8 \text{Comlang}_{ij} + \beta_9 \text{Comcol}_{ij} + \beta_{10} \text{ACFTA}_{ijt} + \varepsilon_{ijt} \quad (2)$$

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	LnGDP _i and LnGDP _j	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	LnPop _i and LnPop _j	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	LnEX _i and LnEX _j	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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Chapter 5

Thailand's Perspective

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1. Introduction

The Association of Southeast Asian Nations (ASEAN) and China established a dialogue relationship in 1991. In 2003, the parties raised the level of their relations to the Strategic Partnership for Peace and Prosperity. In terms of economic relations, the ASEAN–China Free Trade Area (ACFTA), which is ASEAN’s first free trade agreement (FTA) with an external partner, came into effect in 2003 for the Early Harvest Programme. During the last 2 decades, ASEAN–China bilateral trade has expanded more than tenfold, reaching US\$669 billion in 2021. China is ASEAN’s largest trading partner and the second largest non-ASEAN investor.

Recent changes in the global environment, including the United States (US)–China economic tensions, digital transformation, the need to implement the 2030 Agenda for Sustainable Development, and the coronavirus disease (COVID-19) pandemic, which resulted in supply chain disruption, have become trade and investment issues pertinent to businesses. It is necessary to examine the issues that the ACFTA 3.0 needs to consider, including how to solve the ACFTA’s implementation challenges and add new areas of cooperation to become a new, modern, and comprehensive FTA. The upgraded ACFTA will improve the existing economic linkages between ASEAN and China, thereby supporting ASEAN and China growth and prosperity.

The purpose of this study is to identify impediments and potential areas of improvement for the ASEAN–China FTA, as well as potential mutually beneficial areas for further cooperation between ASEAN and China.

2. Impacts of the ACFTA on ASEAN Economic Development

Economic partnership between ASEAN and China has been developed since 2001, with an agreement to implement an ASEAN–China FTA within 10 years. Since its inception, six elements have been included in the framework of cooperation, according to Chirathivat (2002):

- (i) Trade and investment facilitation measures, which cover a wide range of issues such as the removal of non-tariff barriers, mutual acceptance of standards and conformity assessment procedures, and the promotion of trade in services.
- (ii) Provision of technical assistance and capacity building, particularly to new ASEAN Member States (AMS), to expand their trade with China.
- (iii) Positive consideration in terms of promotion measures, consistent with the World Trade Organization rules, to be given to non-World Trade Organization AMS.
- (iv) Expansion of cooperation in various areas, such as finance, tourism, agriculture, human resources development, industrial cooperation, intellectual property rights, environment, and energy.

- (v) Establishment of an ASEAN–China FTA within 10 years, with special and differential treatment given to Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam.
- (vi) Establishment of appropriate institutions between ASEAN and China to carry out the framework of cooperation.

As part of the cooperation framework, the ACFTA was established with the main target of eliminating tariffs¹ by January 2010. This can be considered as the starting point of the fully functioning ACFTA. The agreement has been assessed in many studies. Since the early years of the agreement, Chirathivat (2002) expected that the ACFTA would bring net gains to both parties. Computable general equilibrium (CGE) simulation analysis using the Global Trade Analysis Project (GTAP) database shows that this strategic move should cause more trade creation than trade diversion, with positive welfare gains for both ASEAN and China. Many studies conducted along the ACFTA growth path found positive welfare outcomes (Chirathivat, 2002; Kitwiwattanachai, Nelson, and Reed, 2010; Lakatos and Walmsley, 2012; Li, Scollay, and Maani, 2016). The ACFTA was also expected to create structural changes in AMS and China because of the exploitation of comparative advantage in the agreement commitments (Yang and Chen, 2008).

During the development of the ACFTA in the past 2 decades, some research has pointed out that, for ASEAN and East Asia, regional trade agreements (e.g. The East Asia Free Trade Area or the ASEAN Free Trade Area) tend to generate higher trade volume and welfare gains than bilateral trade agreements (e.g. the ACFTA or the ASEAN–Korea FTA) (Kitwiwattanachai, Nelson, and Reed, 2010). Nonetheless, expanding ASEAN regional trade agreements to include more collaboration from non-partners, especially the large economies in Asia, will always bring benefits in terms of trade volume and welfare gain to all economies involved. Focusing on sectoral trade caused by the ACFTA, Yang and Martinez-Zarzoso (2014) showed that the trade effects of the agreement are positive not only within ASEAN and China but also with trading partners outside the bloc. The study also showed that the top four sectors receiving benefits from trade creation are other manufactured goods, chemical products, machinery and transport equipment, and agricultural products, respectively. These results were confirmed by Tham and Yi (2014), especially in terms of trade creation in manufactured goods.

The benefits of these continuous relationships are demonstrated statistically. China is ASEAN's most important trading partner, in terms of both exports and imports. This could be due in part to the agreement. As indicated in Table 1, China was only marginally surpassed by the US in terms of export value with ASEAN, accounting for a share of almost 15%. Moreover, China is the top destination for ASEAN imports, with a share of almost 23% (Table 5.1).

¹ Except the sensitive list and highly sensitive list.

Table 5.1 ASEAN Top 5 Destinations of Exports and Imports of Goods, 2022

Country/Region	Exports		Country/Region	Imports	
	Value (US\$ billion)	Share (%)		Value (US\$ billion)	Share (%)
ASEAN	449.8	22.9	ASEAN	406.6	21.6
United States	290.9	14.8	China	431.3	22.9
China	290.8	14.8	Korea	141.9	7.5
EU-27	176.4	9.0	Japan	135.3	7.2
Japan	133.3	6.8	United States	129.5	6.9

ASEAN = Association of Southeast Asian Nations, EU = European Union, US = United States.

Source: ASEAN (n.d.), ASEANStats Data Portal. <https://data.aseanstats.org> (accessed 5 April 2024).

When examining trade in goods between China and ASEAN, it becomes evident that China plays a crucial role in ASEAN's trade dynamics for various commodities. Table 5.2 demonstrates that ASEAN's international markets rely heavily on the Chinese economy. The trading value between China and ASEAN accounted for more than 20% of export and import trading values for several commodities. In terms of ASEAN's exports, these items include Harmonized System (HS) 72 iron and steel, HS39 plastics and articles, HS29 organic chemicals, and HS08 fruits and nuts. These commodities constitute a significant portion of ASEAN's exports to China, indicating its reliance on the Chinese market. On the import side, the notable items are HS85 electrical machinery, HS84 machinery and mechanical appliances, HS39 plastics and articles, HS72 iron and steel, HS73 iron and steel articles, HS29 organic chemicals, HS38 chemical products, and agricultural goods such as HS15 and HS08. These imports highlight ASEAN's dependence on China for electrical machinery, fuel, machinery, chemical products, and agricultural goods.

The trading patterns mentioned above indicate the strong economic interconnection between China and ASEAN, with China being a crucial trading partner for AMS. This underscores the significance of the China–ASEAN trade relationship and its impact on the economies of both parties.

Table 5.2 Top 5 Traded Goods Between China and ASEAN, 2022

HS	Commodity	Value (US\$ billion)	Share of ASEAN total exports of the product (%)
Exports			
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	89.4	16.0
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	29.2	12.6
72	Iron and steel	20.3	42.2
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	20.0	10.5
39	Plastics and articles thereof	12.2	22.7
Imports			
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	136.7	28.3
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	68.0	35.2
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	19.5	5.8
39	Plastics and articles thereof	19.3	28.3
72	Iron and steel	17.1	28.7

ASEAN = Association of Southeast Asian Nations, HS = Harmonized System..

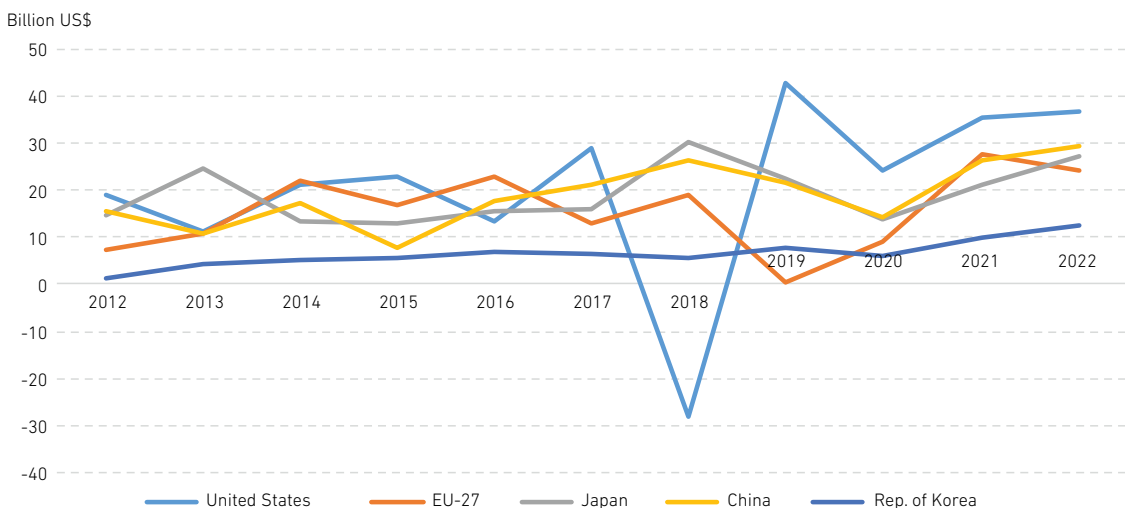
Source: ASEAN (n.d.), ASEANStats Data Portal. <https://data.aseanstats.org> (accessed 5 April 2024).

China has also been one of Thailand’s primary trading partners for the past decade. According to statistics published by the Bank of Thailand, China’s share in Thailand’s total trade has experienced a notable increase – rising from 13.4% of Thailand’s trade in 2012 to 19.2% in 2021.

Investment generation is one of the expected by-products of the ACFTA. Lakatos and Walmsley (2012) assessed this effect by using a dynamic CGE model (GTAP database), compared with static CGE, while Li, Scollay, and Maani (2016) assessed the topic using the gravity model. The results from both studies show that the overall impacts of the ACFTA will be positive on investment flows for both parties. Moreover, Li, Scollay, and Maani (2016) showed that the stimulation of foreign direct investment (FDI) caused by the ACFTA includes both horizontal and vertical FDI in both directions. The authors also found that the positive effect of the ACFTA on FDI comes mainly from the 2005 agreement on trade liberalisation in goods, which also helped develop production networks because more vertical FDI accompanies the trade liberalisation of intermediate goods. Lakatos and Walmsley (2012) also showed that the impact of the ACFTA will cause a significant investment creation effect (and an insignificant investment diversion effect). However, the detailed results have shown that the gains are not uniformly distributed within ASEAN. Significant benefits, in terms of an economic boost and an increase in rates of return on investment, are shown on liberalising members of ASEAN. In addition, Li and Maani (2018) studied the impacts of the ACFTA on FDI for China’s manufacturing industry and found the existence of market-seeking FDI and the vertical fragmentation effect in China.

Statistics on investment show that the value of FDI inflows from China to ASEAN has been steadily increasing over the last decade. As indicated in Figure 1, FDI inflows from China (including Chinese mainland and Hong Kong SAR) to ASEAN have nearly doubled, from around US\$15.7 billion in 2012 to nearly US\$29.4 billion in 2022, making China the second largest source of FDI to ASEAN of the year.

Figure 5.1 Flows of Inward FDI to ASEAN by Source Country, 2012–2022



ASEAN = Association of Southeast Asian Nations, EU = European Union, FDI = foreign direct investment.

Source: ASEAN (n.d.), ASEANStatsDataPortal. <https://data.aseanstats.org> (accessed 31 January 2024).

By value of investment, the ASEAN industries receiving Chinese FDI are highly concentrated in manufacturing, communication, real estate, logistics, and finance. These are just a few of the numerous areas that are seeing an increase in FDI from China.

On the downside of the ACFTA, in addition to the previously mentioned negative implications, such as the uneven distribution of benefits from the agreement, another drawback for the agreement is regarding labour wage inequality. According to the findings of Kitwiwattanachai, Nelson, and Reed (2010), countries with abundant unskilled labour (such as China) will benefit from the agreement, whereas countries with a high number of skilled workers (such as Japan and the Republic of Korea (henceforth, Korea)) are expected to have worse real wage inequality. Moreover, lack of communication from the macroeconomic level to individual enterprises leads to limited understanding and utilisation of the agreements. Furthermore, many AMS are concerned about Chinese products flooding their markets, which might result from potentially unbalanced trade between ASEAN and China, as well as amongst AMS (Jianren, 2012).

3. Good Practices and Lessons When Implementing the ACFTA

Following the implementation of the ACFTA through the Early Harvest Programme in 2003 and the official launch of the ACFTA in 2010, total trade between ASEAN and China increased from US\$64 billion in 2003 to US\$236 billion in 2010, and then reached US\$669 billion in 2021. The tenfold increase in ASEAN–China bilateral trade has demonstrated stronger economic relations.

According to The Department of International Trade Promotion of Thailand (DITP)², the ACFTA utilisation rate increased rapidly from 88.57% in 2018 to 109.29% in 2022. With a utilisation rate of more than 80%, the ACFTA was one of Thailand's top three utilised FTAs by 2022.

This makes the ACFTA one of Thailand's highest performing FTAs because of its high utilisation rate. During the first quarter of 2023, the ACFTA's utilisation rate was 86.53%, with 53.85% coming from the manufacturing sector and 46.15% coming from the agricultural sector. The following are the most utilised categories under the ACFTA:

- (i) Rubber products (13%)
- (ii) Cassava (10%)
- (iii) Durian (7%)
- (iv) Cassava starch (5%)
- (v) Fresh fruits (longan, lychee, rambutan) (3%)

² <https://tax.dtn.go.th/en/calculate>

- (vi) Frozen meat (3%)
- (vii) Sugar (3%)
- (viii) Coconut (2%)
- (ix) Aluminium scape (2%)

The implementation of the ACFTA unveils two important lessons: non-tariff measures (NTMs) and trade facilitation. Interviews with Thai businesses disclosed issues pertinent to these two areas of trade. The first difficulty is with trademarks. Some Thai businesses must deliver their products to the Chinese market through a specific vendor that has registered the Thai product's trademark in China, even if the trademark is Thai. One of the interviewees suggested that there should be mutual recognition in this matter.

The second issue relates to cross-border transit. Shipments are required to undergo processing at border customs checkpoints and pass inspections. However, difficulties may arise when these checkpoints have limited opening hours or when only a few are operational. In addition, some customs checkpoints may be newly established and lack sufficient facilities to facilitate efficient border transportation.

The third issue is about the lack of procedure transparency. One business person referred to a case in which their company identified a Chinese certification agency for containers exporting to China, only to find that the containers had to be certified by another body in China. This caused a delay in transportation.

4. Evolution of ASEAN's Regional Policy Towards China

China is one of ASEAN's 11 Dialogue Partners, with diplomatic relations established since the start of the dialogue in 1991. Their collaboration was promoted to the Strategic Partnership for Peace and Prosperity in 2003. In 2018, the ASEAN–China Strategic Partnership Vision 2030 was commemorated as a future direction for building an open, inclusive, and sustainable world of peace, security, and common prosperity (ASEAN, 2018).

In terms of economic cooperation, the ASEAN–China Strategic Partnership Vision 2030 intends to strengthen economic cooperation between ASEAN and China for a mutually advantageous future. ASEAN and China want to improve trade, investment, and tourism flows between the two parties by implementing and upgrading the ACFTA. New areas of cooperation are being promoted, such as e-commerce, intellectual property rights, and clean energy. The two parties also intend to increase physical and institutional connections, as well as to deepen collaboration in areas such as financial cooperation; maritime economic cooperation; and science, technology, and innovation (ASEAN, 2018).

The dialogue relationship between ASEAN and China continues to grow, and the parties' economic relationship has grown in terms of trade, investment, tourism flows, and connectivity. The year 2023 marks the 20th anniversary of the ASEAN–China Strategic Partnership and the 32nd anniversary of ASEAN–China Dialogue Relations.

Deepening and broadening economic relations between ASEAN and China can be seen from both the regional and national levels. At the regional level, the ACFTA was the first FTA with an external party. In 2002, China and AMS signed the Framework Agreement on Comprehensive Economic Cooperation, which formed the legal basis for the creation of the ACFTA.

The ACFTA includes three agreements aimed at facilitating the free flow of goods, services, and investments. First, the ASEAN–China Trade in Goods Agreement proposes tariff reductions and tariff line removal. Second, the Agreement on Trade in Services aims to liberalise and substantially eliminate discriminatory measures in various service industries. Third, the Investment Agreement seeks to promote and facilitate investment flows within China and the ASEAN region. This agreement includes provisions to assure fair and equitable treatment for investors, non-discriminatory treatment in the case of nationalisation or expropriation, and compensation for losses.

The ACFTA 1.0 was established in 2010, with zero tariffs covering more than 90% of both parties' taxed items. The ACFTA 2.0, the upgraded version, was released in 2019 with expanded market access for both sides. Chinese leaders proposed the development of the ACFTA 3.0 at the ASEAN–China Special Summit to Commemorated the 30th Anniversary of ASEAN–China Dialogue Relations in November 2021 (Global Times, 2022). The ACFTA upgrade negotiations are intended to ensure that the ACFTA contributes to the further development and expansion of ASEAN–China economic relations, as well as the post-pandemic economic recovery of both regions.

The Regional Comprehensive Economic Partnership (RCEP) strengthens the ties of AMS and China. According to the ASEAN–China Strategic Partnership Vision 2030, this is one of the accomplishments between the two parties. ASEAN and China completed negotiations on a modern, comprehensive, high-quality, and mutually beneficial RCEP agreement with Australia, Japan, Korea, and New Zealand, which came into force on 1 January 2022. The RCEP marked the successful launch of the world's largest free trade area and represented a new milestone for East Asian economic integration.

At the national level, Singapore and Cambodia are developing bilateral FTAs with China. On 23 October 2008, Singapore and China signed the China–Singapore Free Trade Agreement (CSFTA), China's first comprehensive bilateral FTA concluded with an ASEAN economy. Singapore and China intend to advance the ACFTA's liberalisation of goods trade and further liberalise services trade. The CSFTA was upgraded in 2018 to improve the standard of rules in trade facilitation, rules of origin, economic and technological cooperation, and e-commerce. In 2020, the two parties upgraded the agreement again to support further liberalisation of service trade and investment using the negative list model.

Singapore and China announced in April 2023 that substantive negotiations on the FTA upgrade were completed, which will improve market access for each other's businesses and provide for more transparent and high-level economic rules. Both parties agreed to elevate their bilateral relationship to an 'all-round, high-quality future-oriented partnership' (Xinhua News Agency, 2023). This is the first time China has adopted the negative list approach for services and investment liberalisation in FTAs (MOFCOM, 2023). The CSFTA upgrade is critical in accelerating the ongoing negotiations for the ACFTA 3.0, further upgrading of the RCEP, and laying an institutional foundation for China's application to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), of which Singapore is a member (Xuanmin and Jingyi, 2023).

Despite calls by the US for decoupling, Singapore's upgrade of the CSFTA shows that it is committed to deeper cooperation with China. Singapore and China also work together to promote regional integration and supply chain stability through the implementation of the RCEP and the establishment of the New International Land–Sea Trade Corridor, which serves as a significant trade route between western Chinese provinces and AMS. Singapore and China will both benefit from the multiple effects of synergies created by improved regional economic, trade, and investment linkages, as well as the resumption of connectivity and people-to-people contacts (Xuanmin and Jingyi, 2023).

The Cambodia–China Free Trade Agreement (CCFTA) is the second Chinese bilateral FTA with an ASEAN economy, whereas it is Cambodia's first bilateral FTA. This agreement was signed in 2020 and came into effect on 1 January 2022. Cambodia and China agreed to cooperate in a comprehensive strategic partnership and jointly build a community with a shared future. Cambodia is also cooperating in the joint construction of the Silk Road Economic Belt and the 21st Century Maritime Silk Road (Medina, 2021).

The CCFTA covers a wide range of sectors, including trade, tourism, investment, transportation, and agriculture. Over 90% of tariff lines in bilateral trade in goods have zero tariffs. Although most of the trade between Cambodia and China is tariff-free under the ACFTA, the CCFTA extends tariff-free trade to over 340 items, including seafood products, garlic, cashew nuts, and dried chilli. Cambodia seeks to benefit from an increase in bilateral trade with China through the CCFTA to partially compensate for the loss of Everything but Arms status from the European Union (EU) in 2020 (Medina, 2021).

Cambodia intends to leverage and improve its agriculture industry by utilising Chinese manufacturing or product efficiency. Since 2010, Beijing has been Cambodia's top source of development aid, particularly financing for agriculture-related projects. Another advantage Cambodia hopes to gain from the CCFTA is the attraction of Chinese tourists (Medina, 2021).

5. Suggested Issues for the ASEAN–China 3.0 Talks

Aside from increasing trade and investment liberalisation and facilitation, AMS must focus on new areas of cooperation for the ACFTA 3.0 negotiations. ASEAN and China face several common development challenges, including an increasing risk of global recession, the acceleration of supply chain and value chain restructuring, digital and green transformation, and the implementation of the United Nations (UN) Sustainable Development Goals (SDGs) by 2030.

Given this situation, ASEAN and China could enhance comprehensive cooperation to foster regional economic recovery and build a shared future. This could be achieved by focusing on strengthening macroeconomic policy cooperation, enhancing trade and investment, bolstering supply chain resilience, improving customs systems interconnectivity, facilitating cross-border flows, investing in sustainable and green infrastructure, and promoting digital integration. Furthermore, the two parties should deepen supply chain and value chain integration, as well as participate in the green transition and develop the digital economy. Improving physical and digital connectivity between the two areas is required for free flow of goods, services, capital, and labour (CIKD, 2023).

The new areas of cooperation that should be included in the ACFTA 3.0 are the digital economy, the green economy/sustainable development, supply chain resilience, and trade facilitation.

5.1. Digital economy

Digital technology has transformed how we engage in economic activities, including production, consumption, trading, and investment. Countries across the world recognise the importance of digital transformation and its impact on economic activity and competitiveness. Because of its widespread impact on all economic sectors and social development via digital technology and infrastructure, the digital economy is increasingly regarded as the engine of economic growth – increasing capital and labour productivity and fostering global value chain participation.

ASEAN and China are highly complementary in the development of the digital economy, and both may benefit from extensive opportunities for cooperation (CIKD, 2023). ASEAN is one of the fast-growing digital economies, with gross merchandise value doubling from US\$102 billion in 2019 to US\$194 billion in 2022. In 2025, the value is expected to reach US\$330 billion. Furthermore, an additional 100 million internet users have joined the internet since 2020, resulting in an estimated 460 million internet users in 2022 (Google, Temasek, and Bain & Company, 2022). ASEAN needs to develop its digital economy, and the region's large market for the digital economy and digital infrastructure provides opportunities for foreign enterprises and investors.

China is a global leader in digital industrialisation, including cross-border trade, digital infrastructure, and digital payments, and it has significant comparative advantages in industrial digitisation, including the industrial internet of things and intelligent manufacturing (CIKD, 2023). China's digital economy is growing rapidly and plays an important role in the new global economic structure. In 2021, China was the world's second largest digital economy, accounting for US\$7.1 trillion, after only the United States, which had a value of US\$15.3 trillion (Chu, 2023). Based on this, ASEAN and China may foster successful collaboration to support each other in their endeavours to develop their digital economies.

According to López González and Jouanjean (2017), governments must prioritise data flows, digital connectivity, and interoperability when developing trade policies. This is because digital trade is all about data transfer, and countries must be linked to connect and move data. Interoperability is also important for international connection since businesses must be able to connect across borders to operate in multiple countries.

Digital connectivity is a critical step in the development of the digital economy. Countries must build digital infrastructure, digital skills, and data protection and cybersecurity rules and regulation. In connecting the markets, both parties must be able to connect, communicate, and complete digital transactions (Herman and Oliver, 2021). Although ASEAN's overall digital development level is satisfactory, there is significant variation between countries, with the Lao PDR and Myanmar struggling to embrace digital transformation (Table 5.3).

Table 5.3 Stages of Digital Development in ASEAN Member States

Country	Infrastructure & access			Internet usage	Enablers & barriers	
	Network coverage: percentage of population covered by at least 4G mobile network, 2019	Mobile phone ownership: individuals owning a mobile phone, 2019 (% of population)	Mobile and fixed broadband subscriptions: active mobile broadband subscriptions per 100 inhabitants, 2019	Percentage of population using the internet, 2019	ICT prices: mobile broadband basket as a percentage of GNI per capita, 2020	ICT skills (basic skills, standard skills, advanced skills), 2019 (% of population with a skill level)
Brunei	95	94	148	95	0.3	60, 36, 28
Cambodia	80	33 ^a	96	41	1.6	29, 3, 1
Indonesia	98	64	81	48	1.3	60, 20, 4 ^b
Lao PDR	43 ^a	n.a.	49	26 ^b	2.4	n.a.
Malaysia	87	96	127	84	0.9	59, 51, 8
Myanmar	75 ^a	62 ^b	93 ^a	24 ^b	1.0	n.a.

Country	Infrastructure & access			Internet usage Percentage of population using the internet, 2019	Enablers & barriers	
	Network coverage: percentage of population covered by at least 4G mobile network, 2019	Mobile phone ownership: individuals owning a mobile phone, 2019 (% of population)	Mobile and fixed broadband subscriptions: active mobile broadband subscriptions per 100 inhabitants, 2019		ICT prices: mobile broadband basket as a percentage of GNI per capita, 2020	ICT skills (basic skills, standard skills, advanced skills), 2019 (% of population with a skill level)
Philippines	80 ^a	79	68 ^b	43	1.4	6, n.a., 1
Singapore	100	88	156	89	0.4	54, 36, 7
Thailand	98	88 ^b	87	67	1.2	21, 9, 1
Viet Nam	97	n.a.	72	69	1.0	n.a.

ASEAN = Association of Southeast Asian Nations, GNI = gross national income, ICT = information and communication technology, n.a. = not available.

^a Data from 2018, as data from 2019 were unavailable.

^b Data from 2017, as data from 2019 were unavailable.

Sources: Sermcheep (2022).

Cross-border e-commerce is a significant digital trade area in which ASEAN and China can collaborate. Despite the resumption of offline shopping and e-commerce businesses' increased focus on profitability, ASEAN's e-commerce continues to develop. The value of ASEAN's e-commerce is expected to reach US\$211 billion in 2025 (Google, Temasek, and Bain & Company, 2022). The rapid expansion of e-commerce presents opportunities for the creation of new technologies that respond to market demand, which could lead to the transformation of the digital economy. AMS should seize opportunities for further collaboration in the digital economy (Sefrina, 2023). Furthermore, there is room for additional e-commerce expansion because ASEAN's e-commerce accounts for only 3%–5% of total retail sales in 2020, whereas e-commerce in China accounts for nearly 30% (Thongsaichon, 2020). As a result, an e-commerce chapter should be included in the ACFTA 3.0.

The COVID-19 pandemic provided an opportunity to deepen regional cooperation in the digital economy, and this will lead to digital economy integration. According to Sefrina (2023: 2), 'digital economy integration does not necessarily mean the removal of trade barriers, but rather a platform for digital economy interoperability in a secure environment'.

The commitments to digital economy integration can be categorised into three groups: (i) market access, such as customs duties, the movement of natural persons, and access to data; (ii) rules and regulations, such as intellectual property rights, competition, and personal data protection; and (iii) facilitation, including paperless trade, digital signatures, and digital authorisation (Yean, 2021).

The elements of e-commerce to be included in the ACFTA can be drawn from existing initiatives relating to the digital economy. Table 4 summarises the digital-related clauses in major digital economy agreements, including the United Kingdom–Singapore FTA; the Singapore–Australia FTA; the Digital Economic Partnership Agreement (DEPA) amongst Singapore, New Zealand, and Chile; the CPTPP; the RCEP; and the ASEAN Agreement on Electronic Commerce (Sefrina, 2023). The first three digital economy agreements (DEAs) – notably the United Kingdom–Singapore DEA, the Singapore–Australia DEA, and the DEPA – are new DEAs that address growing and crucial issues, including artificial intelligence. A DEA for ASEAN and China could be built on the RCEP because it is the most recent commitment made by both parties on the digital economy.

Table 5.4 Comparison of Digital-Related Clauses in Major Digital Economy Agreements

Item	UKSDEA	SADEA	DEPA	CPTPP	RCEP	AAEC	Other	New DEA
Digital trade provisions commitments to facilitate digital trade	✓	✓	✓	✓	✓	✓		
No customs duties on electronic transmissions	✓	✓	✓	✓	✓		5	3
Non-discrimination of digital products	✓	✓	✓	✓	✓		4	3
Domestic electronic transactions framework	✓	✓	✓	✓	✓	✓		
Electronic authentication and signatures	✓	✓		✓	✓	✓		
Cross-border transfer of information by electronic means	✓	✓	✓	✓	✓	✓		
Paperless trading	✓	✓	✓	✓	✓	✓		
Electronic invoicing	✓	✓	✓				3	3
Electronic payments	✓	✓	✓			✓		
Express shipments	✓	✓	✓	✓			3	2
Online consumer protection	✓	✓	✓	✓	✓	✓		
Cooperation on competition policy	✓	✓	✓				3	3
Personal information protection	✓	✓	✓	✓	✓	✓		
Unsolicited commercial electronic messages	✓	✓	✓	✓	✓		5	3
Submarine telecommunications cable systems	✓	✓					2	2
Location of computing facilities for financial services	✓	✓					2	2
Data innovation	✓	✓	✓				3	3
Open government data	✓	✓	✓				3	3
Source code	✓	✓		✓			3	2
Digital identities	✓	✓	✓				3	3

Item	UKSDEA	SADEA	DEPA	CPTPP	RCEP	AAEC	Other	New DEA
Standards and conformity assessment for digital trade	√	√					2	2
Artificial intelligence	√	√	√				3	3
Fintech and Regtech cooperation	√	√	√				3	3
Dispute settlement	√	√	√	√	√	√		
Number of Clauses	23	24	19	13	10	9		

AAEC= ASEAN Agreement on Electronic Commerce, ASEAN=Association of Southeast Asian Nations, CPTPP= Comprehensive and Progressive Agreement for Trans-Pacific Partnership, DEA=Digital Economy Agreement, DEPA=Digital Economy Partnership Agreement, RCEP=Regional Comprehensive Economy Partnership, SADEA= Singapore-Australia Digital Economy Agreement, UKSDEA= United Kingdom-Singapore Digital Economy Agreement.

Notes: In the 'Other' column, shaded figures indicate what is not addressed in four of five agreements other than the AAEC. The shading in the 'New DEA' column indicates what is not addressed in the RCEP or CPTPP but is Addressed in all three new DEAs (UKSDEA, SADEA, and DEPA)

Source: Author, based on Elms (2022), Sawatari (2022), and Sefrina (2023).

The e-commerce chapter in the ACFTA 3.0 should at least include the aspects referred in the RCEP.

Thus, the e-commerce chapter should include:

- Trade facilitation: paperless trading, electronic authentication, and electronic signatures
- Online consumer protection
- Online personal information protection
- Domestic regulatory frameworks
- Data issues
- Customs duties
- Small and medium-sized enterprise (SME) cooperation
- Transparency
- Cybersecurity
- Cross-border e-commerce
- Cooperation: digital infrastructure development, capacity building, and sharing of information, experience, and best practices
- Dispute settlement

These items address the three aspects of digital economy integration – market access, rules and regulations, and facilitation.

It is difficult for the ACFTA to establish the same level of binding rules and regulations as those found in agreements like the CSFTA, the United Kingdom–Singapore DEA, the Singapore–Australia DEA, and the DEPA, since AMS are at different stages of development. Thus, the ACFTA should have grace provisions and provide technical assistance for some AMS.

Furthermore, ASEAN is laying the foundation for an integrated ASEAN digital economy as outlined in the Bandar Seri Begawan Roadmap of 2021, through the ASEAN Digital Economy Framework Agreement. The development of ASEAN's digital economy integration could supplement the ACFTA's digital economy integration.

Potential benefits and costs to ASEAN and China

1. A digital economy agreement between ASEAN and China could help govern cross-border e-commerce. In contrast to the traditional trade chapter, which focuses on market access, a digital-related commitment would encourage domestic regulatory reforms and soft cross-border collaboration on issues such as digital identities, cybersecurity, consumer protection, and digital inclusion (Warren and Fan, 2022). These are necessary developments to permit the expansion of cross-border e-commerce and digital transactions, which serve as part of a new engine of growth for the region.
2. As ASEAN and China's e-commerce become more connected, AMS digital connectivity will improve, and the value of digital transactions will rise. This readiness in the digital economy and economic potential could attract non-AMS to invest in the region.
3. Thailand's large enterprises have opportunities to participate in the global market, and Thai micro, small, and medium-sized enterprises could gain access to a larger market. Micro, small, and medium-sized enterprises benefit the most from consistent and interoperable digital regulations (Warren and Fan, 2022).
4. As business opportunities increasingly rely on digital means, and governments are unable to guarantee universal access or develop digital skills, some groups may experience a digital divide and be unable to participate and benefit from this integration.

Some foreseeable challenges

1. The disparity in the development of digital connectivity throughout the ASEAN region could pose difficulties regarding digital economy integration. Infrastructure development (universal access, affordable, and seamless connectivity) is necessary, as well as interoperability, capacity building, and data governance (rules and regulations on data movement, localisation, and personal data protection that are aligned and consistent with those at the international level).
2. Digital economy integration involves providing a platform for digital economy interoperability in a secure environment (Sefrina, 2023). To truly integrate the digital economy, countries may need to revise and reform domestic regulations, where necessary, to align them with international and regional best practices.

Policy suggestions

1. To drive negotiations forward on this issue, AMS should emphasise the shared benefits that this agreement will provide. It will be necessary to do research on the potential impact of the ACFTA's digital economy integration on ASEAN and China. Since AMS are at different levels of development, having the same binding clauses for all AMS creates difficulties for some countries. Thus, preparing technical assistance for some countries, as in the RCEP, is needed to move these negotiations forward. Furthermore, emphasis on consumer protection and building trust are critical for growth in this area.
2. Issues related to the digital economy should be in the upgrade of the agreement. However, since many issues are beyond the remit of the agreement, AMS should prioritise implementation of the ASEAN Digital Economy Framework

2.1. Data collection and update on digital economy integration readiness

AMS and China are at different levels of digital development. Some AMS are more prepared than others to implement the agreement. It is necessary to assess specific countries' readiness. The ASEAN Digital Integration Index, established with the assistance of the United States Agency for International Development, is an example of an index that can assess the readiness of AMS, thus providing insights into the readiness of each AMS. This index is built on six pillars: (i) digital trade and logistics, (ii) privacy and cybersecurity, (iii) digital payments and identities, (iv) digital skills and talent, (v) innovation and entrepreneurship, and (vi) institutional and infrastructure readiness. The non-existence of a necessary legal framework should be noted as well because the absence of certain rules and regulations, such as personal data protection, can slow down the process (Sefrina, 2023).

2.2. Technical assistance

Data on countries' readiness is critical for designing appropriate interventions or technical assistance for countries in need. Such assistance could take the form of other members sharing their knowledge, experience, and best practices to improve infrastructure development, capacity building, and assistance with digital rules and regulations.

2.3. Flexible timeline

Since AMS are at various levels of digital development, and the agreement on digital economy issues represents a commitment for all 10 AMS and China, some countries require a grace period to adjust.

2.4. Roles of government and the private sector

The development of the digital economy requires the cooperation of both the public and private sectors. As an investor and service provider, the private sector drives the digital economy, while the government creates an environment that encourages and supports technological investment and growth. Infrastructure and access to services issues that may impede digital economy integration can be addressed by the private sector. Public–private sector involvement and public–private partnerships could be a starting point for addressing the issues mentioned above (Sefrina, 2023).

5.2. Green economy

According to the Global Risk Report 2023 (World Economic Forum, 2023), the risk profile for the next 10 years concentrates on environmental risk rather than other types of risk. Environmental risk factors include failure to mitigate climate change, failure to achieve climate change adaptation, natural disasters and extreme weather events, and biodiversity loss and ecosystem collapse. The Paris Agreement was signed in 2015 at the UN Climate Change Conference (COP 21) and has been in force since 2016. Adopted by 196 parties, the Paris Agreement is a legally binding international treaty on climate change. According to the agreement, ‘Its overarching goal is to hold “the increase in the global average temperature to well below 2°C above pre-industrial levels” and pursue efforts “to limit the temperature increase to 1.5°C above pre-industrial levels”’ (United Nations, n.d.).

Several recent summits have underlined the increasing importance of environmental risk compared with a decade ago. The SDGs or the Global Goals serve as a prime example of global cooperation. Adopted by the UN in 2015, they represent a universal initiative aimed at reducing poverty, promoting peace and prosperity, and safeguarding the planet. The private sector has also promoted awareness in doing business in terms of profit, people, and the planet. The 2021 UN Climate Change Conference (COP 26) raised commitments amongst member nations for a carbon-neutral economy and net zero emissions. Without implementation amongst countries by the private and public sectors, climate change will cause serious natural disasters such as floods, biodiversity loss, food insecurity, global warming, and likely new kinds of pandemics.

The EU has taken climate change and environmental degradation seriously and has introduced the European Green Deal to tackle the environmental risk. It aims to transform the EU into a modern, resource-efficient, and competitive economy. The European Commission proposed EU policies to reduce net greenhouse gas (GHG) emissions by at least 55% below 1990 levels by 2030. The policy tools are related to NTMs, financial support, renewable energy and environmental taxation, new manufacturing and agricultural production processes, research and innovation, and more efficient logistics. The European Green Deal aims to provide current and future generations with a better quality living environment, clean energy, food security, efficient transportation, clean technology, a recycle–reuse–repair system, and competitive and resilient industry.

China also underlined its commitment towards the green economy in the 11th Five-Year Plan (2006–2010). The plan aims to use renewable energy sources to limit environmental pollution. China later included seven major targets for reducing pollutant emissions, improving drinking water sources and quality, controlling the pollution caused by hazardous chemicals and dangerous waste, improving urban environmental infrastructure operations, reversing ecological deterioration, improving nuclear safety, and enhancing environmental regulatory institutions. Again, the overall objective is to reduce carbon emissions, achieve efficient energy consumption, and undertake reforestation.

In 2020, President Xi Jinping announced that China would reduce carbon emissions at a pace ahead of its commitment by reaching the carbon emissions target in 2030 and carbon neutrality by 2060. In 2021, China introduced (i) the Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy, and (ii) the Action Plan for Reaching Carbon Dioxide Peak Before 2030. China's policy framework is known as the 1+N Policy Framework, where 1 represents the working guidance and N refers to an unspecified number of auxiliary policy documents targeting specific industries, regions, fields, and goals. In 2022, China's State Council issued the Guiding Opinions on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System, which set broader goals for China's transition towards a green economy (Table 5.5).

Table 5.5 China's Transition to Green, Low-Carbon, and Circular Economy – Key Tasks

Goals	Tasks
Improving the production system	<ul style="list-style-type: none"> • Promoting green upgrading of industries • Accelerating green development of agriculture • Improving the level of green development of the service industry • Expanding green and environmental protection industries • Improving the recycling level of industrial parks and industrial clusters • Building a green supply chain
Improving the circulation system	<ul style="list-style-type: none"> • Creating green logistics • Strengthening the recycling of renewable resources • Establishing a green trade system • Promoting the consumption of green products • Advocating a green and low-carbon lifestyle
Improving the consumption system	<ul style="list-style-type: none"> • Promoting the consumption of green products • Advocating a green and low-carbon lifestyle
Accelerating the green upgrading of infrastructure	<ul style="list-style-type: none"> • Promoting the green and low-carbon transformation of the energy system • Promoting the construction and upgrading of urban environmental infrastructure • Improving the green development of transportation infrastructure • Improving the urban and rural living environment

Goals	Tasks
Building a market-oriented green technology innovation system	<ul style="list-style-type: none"> • Encouraging research and development of green and low-carbon technologies • Accelerating the transformation of scientific and technological achievements
Improving a system of laws, regulations, and policies	<ul style="list-style-type: none"> • Strengthening the support of laws and regulations • Improving the price mechanism for green charges • Increasing fiscal and tax support • Vigorously developing green finance • Improving green standards, green certification system, and statistical monitoring system • Cultivating green trading market mechanism

Source: Zhou and Huld (2022).

According to Zhou and Huld (2022), foreign investors can participate in three aspects of this process. First, they can avail of new opportunities for emerging economic partners regarding FDI in innovation and technologies to assist China during the transition towards a green economy. These include green goods and services and green energy, as well as carbon emissions reduction. Second, foreign investors can help upgrade the existing investment, operation, and supply chain for efficient production processes with low energy consumption, low pollution emissions, and a recycle–reuse process. Products and services can carry the green certified mark. Last, China needs to achieve compliance with international standards on green products and services. Its laws, regulations, and standards must meet global green standards or trading partners' regulations and standards, such as the European Green Deal. Firms' satisfaction of environmental, social, and governance (ESG) requirements must be documented for international trade and investment.

For ASEAN, Han et al. (2022) evaluated the green development level within AMS. The findings showed that there are differences between a high degree and low degree of green development amongst AMS. Countries with a low or modest degree of green development have problems with low economic growth and environmental preservation, whereas countries with a high degree of green development can enjoy the benefits of a high-level coordinated development economy, society, and environment. ASEAN needs to perform capacity building for coordination of green development. An example at the firm level is the ASEAN Comprehensive Recovery Framework, which includes the transition towards a green and circular economy via SMEs. SMEs will be promoted as engines for green economic recovery and growth. The challenge is to provide SMEs with financial access, regulatory compliance, and updated information. During the 33rd ASEAN Senior Officials' Meeting on Environment in 2023, the secretary of state at Cambodia's Ministry of Environment stated that AMS are focused on environmental work, green economy development, smart cities, sustainable infrastructure, and comprehensive economic recovery, centred on sustainable production and consumption. Green economy development is the focus of ASEAN for the next decade.

Thailand and the green economy

In dealing with the green economy, a taxonomy is required to provide a common framework for classifying economic activities for stakeholders, market participants, regulators, and policymakers to understand the definition, processes, standards, qualifications, and promotion required to achieve sustainability goals. Using this framework, a country can then achieve the SDGs, ESG, a bio-circular green economy model (BCG), and carbon emissions targets. The EU's taxonomy includes climate change mitigation, climate change adaptation, the sustainable use and protection of water resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. ASEAN's taxonomy is based on climate change mitigation, climate change adaptation, the preservation of healthy ecosystems and biodiversity, the promotion of resource resilience, and the transition to a circular economy. The Thai taxonomy is expected to align with the EU taxonomy.

Thailand, with the cooperation of the private and public sectors, has defined a national taxonomy classification of economic activities according to sustainability level. The guiding principles are to support the transitional period to achieve the sustainability objectives, to prevent greenwashing, and to bring national standards into line with global standards. The Thailand Taxonomy Board, which was established to handle this matter, consists of representative agencies such as the Bank of Thailand, the Securities and Exchange Commission, the Office of Insurance Commission, the Federation of Thai Industries, the Eastern Economic Corridor (EEC) Board, the Thailand Greenhouse Gas Management Organization, and the Ministry of Energy. The first phase of the implementation of the taxonomy classification relates to the energy and transportation sector, with 23 activities and the objective of climate change mitigation. The next phase will cover GHG emissions activities, at least in the manufacturing and agricultural sectors. The design of the related taxonomy measures and activities will be based on environmental science. The implementation of the taxonomy will follow a traffic-light system: green for activities that clearly and substantially contribute to GHG emissions mitigation; amber for activities that contribute to a credible transition towards green, in line with the national determined contributions; and red for activities that have no climate-aligned goals or that are out of scope for a credible transition. The colour code will specify whether an activity is eligible or not.

A detailed description of the first phase, involving the energy and transport sectors, is given below.

- **Energy sector** – includes solar energy generation; wind energy generation; hydropower energy generation; geothermal-based energy generation; bioenergy generation; natural gas energy generation; marine energy generation; electricity generation from renewables to non-fossil, gaseous, and liquid fuels; cogeneration of heating, cooling, and power using renewable sources of energy production for heating/cooling using waste heat; the installation and operation of electric heat pumps; heating and cooling distribution transmission and distribution networks for renewable and low-carbon gases, including green hydrogen storage of electricity thermal energy and green hydrogen; and the transmission and distribution of electricity.

- **Transport sector** – includes transport via railways, other passenger land transport, urban and suburban passenger land transport, freight transport by road, enabling infrastructure for low-emissions transport, sea and coastal water transport, inland water transport, retrofitting of sea and coastal freight, and passenger water transport.

Additionally, the principles of Do No Significant Harm and Minimum Safeguard Measures aim to ensure that the operational activities undertaken for environmental purposes must not affect social dimensions such as human rights, labour rights, gender equality, and more.

The Thailand Board of Investment (BOI) and Eastern Economic Corridor (EEC) play important roles in promoting FDI in Thailand as well as establishing new green industries. The BOI focuses on investment promotion and the provision of tax incentives, which have become major tools in attracting FDI. The new investment promotion strategy (2023–2027) is set to restructure the Thai economy in three areas: (i) innovation, technology, and creativity; (ii) competitiveness and the ability to adapt quickly; and (iii) inclusiveness for environmental and social sustainability. In addition to tax incentives, the BOI will promote the provision of tax and non-tax benefits, integrate investment support tools, facilitate service providers, connect and build industry networks, and create more business opportunities. For green technology, the BOI concentrates on carbon capture, utilisation, and storage in three main industries: (i) electric vehicles, (ii) a full spectrum of upstream electronics, and (iii) digital infrastructure and transformation for business operators.

It is worthwhile noting that nine new investment promotion programmes became effective on 3 January 2023: (i) the promotion of targeted industries, (ii) the competitive enhancement programme, (iii) the retention and expansion programme, (iv) the relocation programme, (v) investment stimulation measures and economic recovery, (vi) the smart and sustainable industrial upgrade programme, (vii) investment promotion for SMEs, (viii) area-based promotion measures, and (ix) the social and local development investment programme. The new BOI strategies are about restructuring industries and strengthening supply chains, accelerating industrial transformation to smart and sustainable industries, enhancing the competitiveness of SMEs and start-ups and connecting to the global market, and promoting investment based on the potential of each area to generate inclusive growth. The priority industries are BCG, electric vehicles, smart electronics, and the digital and creative industries.

The EEC is an area-based development initiative for transforming Thailand's traditional industries into new advanced industries. The new advanced industries consist of modern agriculture, biorefineries, modern automotives, aviation, robotics, and more. The BCG strategy is applied to the EEC's energy consumption, resource and waste management, and business ecosystem. The corridor aims to achieve net zero emissions with green energy and carbon credit trading. The EEC also plans to achieve international standards of production under the green and circular economy, such as ISO 14021/14024/14025, to upgrade the overall business ecosystem.

Here, Electric Vehicle industry provides an example of the green economic model. The production of electric vehicles comprises electric motorcycles, hybrid electric vehicles, plug-in hybrid electric vehicles, and battery electric vehicles (BEVs). BEVs rely only on batteries to operate. BEVs will be our focus since this study relates to the Green Economic (Pure green) model. The major automobile manufacturers in ASEAN, which mostly produce internal combustion engine (ICE) vehicles, are located in Thailand (1.6 million units), Indonesia (1.1 million units), Malaysia (0.5 million units), and Viet Nam (0.2 million units). (ASEAN Briefing, 2019)

The shift from ICE to electric vehicles is a challenge for Thailand as the ICE automobile industry is sizeable – it employs nearly 1 million workers and generates a large amount of export income. The technology as well as research and development come from FDI, and knowledge transfer is limited. First-tier investment is mostly from Japanese and European firms, while local Thai firms play the role of supporting manufacturers, known as second- and third-tier firms. In 2023, the Federation of Thai Industries expects ICE automobile production to reach 1.95 million units, with 1.05 million units serving the export market. On the demand side, although domestic demand in Thailand can absorb nearly half of the automobile production, the export of automobiles and parts is very high and is ranked amongst the top five Thai export products. Therefore, to transform the ICE industry into a BEV industry in Thailand, we need new investment from firms that have experience in BEVs, likely from China, with local BEV demand to support the new investment initiatives. To attract FDI and create local demand, some government incentives are crucial. Currently, AMS compete to promote BEV production and lack business cooperation.

On the ASEAN demand side, according to a McKinsey report quoted in Tham (2023), BEV adoption as a percentage of total new passenger vehicles was 0.7%, 0.3%, and 0.1%, respectively, for Thailand, Malaysia, and Indonesia in 2021. Singapore also has high demand, in second place after Thailand, but is not likely to be a production base. Thailand is therefore the fastest growing purchaser of BEVs and is moving towards becoming the electric vehicle production hub in the region. To attract FDI for BEV industrial development, some AMS have introduced government promotional policies to create demand and/or supply.

To transform the ICE automobile industry into a BEV industry, the regional value chain (RVC) must be analysed throughout the whole process, i.e. acquiring raw materials, securing adequate technology and its knowledge transfer, attracting FDI, developing an efficient production line, creating sizeable market demand, and establishing efficient services such as charging stations. Since no single AMS can complete the BEV production chain alone, the RVC must be developed amongst AMS together with China, Korea, and/or Japan.

Chinese manufacturers are more advanced in BEV production technology than manufacturers in Korea or Japan. China has 94 electric vehicle brands, including both established and start-up firms, with a sizeable domestic market. According to Counterpoint (2023), sales of passenger BEVs and plug-in

hybrid electric vehicles in China increased by nearly 87% year on year in 2022. BYD, Wuling, Chery, Changan, and GAC are some of the top Chinese producers. China also has a wide range of electric vehicle start-ups such as Nio, Xpeng, Neta, AITO, IM Motors, Zeeker, Aiways, and Livan, which are performing well.

Japanese car companies tend to develop more advanced automobiles (e.g. hydrogen cars) rather than BEVs, while Korean producers have been relatively slow in developing the electric vehicle industry, with only a few brands. However, Japan still has a long way to go in developing the hydrogen car industry. Therefore, the development of BEV production in ASEAN is likely to rely heavily on China, and the ACFTA will be the basis of ASEAN–China RVC success. Nonetheless, ASEAN will welcome FDI from Japan and Korea when new technology is available, utilising the ASEAN–Japan Comprehensive Economic Partnership, the ASEAN–Korea Free Trade Area, or the RCEP.

Tham (2023) mapped BEV production in ASEAN, together with green infrastructure such as green electricity power supply and the national grid. The value chain analysis and supporting industries are outlined in Table 5.6.

Table 5.6 BEV Production in ASEAN

Parts	Indonesia	Malaysia	Thailand	Viet Nam
Mineral resources (nickel)	Yes	No	No	Yes
Electric vehicle battery production	Planned	In production	In production	Planned
Battery swapping	Yes	Planned	Yes for e-motorbikes	No
Semiconductor chips	No	Yes	Yes	No
Assembly of electric vehicles	Yes	Planned	Yes	Yes
Battery recycling	No	No	Planned	No
R&D activities	No	No	Yes	Yes
Greening the Grid*	10%	8%	8%	23%

ASEAN = Association of Southeast Asian Nations, BEV = battery electric vehicle, R&D = research and development.

* Renewable energy supply as a percentage of total power supply (including fossil fuels) in 2021.

Source: Tham (2023).

Government policies to support the creation of the BEV industry are needed for ASEAN BEV producers. Table 5.7 is summarised from Tham (2023), with updated information from Thai promotional policies.

As battery production, semiconductor manufacturing, and software development are key success factors for BEVs, no single AMS has all the essential elements for establishing an autonomous BEV industry. A Vietnamese BEV firm introduced the VinFast brand to the global market in 2018, but it has not yet achieved commercial success. Indonesia and Viet Nam have comparative advantages in battery

production due to an abundance of nickel, which is the most important metal for making lithium-ion battery cathodes. Indonesia is the top global source of nickel. Indonesia and Australia have 22% and 21% of global nickel reserves, respectively (Statista, 2024). Currently, world nickel production mainly comes from Indonesia, the Philippines, Russia, New Caledonia, Australia, Canada, and China. China invested heavily in nickel production in Indonesia before exports of unprocessed nickel were banned. However, the presence of nickel resources is not sufficient to establish a BEV industry.

Table 5.7 Government Policies to Support the Creation of the BEV Industry

Policy area	Indonesia	Malaysia	Thailand	Viet Nam
Promote domestic demand	Luxury tax incentive and lower parking tariffs	Road tax incentive and income tax deductible	Cut excise tax and import duties but the amount sold must be equal to the amount produced in 2025	Exempt registration fee and lower consumption tax and several tax more incentive
Charging stations	SOEs to supply 31,000 stations in 2030	10,000 stations in 2025	12,000 in 2030 and 36,500 stations in 2035	2,000 stations completed
Targets	Minimum of 20% of cars will be EVs by 2025, and ICE banned by 2035 (demand)	10% of the market will be EVs by 2023 and 20% by 2025 (demand)	EV hub for ASEAN in 2025, and EVs represent 30% of total car production by 2030 (supply)	500,000 units by VinFast in 2025 (supply)
Production and FDI	Custom duty exemptions for parts and charging equipment	FDI incentives such as tax allowances and custom duty exemptions	Corporate tax and import tariff exemptions for production machines	N/A

ASEAN = Association of Southeast Asian Nations, BEV = battery electric vehicle, EV = electric vehicle, FDI = foreign direct investment, ICE = internal combustion engine, N/A = not available, SOE = state-owned enterprise.

Source: Tham (2023) with updated information from Thailand.

Semiconductors are essential for controlling automobiles and making batteries for BEVs. Taiwanese, US, and Korean firms are the main producers of semiconductors (Shiphub, n.d.), while China is the world's largest BEV battery producer (77% of global BEV battery production), mainly from CATL (Bhutada and Parker, 2023). The supply of semiconductors from the US, Korea, and Taiwan is an important input factor for Chinese battery production. The Chinese technology and semiconductor production industry lags Taiwan, the US, and Korea in semiconductors (GlobalData, 2021), but Chinese firms are gradually improving to fill knowledge gaps. To sum up, BEV batteries require international production networks and depend on both nickel-rich nations and semiconductor-making nations.

The ASEAN Leaders' Declaration on Developing Regional Electric Vehicle Ecosystem was issued at the ASEAN Summit in May 2023 to develop ASEAN's BEV industry. The objectives are to fill in the BEV development gap, strengthen regional competitiveness, and improve regional weaknesses to construct BEV RVCs. The ACFTA will be a key success factor in developing an ASEAN BEV production base, as China has an extremely advanced electric vehicle industry and is the world's largest BEV producer. Thailand is the main ASEAN customer of Chinese BEV products such as MG, BYD, and Neta. The Thai government provides tax subsidies of B80,000–B120,000 per BEV, but this will only apply to BEVs made in Thailand from 2025. Therefore, several Chinese BEV firms have established operations in Thailand to qualify for the subsidy and retain their market share. Technology transfer and FDI from China will prepare Thailand to be the BEV production hub of ASEAN.

To support the new investment and participate in the green economy, Thailand has invested in renewable energy as the power source for new industries. Renewable energy will increasingly replace traditional fossil fuel sources to produce electricity. This will help create a green production process for BEVs.

The BEV industry and green energy will satisfy government commitments on carbon neutrality and net zero emissions. New ACFTA negotiations will be needed for establishing a BEV industry in ASEAN and China to reduce the cost of unbundling or fragmentation of the production process and to cut service-linked costs. To support initial BEV sales and create regional demand and supply, ACFTA parties will link nickel supply, semiconductor and BEV battery production technologies, software development, automobile assembly, green energy supply, and regional demand. The importance of cooperation in this sector was underlined in the ASEAN Leaders' Declaration on Developing Regional Electric Vehicle Ecosystem.

Potential benefits and costs to ASEAN and China

1. ASEAN and China share similar environmental values, which are consistent with the global trend towards environmental protection, and mitigation and adaptation to climate change. The position of Thailand is to support such initiatives and to prepare the implementation of the related measures. The first step that has been done is to design the Thailand Taxonomy, with detailed standards and processes.
2. To create a green regional supply chain between China and ASEAN, the production process – ranging from downstream to upstream – must be in line with international standards on green and environmental measures. To export products to trading partners such as the EU, ASEAN and China must share information and have common regulations that comply with the European Green Deal.

3. Mutual benefits can be realised in some newly developed industries, such as smart electronics and electric vehicles. These two industries are of interest to both ASEAN and China since ASEAN has natural resources and consumer markets, while Chinese firms have technology and experience in production and marketing.
4. To benefit from the new green or environmental protection rules, information sharing between ASEAN and China is required. In addition, ASEAN and China need to collaborate to negotiate a new green and sustainable strategy and regulations at the global level.
5. The challenge for ASEAN and China is to develop a common understanding, on and standards for, sustainability. Capacity building and technical assistance should be provided to less developed areas.

Challenges facing domestic reforms

1. To implement a green RVC, a large amount of funding is needed for infrastructure development for clean energy, green production processes, green logistics and marketing, and waste treatment.
2. The development pace is different amongst AMS and China. Flexibility in financial contributions and adjustment periods should be allowed for less developed members.
3. Job losses may occur in some industries and countries due to the shutdown of non-green businesses. Remedies and reskilling and upskilling of workers must be provided, but concerns surround who will bear the cost of adjustment.

Policy recommendation for negotiation and implementation of the agreement

1. A joint feasibility study is required in the first phase for strengthening cooperation, sharing knowledge, sharing experience, and sharing best practices.
2. Awareness regarding green initiatives and sustainability needs to be heightened amongst the citizens of ASEAN and China. It is important that lifestyle adjustments are embraced.
3. ASEAN and China should support industries that need adjustment periods, technology, and financial support.
4. ASEAN and China should cooperate in negotiating with other nations and make optimal use of their comparative advantages to serve global demand.

5.3. Supply chain resilience

The COVID-19 pandemic alerted the world to supply chain disruptions. ‘Decoupling’ was the term used when the production chain of Western economies (especially the US) was disrupted by Eastern economies (especially China) as a result of the US–China trade war and the pandemic. However, at the Group of Seven (G7) Summit in 2023, the term indicating supply chain disruption was ‘de-risking’, which is a sign of the importance of global supply chains. This suggests that global value chains (GVCs) cannot be entirely disaggregated. On the contrary, supply chains should be expanded and should have a better and stronger network to reduce potential challenges in the future.

The importance of developing GVCs for the world economy has been evident for many years. ASEAN and China have partially developed GVCs within the bloc via the ACFTA. However, given the disruptions, the main concern is how to achieve GVCs’ resilience. Ongoing negotiations on the ACFTA 3.0 could strengthen GVCs by putting this issue on the table.

Resilience in the broader economic sense may include the ability to recover, grow, and sustain in an inhospitable economic environment. Firms participating in GVCs mostly see resilience as discovering the right equilibrium between operational efficiency and risk mitigation. Resilience could also mean securing the resource base through human development, decarbonising GVCs, and making the available technology more inclusive. Thus, the building blocks to create a resilient value chain should deal with factors affecting firms’ participation in GVCs. Those factors include factor endowment and capital, geography, domestic industrial capacity, trade policy and FDI, institutional quality, connectivity, and macroeconomic factors (Fernandes, Kee and Winkler, 2020).

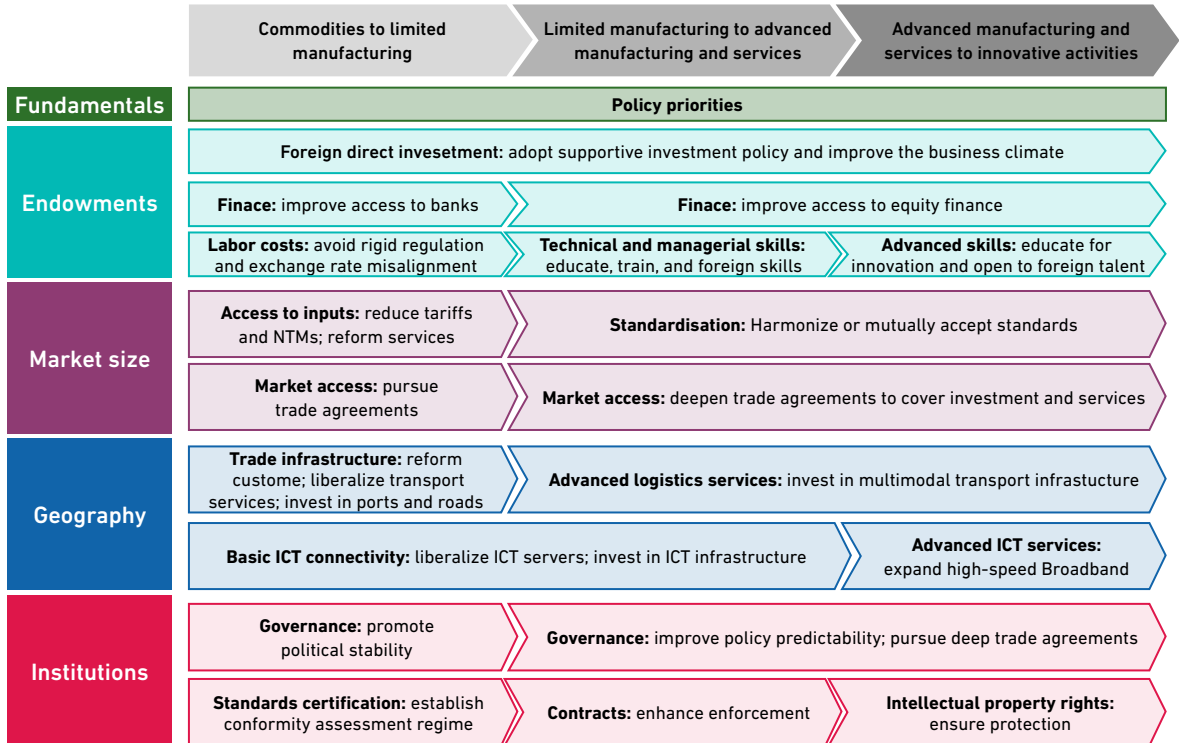
Although firms (multinational enterprises) created the building blocks of GVCs, policymakers should create an economic environment to support resilient value chains. OECD (2020) suggested that the governance of reliable GVCs requires multinational enterprises to develop their own risk management strategies. Such strategies, according to He (2021), include securing alternative supply and distribution channels, arranging for reasonable production capacity, engaging in new partnerships, and expertly handling relevant information. Moreover, the entire GVCs could be considered as multiple RVCs, which are easier to manage relative to the entire global network. This fits into the context of the ACFTA perfectly. Multiple RVCs should be extensions of the common tasks that could stabilise GVCs, such as maintaining an open, stable trade and investment regulatory environment and supporting a secure knowledge sharing platform.

Debate surrounds whether the gains from participating in GVCs outweigh the risks of shock transmission. OECD (2021) showed that the benefits involved in participating in GVCs outweigh the risks, although some sectors may be more exposed to risk than others. Nonetheless, GVC involvement needs to be structured towards resilience, as mentioned above. Policymakers could play important roles in building a conducive environment for GVC participation. AMS and China have participated significantly at the lower end of GVCs (He, 2021). Therefore, moving towards resilient RVCs would be of common interest for both parties, since it would strengthen comparative advantages and move upstream in the GVC. With good management and support from the governments of the two parties, benefits in the form of efficiency gains from building resilient RVCs and GVCs could be huge, along with lower risks of transmission of any future shocks.

However, GVC participation will also introduce challenges. The theory of the international division of labour reveals that different countries can specialise in different stages of production in international trade. Overall, there are welfare gains when each stage of the production process is carried out by a country that is specialised in that task to generate an efficient GVC. This entails two main challenges: (i) the distribution of benefits from involvement in supply chains, and (ii) maintaining a country's specialisation to ensure supply chain resilience. The first challenge underlines the difficulty of evenly distributing the benefits of involvement in supply chains to each AMS. ASEAN as a group needs to reach a consensus on how each country plays a role in the supply chains to make the development inclusive to all AMS. The second challenge could be a core factor in creating resilient supply chains. ASEAN as a group, and each AMS, need to produce strategic plans to strengthen their comparative advantages. This could guarantee involvement in supply chains.

In *the World Development Report 2020*, the World Bank separated GVC involvement into four main levels, from weak to strong involvement: (i) commodities level, (ii) limited manufacturing level, (iii) advanced manufacturing and services level, and (iv) innovative activities level. The World Bank (2020) showed that the fundamental factors for GVC involvement are factor endowments, market size, geography, and the quality of institutions. World Bank (2020) put together policies that can support each of these factors for each level of GVC participation (Figure 5.2). These policy suggestions could create a fundamental building block to achieve supply chain resilience.

Figure 5.2 Examples of Policies Supporting GVC Participation, Classified by Level and Fundamental Factors



GVC = global value chain, ICT = information and communication technology, NTM = non-tariff measure.

Source: World Bank (2020).

Up to this point, from the pandemic to the idea of creating resilient supply chains at a global or regional level, the process of keeping value chains going is important for each phase. OECD (2020) provided policy recommendations for each phase of the pandemic (Table 5.8). These recommendations could be a building block for generating resilient supply chains in the future.

Table 5.8 Main Policy Recommendations for GVCs – From Crisis to the Future

Crisis	Recovery	New normal
Maintain operations of essential GVCs and increase supply	Help to restart GVCs	Promote robustness and resilience in GVCs
Facilitate trade by removing trade barriers and by ensuring the smooth functioning of international transport and customs	Maintain an open trade and investment environment to reduce the time to recover and continue to support trade facilitation	Create a stable regulatory environment (including through trade and investment agreements that can include provisions for the smooth operations of GVCs)
Prioritise shipments for essential goods and adapt rules for movement of key personnel	Address financial and other issues of firms that can delay the recovery of GVCs and support MSMEs	Promote standards and certification procedures, including risk awareness; review transport, logistics, and customs clearance regulations to better mitigate disruptions
Increase supply of essential goods by facilitating investment and operation permits and by expediting certification procedures	Adapt health measures to the needs of firms operating in an international environment	Develop stress tests for critical supply chains and include criteria for robustness of supply chains in government procurement procedures on a non-discriminatory basis. Promote the diffusion of digital technologies that can improve information systems for risk management (e.g. internet of things)

GVC = global value chain; MSMEs = micro, small, and medium-sized enterprises.

Source: OECD (2020).

With these policy recommendations in mind, to prepare and collaborate on a system to improve those factors to serve supply chain resilience, countries need to develop three strategic plans: (i) development to facilitate the compatibility of products and services; (ii) the development of cooperative programmes, exchanges of expertise, and best practices; and (iii) the development of workforce capabilities to enhance strength (Phoolpipat, 2021). These plans can be carried out by applying the following policies recommended by CAITEC et al. (2020):

- (i) Carry out a holistic analysis of supply chain connectivity to include essential services as well as human resources and intermediate inputs for the production of essential products.
- (ii) Improve both physical and soft infrastructure: production, logistics, and new and digital technologies.
- (iii) Ensure supply chain resilience by strengthening the development of domestic supporting industries and ensuring the openness of and circulation in the domestic market, as well as the diversification of production bases and procurement sources.
- (iv) Strengthen regional coordination and dialogue to deepen supply chain connectivity and intra-regional trade, especially the implementation of FTAs and the signing and early entry into force of the RCEP.
- (v) Address cross-border bottlenecks by implementing the necessary reforms to simplify and expedite border formalities and exploring the expansion of trade facilitation initiatives.
- (vi) Prioritise investment in information and communication technology infrastructure and corresponding human resources development, and promote the use of digital technology in supply chains, with the aim of achieving end-to-end trade digitisation.

So far, the policy recommendations have mostly come down to cross-national collaboration, especially trade, which is at the heart of all these agreements. Thus, with a robust relationship, as we believe the ACFTA has been, the first objective is to strengthen trade cooperation. Reducing pressure on the trading system, lowering protectionism, and removing uncertainty could sustain trade openness (World Bank, 2020), resulting in a strong structure for GVC resilience. Nonetheless, collaboration beyond trade policy, such as in taxes, regulation, competition policy, and infrastructure, is essential (World Bank, 2020).

5.4. Trade Facilitation

Trade facilitation is an important aspect in achieving free flow of goods across borders. Land transportation is an essential avenue for trade with China along the route from Thailand to the Lao PDR, and finally to China. Logistics performance should be analysed to better understand ASEAN and China's trade facilitation capacity. The main way of improving logistics performance is to reduce causes of complication when products move across borders. Some key issues may help and should be on the negotiation table: the ASEAN Single Window (ASW) and cross-border e-commerce.

The ASW was developed to facilitate and streamline trade and customs processes amongst AMS. It allows traders, exporters, importers, and customs authorities to submit and receive trade-related documents and data electronically through a single point of entry. This digital platform helps reduce paperwork, simplify administrative procedures, enhance transparency, and expedite the clearance of goods across borders.

Each AMS has made a commitment to establish a national single window (NSW) within their respective countries. To integrate the system, AMS are linked to the ASEAN Single Window (ASW) gateway application via a secure network and distribute data from their own gateway model, which is developed and installed regionally by each AMS. The ASW began in 2013 when Singapore, Thailand, the Philippines, Malaysia, Indonesia, and Brunei Darussalam developed NSWs. Viet Nam launched its NSW in 2018, but found that its implementation did not meet expectations, especially for enterprises (Indira and Kusumasari, 2020).

Since the launch of the ASW and the subsequent exchange of trade data between countries to boost their international trade activities, many countries have used the Logistics Performance Index (LPI) to evaluate and rank their country's logistics performance. The LPI score provides assessments of six aspects: (i) customs and border management, (ii) transport-related infrastructure, (iii) the availability of competitively priced international shipments, (iv) logistics competence and quality, (v) the timeliness of shipments, and (vi) the ability to track and trace. It is also used as a measure of trade facilitation.

Table 9 shows the LPI for China and AMS from 2007 to 2023. The indexes reflect a significant improvement in Chinese logistics performance during the past decade. Singapore has been one of the top 10 scorers since 2012. Amongst AMS, Thailand, the Philippines, and Viet Nam have shown improvement in their LPI. In addition, China, Malaysia, and Thailand are amongst the top 10 upper middle-income scorers, while the Philippines, Viet Nam, and Indonesia are the top 10 lower middle-income scorers. The Lao PDR, Cambodia, and Myanmar did not achieve a rating of 3.0 on the LPI, indicating that their logistics capabilities and trade facilitation measures are lower than those of other AMS.

Table 5.9 LPI Index for China and ASEAN Member States, 2007–2023

Country	2007	2010	2012	2014	2016	2018	2023	Note
Singapore	4.19	4.09	4.13	4.00	4.14	4.00	4.3	Top 10 scorer in 2012, 2014, 2016, 2018, and 2023
China	3.32	3.49	3.52	3.53	3.66	3.61	3.7	Top 10 upper middle-income scorer in 2012, 2014, 2016, 2018, and 2023
Malaysia	3.48	3.44	3.49	3.59	3.43	3.22	3.6	
Thailand	3.31	3.29	3.18	3.43	3.26	3.41	3.5	
Philippines	2.69	3.14	3.02	3.00	2.86	2.90	3.3	Top 10 lower middle-income scorer in 2012, 2014, 2016, 2018, and 2023
Viet Nam	2.89	2.96	3.00	3.15	2.98	3.27	3.3	
Indonesia	3.01	2.76	2.94	3.08	2.98	3.15	3.0	
Cambodia	2.50	2.37	2.56	2.74	2.80	2.58	2.4	
Lao PDR	2.25	2.46	2.50	2.39	2.07	2.70	2.4	
Brunei Darussalam	N/A	N/A	N/A	N/A	2.87	2.71	N/A	
Myanmar	1.86	2.33	2.37	2.25	2.46	2.30	N/A	

ASEAN = Association of Southeast Asian Nations, LPI = Logistics Performance Index, N/A = not available.

Source: World Bank (2023).

Table 5.10 shows the performance of trade facilitation in China and ASEAN according to the six components in 2023. Discrepancies are present in the logistics performance of AMS in every aspect. The scores on four components – customs, international shipments, logistics competence and quality, and timeliness – of China, Malaysia, and Thailand vary only slightly, except for the infrastructure component where China outperformed these countries during the period of study.

Table 5.10 Six Components of Logistics Performance in 2023

Country	LPI		Customs		Infrastructure		International shipments		Logistics competence		Tracking & tracing		Timeliness rank	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Singapore	1	4.3	1	4.2	1	4.6	2	4.0	1	4.4	1	4.4	1	4.3
China	19	3.7	31	3.3	14	4	14	3.6	20	3.8	23	3.8	30	3.7
Malaysia	26	3.6	31	3.3	30	3.6	8	3.7	28	3.7	29	3.7	30	3.7
Thailand	34	3.5	31	3.3	25	3.7	22	3.5	38	3.5	34	3.6	46	3.5
Philippines	43	3.3	59	2.8	47	3.2	47	3.1	46	3.3	49	3.3	21	3.9
Viet Nam	43	3.3	43	3.1	47	3.2	38	3.3	53	3.2	41	3.4	59	3.3
Indonesia	61	3.0	59	2.8	59	2.9	57	3.0	65	2.9	65	3.0	59	3.3
Cambodia	115	2.4	110	2.2	125	2.1	121	2.3	110	2.4	80	2.8	109	2.7
Lao PDR	115	2.4	101	2.3	108	2.3	121	2.3	110	2.4	105	2.4	101	2.8

LPI = Logistics Performance Index.

Source: World Bank (2023)

The efficiency of customs and border management clearance is one common factor where China and most AMS can still find room for improvement together. This is because the score of the customs aspect lies between 2.8 to 3.3 for China, Malaysia, Thailand, the Philippines, Viet Nam, and Indonesia, which is lower than their overall logistics performance. For countries with low LPI scores, such as Cambodia and the Lao PDR, both the customs and infrastructure scores are below the overall LPI score. The LPI scores show that AMS use different levels of NSWs, which could affect the implementation of the ASW. Indira and Kusumasari (2020) proposed a roadmap for the ASW that involves integrating it with transportation management to develop trade facilitation via transportation. This integration could help enhance the system's readiness to connect with all border trade functions. The roadmap should include improving the e-customs process and ensuring that all modes of transportation are accessible to customers throughout the region.

Fang et al. (2022) reported that cross-border e-commerce between ASEAN and China grew remarkably during the pandemic (2020–2022). In recent years, several major infrastructure projects, such as the China–Lao PDR Railway, have enhanced China–ASEAN connectivity and facilitated the cross-border flow of parts and components. China and ASEAN have become each other's biggest trading partner (Li and Qianzheng, 2022).

To facilitate cross-border e-commerce between ASEAN and China, the following tasks should be carried out to strengthen ASEAN's access to China:

- Build a standardised cross-border logistics monitoring platform that helps integrate all cross-border logistics and transportation data between ASEAN and China. This platform should integrate data from various logistics and transportation providers, enabling real-time tracking, monitoring, and coordination of shipments.
- Promote cross-border e-commerce business-to-business exports and imports by providing one-stop customs declaration and inspection services for cross-border e-commerce enterprises. This will allow businesses that are engaged in cross-border e-commerce to save time and reduce administrative burdens.
- Align standards and rules for e-commerce and digital trade between China and ASEAN. Harmonising standards and rules related to e-commerce and digital trade will help promote seamless transactions between China and ASEAN. This includes aligning product standards, data protection and privacy regulations, electronic signatures, cybersecurity measures, and other relevant areas.

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Chapter 6

Viet Nam's Perspective

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1. Introduction

Since the start of Doi Moi (Renovation), Viet Nam has emphasised the importance of economic integration. Accession to the Association of Southeast Asian Nations (ASEAN) in 1995 and ASEAN integration thereafter were important milestones in Viet Nam's economic integration. Indeed, ASEAN offered the first international playground for Viet Nam to practise trade and investment liberalisation. Following its accession to ASEAN, Viet Nam joined important free trade agreements (FTAs) of ASEAN with Dialogue Partners, such as China (ASEAN–China Free Trade Area (ACFTA)); Japan (ASEAN–Japan Comprehensive Economic Partnership); the Republic of Korea (henceforth, Korea) (ASEAN–Korea Free Trade Agreement (AKFTA)); Australia and New Zealand (ASEAN–Australia–New Zealand Free Trade Area (AANZFTA)); and India (ASEAN–India Free Trade Area).

From Viet Nam's perspective, the ACFTA has been important for several reasons. First, it was the first FTA that ASEAN made joint efforts to negotiate with an external partner. This process had important lessons for subsequent ASEAN Plus FTA negotiations. Second, the ACFTA entered into force when China started to expand its economic scale. Third, the ACFTA entails an important approach (incorporating the Early Harvest Programme) and openness in discussing issues related to implementing the agreement (e.g. trade deficit).

By 2022, two new-generation FTAs – i.e. the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the European Union (EU)–Viet Nam FTA (EVFTA) – and the Regional Comprehensive Economic Partnership (RCEP) had entered into force for Viet Nam. These agreements did not mark the end of regional economic integration. Instead, they induced consideration of upgrading existing ASEAN FTAs. As of March 2023, some ASEAN Plus FTAs are undergoing negotiations for upgradation (e.g. the AANZFTA) or are under consideration for potential upgradation (e.g. the AKFTA). This paper attempts to assess the economic impacts of the ACFTA on Viet Nam's economy. In doing so, it focuses on the impacts of trade, investment, and technical assistance on Viet Nam. On that basis, it aims to make a set of recommendations on key areas for further improvements in ASEAN–China economic relations.

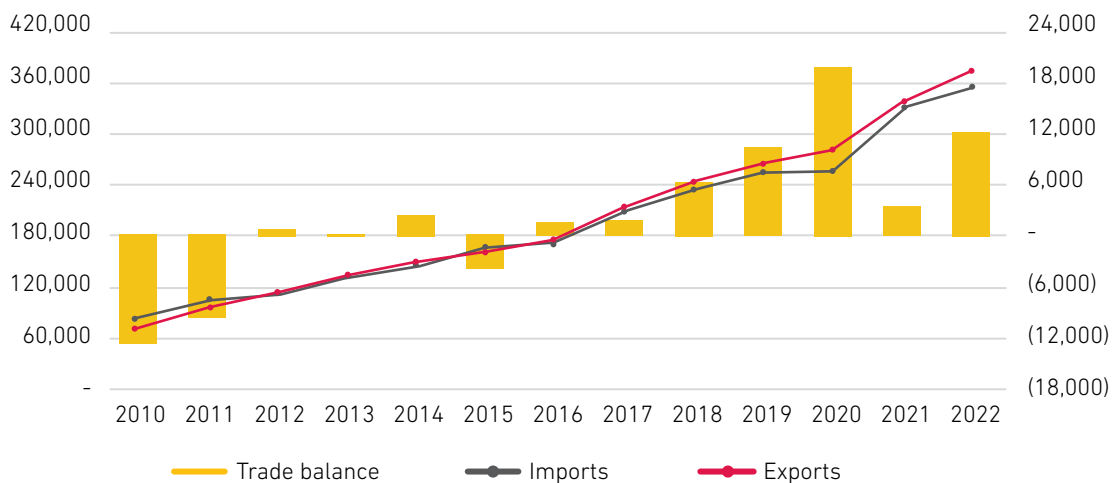
The remainder of the paper is structured as follows. Section 2 provides an overview of the trade, investment, and technical assistance of Viet Nam that can be attributed to the ACFTA. Section 3 elaborates on the key issues and lessons from implementing the ACFTA. Section 4 discusses the benefits of and cooperation measures for upgrading the ACFTA. Section 5 concludes with some recommendations.

2. Impacts of the ACFTA on Viet Nam's Economy

2.1. Trade

Viet Nam's imports and exports achieved continuous and rapid growth during 2011–2022. Exports grew on average by 14.6% per year, while imports attained average annual growth of 12.8% during this period. Most notably, the trade balance changed dramatically from a deficit of US\$9.8 billion in 2011 to a modest surplus in 2013, before consecutive surpluses during 2016–2022 (Figure 6.1). Besides, the rapid expansion of trade (including both exports and imports) during 2021 and 2022 was induced by Viet Nam's efforts to promote trade via major FTAs, including the RCEP, which also includes ASEAN and China. This has underlined the importance of the RCEP in tying Viet Nam's export and economic recovery to the regional economic recovery after the coronavirus disease (COVID-19) pandemic (Nguyen, 2023; CIEM, 2022).

Figure 6.1 Viet Nam's Imports and Exports, 2010–2022
(US\$ million)



Note: Exports and imports are measured on the left-hand axis. The trade balance is measured on the right-hand axis.

Sources: Calculation from statistics of the General Department of Vietnam Customs (n.d.), www.customs.gov.vn, (accessed 3 May 2023); and General Statistics Office (n.d.), www.gso.gov.vn (accessed 3 May 2023).

ASEAN and China have attained increasing importance in Viet Nam’s trade structure. During 2010–2020, while the United States (US) and the EU27 continued to be Viet Nam’s top export destinations, the share of exports of ASEAN Member States (AMS) gradually decreased while China and Korea’s shares increased (Table 6.1). Viet Nam’s exports to all major markets went up in absolute terms, but at different growth rates. Exports to China grew more quickly, on average by 21.8% per year between 2010 and 2015 and 25.7% per year between 2016 and 2020. In terms of imports, China and ASEAN were amongst the main sources of imports of Viet Nam, with respective import shares in 2020 of 40.4% and 13.8% (Table 6.2). Import growth from China reached an average of 19.9% per year during 2011–2015 and decelerated to 12.4% per year in 2016–2020.

Table 6.1 Share and Growth Rate of Viet Nam’s Exports by Country and FTA Partner, 2010–2020

FTA partner	Share (%)											Growth rate (%)	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2010–2015	2016–2020
ASEAN	14.3	14.1	15.2	14.1	12.7	11.2	9.9	10.1	10.1	9.4	8.2	13.7	5.3
RCEP	44.0	45.4	45.7	42.2	40.1	37.7	38.9	43.0	44.1	41.8	40.7	16.7	13.9
China	10.7	12.0	11.2	10.0	9.9	10.2	12.4	16.5	17.0	15.7	17.4	21.8	25.7
Rep. of Korea	4.3	5.0	4.9	5.1	4.8	5.5	6.5	6.9	7.5	7.5	6.8	28.7	16.7
Japan	10.7	11.4	11.4	10.3	9.8	8.7	8.3	7.8	7.7	7.7	6.8	15.2	6.5
CPTPP	22.4	21.2	22.2	21.0	19.8	17.9	16.6	15.9	15.1	15.0	13.7	13.7	6.0
EU27	15.8	17.1	17.7	18.4	18.6	19.0	19.2	17.8	17.2	15.6	12.5	22.3	5.9
US	19.7	17.5	17.2	1.1	19.1	20.7	21.8	19.3	19.5	23.2	27.4	19.7	18.3

ASEAN = Association of Southeast Asian Nations, CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership, EU = European Union, FTA = free trade agreement, RCEP = Regional Comprehensive Economic Partnership, US = United States.

Source: Nguyen and Doan (2023).

Table 6.2 Share and Growth Rate of Viet Nam's Imports by Country and FTA Partner, 2010–2020

FTA partner	Share (%)											Growth rate (%)	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2010–2015	2016–2020
ASEAN	19.3	19.6	18.3	16.1	15.5	14.3	13.8	13.3	13.4	12.7	13.8	9.9	5.5
RCEP	67.4	67.3	69.6	70.0	70.1	70.8	71.0	72.4	71.0	70.7	76.6	16.9	10.6
China	23.8	23.3	25.5	27.9	29.5	29.8	28.6	27.5	27.7	29.8	40.4	19.9	12.4
Rep. of Korea	11.5	12.3	13.7	15.7	14.7	16.6	18.4	22.0	20.1	18.5	17.2	26.3	12.5
Japan	10.6	9.7	10.2	8.8	8.7	8.6	8.6	7.9	8.0	7.7	6.1	11.5	7.5
CPTPP	22.6	22.7	22.4	18.8	18.7	17.0	16.6	15.9	15.9	15.0	14.8	10.1	5.8
EU27	7.5	7.3	7.7	7.1	6.0	6.2	6.4	5.7	5.8	5.9	3.4	10.3	2.9
US	4.5	4.3	4.3	4.0	4.3	4.7	5.0	4.4	5.4	5.7	3.0	17.4	11.2

ASEAN = Association of Southeast Asian Nations, CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership, EU = European Union, RCEP = Regional Comprehensive Economic Partnership, US = United States.

Source: Nguyen and Doan (2023).

ASEAN's exports to China grew from US\$136.8 billion in 2011 to US\$282.0 billion in 2021 (Table 6.3). This reflects an average annual growth rate of 7.5%. Viet Nam had relatively fast export growth to China, attaining 17.0% per year. As of 2021, Viet Nam ranked second (after Singapore) within ASEAN in terms of exports to China. By contrast, between 2011 and 2021, AMS altogether had their imports from China rise from US\$149.4 billion to US\$386.4 billion, i.e. an average annual growth rate of 10.0%. (Table 6.4). As of 2021, within ASEAN, Viet Nam was the largest importer of Chinese goods, with an average annual growth rate of 16.0%. ASEAN as a whole experienced a widening trade deficit with China, from US\$12.7 billion in 2011 to US\$104.4 billion in 2021. Viet Nam's trade deficit with China reached US\$54.0 billion in 2021.

Table 6.3 ASEAN's Exports to China, 2011–2021
(US\$ billion)

Country	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Brunei	0.5	0.3	0.2	0.1	0.1	0.2	0.3	0.2	0.4	1.2	2.2
Cambodia	0.2	0.2	0.3	0.4	0.4	0.6	0.8	0.9	1.0	1.1	1.5
Indonesia	22.9	21.7	22.6	17.6	15.0	16.8	23.1	27.1	28.0	31.8	53.8
Lao PDR	0.1	0.1	0.4	0.7	1.0	1.1	1.2	1.5	1.6	1.5	1.9
Malaysia	29.8	28.7	30.8	28.2	26.1	23.8	29.3	34.5	34.0	37.9	46.4
Myanmar	1.5	1.4	3.1	3.8	4.4	4.8	5.4	4.7	5.7	5.4	4.5
Philippines							8.0	8.7	9.8	9.8	11.5
Singapore	42.7	44.3	49.3	54.7	51.4	44.4	54.0	50.4	51.6	51.3	67.7
Thailand	27.4	26.9	27.2	25.1	23.7	23.7	29.5	30.2	28.1	29.8	36.6
Viet Nam	11.6	12.8	13.2	14.9	16.6	22.0	35.4	41.4	41.4	48.9	55.9
Total	136.8	136.4	146.9	145.5	138.7	137.3	187.0	199.6	201.7	218.6	282.0

ASEAN = Association of Southeast Asian Nations.; Note: Totals may not sum exactly due to rounding.

Source: Calculations from World Bank (2023), World Integrated Trade Solution. <https://wits.worldbank.org> (accessed 3 May 2023).

Table 6.4 ASEAN's Imports from China, 2011–2021
(US\$ billion)

Country	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Brunei	0.3	0.4	0.4	0.4	0.3	0.3	0.6	1.6	0.7	0.6	0.6
Cambodia	1.7	2.2	3.0	3.7	3.9	4.6	5.3	6.1	7.6	7.1	9.7
Indonesia	26.2	29.4	29.8	30.6	29.4	30.8	35.8	45.5	44.9	39.6	56.2
Lao PDR	0.4	0.5	0.5	0.6	0.7	0.7	1.5	1.3	1.7	1.3	1.3
Malaysia	24.7	29.7	33.7	35.3	33.2	34.3	38.3	43.5	42.4	41.0	55.3
Myanmar	2.3	2.5	3.7	5.0	6.4	5.4	6.1	6.2	6.4	6.5	4.2
Philippines							18.5	22.6	26.8	22.0	28.2
Singapore	38.3	39.7	44.0	44.4	42.1	40.5	45.3	49.6	49.0	47.4	54.6
Thailand	30.6	37.0	37.7	38.5	41.0	42.0	44.2	49.9	45.8	49.8	66.4
Viet Nam	24.9	29.0	36.9	43.6	49.4	50.0	58.5	65.5	75.6	84.2	109.9
Total	149.4	170.4	189.8	202.2	206.7	208.7	254.2	291.9	300.9	299.5	386.4

ASEAN = Association of Southeast Asian Nations.; Note: Totals may not sum exactly due to rounding.

Source: Calculations from World Bank (2023), World Integrated Trade Solution. <https://wits.worldbank.org> (accessed 3 May 2023).

During 2011–2021, the structure of ASEAN's exports to China shifted towards a slightly higher share of industrial products and a smaller share of agriculture, forestry, and fishery (AFF) products (Table 6.5). As for the case of Viet Nam, the structure of exports to China in 2011–2021 also shifted towards a smaller share of AFF products and a higher percentage of industrial goods (Table 6.6). Despite the small share, the total export turnover of AFF products increased from US\$2.9 billion in 2011 to US\$7.9 billion in 2021, accounting for 4.8% of gross exports to China in 2021. Exports of industrial products grew faster, from US\$33.6 billion in 2011 to US\$157.9 billion in 2021, accounting for 94.2% of gross exports to China in 2021 (Table 6).

Table 6.5 Share of ASEAN's Exports to China by Product Category, 2011–2021
(%)

Product group	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
AFF products	7.1	7.3	6.8	6.8	6.8	7.4	6.8	6.5	6.9	7.1	6.8
01-05_Animal	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.8	0.9	0.9	0.7
06-15_Vegetable	5.2	5.2	4.8	4.6	4.7	4.8	4.5	4.2	4.4	4.6	4.7
16-24_Foodstuff	1.3	1.5	1.4	1.5	1.5	1.9	1.6	1.5	1.6	1.6	1.5
Industrial products	92.9	92.7	93.2	93.2	93.2	92.6	93.2	93.5	93.1	92.9	93.2
25-26_Minerals	1.4	1.2	1.5	0.8	1.0	1.0	1.0	1.1	1.3	1.1	1.1
27-27_Fuels	10.2	8.7	8.4	7.6	6.3	6.3	7.5	7.3	7.8	5.6	6.6
28-38_Chemicals	8.0	7.6	7.5	7.8	6.7	6.9	6.9	7.6	6.9	6.8	8.2
39-40_Plastics rubber	9.6	8.6	8.3	7.4	6.8	7.0	7.4	7.1	7.1	7.0	6.6
41-43_Hides and skin	0.4	0.4	0.4	0.5	0.6	0.7	0.6	0.6	0.7	0.5	0.5
44-49_Wood	2.2	2.0	2.1	2.1	2.1	2.3	2.4	2.4	2.4	2.5	2.5
50-63_Textile and garment	4.5	4.5	4.8	5.3	5.9	6.4	5.8	6.1	6.2	5.5	4.9
64-67_Footwear	0.5	0.5	0.5	0.6	0.8	0.9	0.9	1.0	1.0	1.0	0.8
68-71_Stone and glass	1.4	1.5	1.7	2.5	2.6	2.0	2.5	2.1	2.6	1.8	1.7
72-83_Metals	6.7	7.2	7.9	8.4	9.2	9.2	8.4	9.1	8.5	9.4	10.7
84-85_Machinery, electrical equipment	42.5	44.3	43.9	43.6	43.6	42.4	42.3	42.0	41.5	45.2	43.5
86-89_Transport	1.9	2.2	2.2	2.4	2.9	2.4	2.4	2.1	2.2	2.0	2.0
90-99_Miscellaneous	3.5	3.9	3.8	4.2	4.6	5.2	5.0	4.9	4.9	4.5	4.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

AFF = agriculture, forestry, and fishery; ASEAN = Association of Southeast Asian Nations.

Note: Totals may not sum exactly due to rounding.

Source: Calculations from World Bank (2023), World Integrated Trade Solution. <https://wits.worldbank.org> (accessed 3 May 2023).

Table 6.6 Share of Viet Nam’s Exports to China by Product Category, 2011–2021
(%)

Product group	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
AFF products	7.8	10.2	8.8	7.9	7.7	8.8	8.4	7.6	6.7	5.4	4.8
01-05_Animal	0.8	0.9	1.1	1.2	1.0	1.4	1.4	1.3	1.4	1.1	0.8
06-15_Vegetable	5.2	7.6	5.8	5.1	5.4	6.0	5.9	5.2	4.1	3.2	2.9
16-24_Foodstuff	1.7	1.7	1.9	1.6	1.3	1.4	1.1	1.2	1.2	1.1	1.1
Industrial products	92.2	89.8	91.2	92.1	92.3	91.2	91.6	92.4	93.3	94.6	95.2
25-26_Minerals	0.9	0.6	0.6	0.4	0.3	0.2	0.3	0.5	0.7	0.8	0.7
27-27_Fuels	13.4	9.9	6.4	6.6	3.8	3.4	2.6	2.6	2.4	1.2	0.7
28-38_Chemicals	7.3	6.6	6.1	5.7	5.0	4.6	4.5	4.6	4.4	4.2	4.9
39-40_Plastics rubber	8.6	6.6	5.8	4.9	4.8	5.4	5.6	5.5	5.9	6.1	6.2
41-43_Hides and skin	0.7	0.7	0.7	0.9	1.2	1.1	0.9	0.9	0.8	0.6	0.6
44-49_Wood	2.7	2.7	3.0	2.4	2.4	2.3	2.1	2.1	2.2	2.3	2.3
50-63_Textile and garment	12.2	11.9	12.8	13.6	13.5	13.5	12.0	12.5	12.4	10.1	10.0
64-67_Footwear	1.2	1.2	1.3	1.4	1.8	1.9	1.9	2.1	2.2	2.3	1.6
68-71_Stone and glass	1.0	1.0	1.1	1.1	1.0	1.2	1.1	1.0	1.2	1.2	1.1
72-83_Metals	7.9	8.1	8.8	10.6	11.9	11.2	8.1	8.6	8.0	7.7	8.7
84-85_Machinery, electrical equipment	31.0	36.6	42.0	39.8	40.4	39.9	45.9	46.1	47.9	53.9	54.3
86-89_Transport	1.4	1.0	1.0	2.6	3.0	1.7	1.3	0.8	0.9	0.9	1.3
90-99_Miscellaneous	3.8	3.1	1.7	2.1	3.2	4.6	5.2	5.2	4.2	3.3	2.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

AFF = agriculture, forestry, and fishery; ASEAN = Association of Southeast Asian Nations.

Note: Totals may not sum exactly due to rounding.

Source: Calculations from World Bank (2023), World Integrated Trade Solution. <https://wits.worldbank.org> (accessed 3 May 2023).

Viet Nam's shares of high-tech exports to China, ASEAN, and RCEP partners have improved over time (Table 6.7). This could be explained by the numerous efforts of Vietnamese enterprises restructuring exports towards higher-tech products, meeting the high standards of quality and sustainable development of markets. The export share of products with low-tech content tends to decrease gradually but still accounts for a relatively high proportion of total exports to the RCEP and China. Meanwhile, Viet Nam's import structures from China, ASEAN, and RCEP partners in 2011–2021 also shifted gradually towards a higher share of high-tech goods and smaller shares of low-tech goods. However, the higher share of low-tech exports to China than that of low-tech imports from China may indicate Viet Nam's material risk of being pushed further behind China in the value chains.

Table 6.7 Share of Viet Nam's Imports and Exports by Technology Content to Selected Partners, 2011–2021 (%)

Exports	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
ASEAN	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	28.7	38.5	44.3	39.9	37.9	42.4	43.7	36.4	31.7	29.9	32.9
Medium-tech	32.4	29.2	26.0	26.7	27.2	24.1	22.3	24.4	24.7	27.0	26.0
Low-tech	38.9	32.3	29.7	33.4	34.9	33.5	34.0	39.2	43.6	43.1	41.2
RCEP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	25.6	31.3	33.6	30.4	34.6	41.4	50.6	49.2	47.2	49.8	49.4
Medium-tech	28.2	28.0	25.3	25.5	22.4	19.4	16.5	17.3	17.6	18.9	21.3
Low-tech	46.3	40.8	41.0	44.2	43.0	39.2	32.8	33.6	35.2	31.3	29.3
China	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	45.0	55.1	51.4	43.3	49.1	54.8	70.4	69.6	67.8	69.6	66.3
Medium-tech	12.0	4.8	5.6	11.0	9.1	12.6	12.9	17.4	16.8	30.2	39.5
Low-tech	43.0	15.9	17.7	24.7	31.0	34.3	32.9	34.8	38.4	41.2	34.6
Imports											
ASEAN	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	20.7	33.3	41.4	43.0	36.5	32.8	34.3	32.5	31.5	37.9	37.9
Medium-tech	57.6	47.6	42.4	40.9	46.4	51.0	50.8	51.7	52.4	46.8	47.4
Low-tech	21.7	19.1	16.2	16.1	17.1	16.3	14.9	15.8	16.1	15.3	14.7
RCEP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	26.5	34.5	39.3	37.1	36.9	38.7	43.8	44.1	44.2	49.6	49.9

Exports	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Medium-tech	41.9	36.8	33.9	35.2	37.5	35.7	34.3	32.5	33.0	29.5	29.2
Low-tech	31.6	28.7	26.8	27.8	25.6	25.6	22.0	23.4	22.9	20.9	20.9
China	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High-tech	30.6	36.1	40.1	36.9	35.4	35.4	38.8	37.5	39.2	46.0	45.5
Medium-tech	39.2	35.4	32.2	32.7	34.9	32.0	31.4	30.8	31.3	27.8	27.9
Low-tech	30.1	28.5	27.8	30.4	29.7	32.7	29.9	31.7	29.5	26.3	26.6

ASEAN = Association of Southeast Asian Nations, RCEP = Regional Comprehensive Economic Partnership.

Note: Totals may not sum exactly due to rounding.

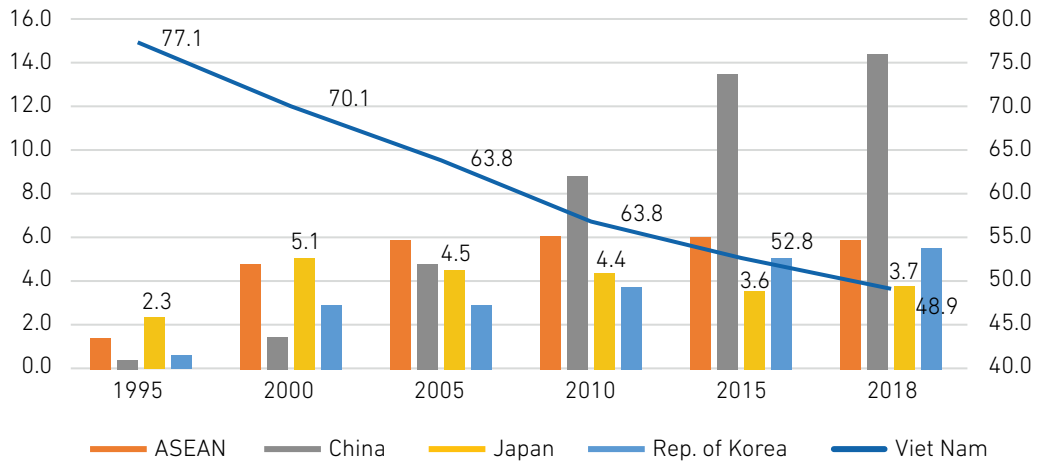
Source: Calculations from World Bank (2023), World Integrated Trade Solution. <https://wits.worldbank.org> (accessed 3 May 2023).

Nguyen and Doan (2023) updated the calculations of selected trade indicators – including trade complementarity and trade intensity – of Viet Nam and selected trade partners¹ for 2001–2020, yielding important findings. First, Viet Nam’s exports became more complementary to the import needs of all major partners, including ASEAN and China. Amongst the major partners, however, Viet Nam’s exports had the lowest trade complementarity level with China in 2020, while the level with ASEAN only ranked after the US and Japan. Second, the exports of major partners also attained higher complementarity to Viet Nam’s import needs. As of 2020, ASEAN’s exports had the highest level of complementarity, followed by Korea and China. Third, for all major partners (except the US), the complementarity of Viet Nam’s exports to the partner’s import needs is lower than that of the partner’s exports to Viet Nam’s import needs. This suggests the relatively weak competitiveness of Viet Nam’s products vis-à-vis those of the concerned partners. Finally, trade intensity indicators show that Viet Nam’s trade with China and ASEAN has exceeded the potential.

Over the past decades, East Asian countries – including ASEAN and China – have increased value added in Viet Nam’s exports. The share of domestic value added in Viet Nam’s exports went down from 77.1% in 1995 – the year of ASEAN accession – to 48.9% in 2018 (Figure 6.2). Meanwhile, foreign value added has become more important in contributing to Viet Nam’s exports. ASEAN had its value-added share in Viet Nam’s exports rise from 1.3% in 1995 to 5.9% in 2005, then fluctuate before remaining stable at 5.9% in 2017–2018. The figure for China rose almost continuously from 0.4% in 1995 to 4.8% in 2005, 13.5% in 2015, and 13.8% in 2018. In this regard, ASEAN and China have helped facilitate Viet Nam’s approach to East Asian trade resembling the acceptance of a ‘smaller share of a bigger pie’.

¹ Including ASEAN, China, Japan, Korea, the US, the EU-27, the RCEP, and the CPTPP.

Figure 6.2 Share of Value Added in Viet Nam's Exports (%)



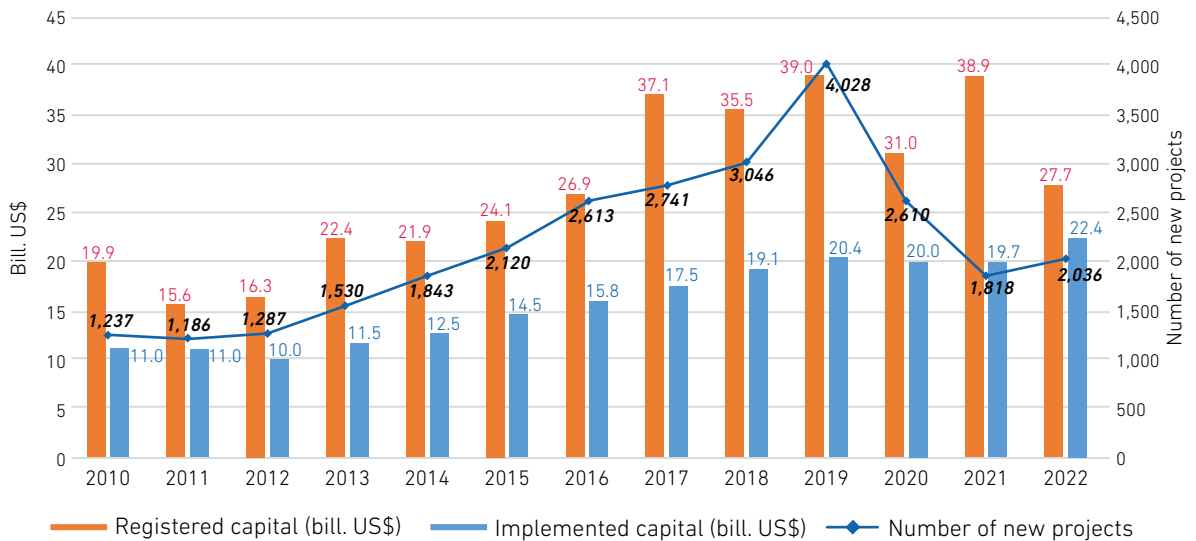
ASEAN = Association of Southeast Asian Nations.

Source: Nguyen (2023).

2.2. Investment

Viet Nam recorded a rapid increase in foreign direct investment (FDI) in terms of registered capital, implemented capital, and the number of new projects (Figure 6.3). This could be explained by such factors as Viet Nam's economic integration and FTAs, reforms to the domestic investment environment, and the diversification of investment locations by foreign investors (including during the US–China trade war and the COVID-19 pandemic). Registered capital increased sharply during 2017–2019 before fluctuating in 2020–2022. Implemented capital, meanwhile, depicts a clear upward trend from 2012 onwards, apart from some contraction during 2020–2021 due to the COVID-19 pandemic.

Figure 6.3 FDI Inflows to Viet Nam, 2010–2022

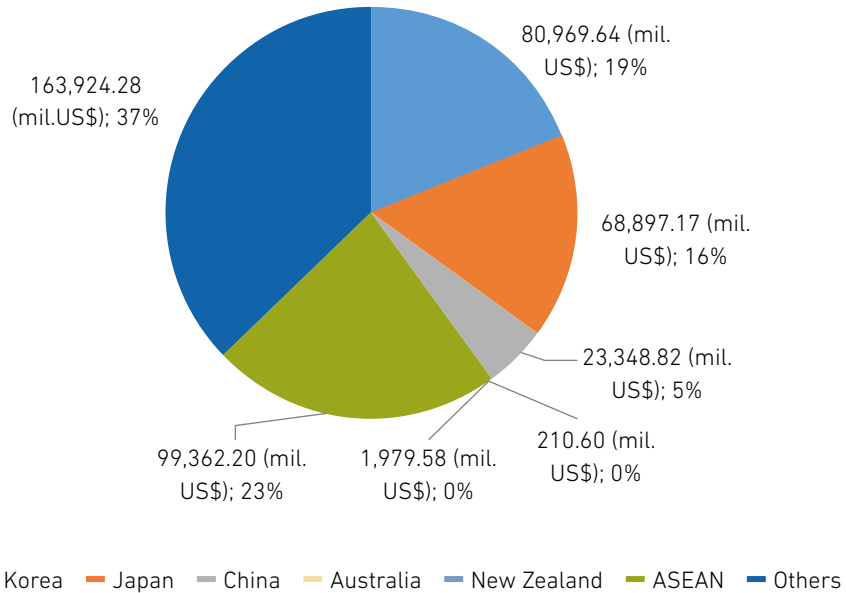


FDI = foreign direct investment.

Note: Registered capital, including newly registered capital and supplementary capital of existing projects. Since 2016: including contributing capital and purchase shares of foreign investors.

Source: General Statistics Office, www.gso.gov.vn (accessed 19 October 2023).

By partner, Viet Nam has investors from over 160 countries and territories. However, most of them are small. FDI capital was mainly sourced by investors from 15 countries and territories, altogether accounting for about 93.2% of the registered capital by 2022. Those countries and territories were mainly concentrated in Asia. It should be noted that six out of the 10 largest investment partners in Viet Nam are East Asian countries: Korea, Japan, Singapore, China, Malaysia, and Thailand. Thus, China and selected AMS are already amongst the key investors in Viet Nam.

Figure 6.4 FDI Inflows by Partner, by End of 2022

ASEAN = Association of Southeast Asian Nations, FDI = foreign direct investment.

Source: Ministry of Planning and Investment (2022), www.mpi.gov.vn (accessed 26 March 2023).

The increase in investment from China in the first quarter of 2019 was noticeable. On the one hand, this increase reflects the shift of Chinese investors to Viet Nam in the context of the complicated US–China trade war. However, by 2019, China had already sharply increased its investment in Viet Nam and become the fourth largest investor in the country. T.T.A. Nguyen (2019, cited in CIEM (2019)) pointed out that China has expanded its investment in Viet Nam in many sectors, diversified investment methods, and more than tripled its project size from only US\$1.5 million per project in 2007 to US\$5.0 million per project in 2017. In the processing and manufacturing industry, Chinese investors invest heavily in the metal processing and textile industries, with estimates reaching more than half of the capital volume. CIEM (2019) noted that the shift in Chinese investment to labour-intensive industries in Viet Nam, such as textiles and garments and metal processing, was most likely aimed at taking advantage of opportunities from rules of origin and preferential tariff treatment within the framework of the CPTPP and EVFTA.

Another aspect concerns the linkage between FDI and local firms. Exports have increased thanks to foreign investment, both directly and indirectly. Nguyen, Vo, and Do (2018) and Vo and Nguyen (2011a), using macroeconomic data and error-correction models, demonstrated that an increase in implemented FDI tends to enhance exports, with the gain being bigger in the long term than the short term. The effects of FDI spillover on the exports of other domestic businesses account for the greater long-term impact. In a similar vein, an even higher contribution of FDI to total employment may be expected when additional employment generated indirectly by FDI in domestic enterprises is taken into account.

Linkages between FDI and domestic companies are still inadequate. About 1,500 Vietnamese businesses have received only a small amount of technology and knowledge transfer from FDI on a sectoral level (UNIDO and Ministry of Planning and Investment of Viet Nam, 2012). The primary sources of supply for FDI businesses are imported raw materials and intermediary commodities, with no established connections to domestic supply chains (MUTRAP, 2015; Ministry of Planning and Investment, 2022). Nguyen and Truong (2022) argued further that in many manufacturing industries, Viet Nam only engages in the lowest midstream activities of global value chains (GVCs), such as sub-assembly and finished products.

2.3. Development cooperation

The ACFTA did not incorporate explicit provisions related to development cooperation as part of the Trade in Goods Agreement. However, the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, which entered into force on 1 July 2003, already includes such provisions. Article 7 on Other Areas of Economic Cooperation includes generic provisions on various sectors, via such measures as increasing the competitiveness of small and medium-sized enterprises (SMEs), capacity building, and technology transfer. Item 4 of Article 7 states that 'the Parties agree to implement capacity building programmes and technical assistance, particularly for the newer ASEAN Member States, in order to adjust their economic structure and expand their trade and investment with China' (ASEAN, 2002).

It should be noted that development cooperation is not confined to ASEAN–China cooperation. Vo and Nguyen (2010) argued that development cooperation has been a key feature of ASEAN Plus FTAs, and this argument remains valid even in the case of the RCEP. First, East Asian economies have attempted to build and improve socio-economic infrastructure, particularly economic infrastructure. This has been amongst the key factors contributing to expanding regional trade and investment and, ultimately, promoting economic growth. Second, cooperation has been enhanced in the development of human resources and of institutional capacities in both the public and private sectors. Such cooperation has been in various forms, including capacity building and technical assistance. Third, development cooperation also incorporates trade and investment linkages, which in turn helps deepen regional economic integration, creates economic opportunities, and promotes domestic production. Finally, East Asian economies have been involved in intra-regional cooperation to help address social issues and to promote social development. This serves to enhance social stability and narrow development gaps at both national and regional levels, thereby contributing to regional economic growth and cooperation.

Besides, parallel cooperation with China has been extended under various frameworks. The leaders of China and Viet Nam have reached a common understanding on strengthening coordination and promoting cooperation in the areas of economy and trade, production capacity and investment, infrastructure, finance and money, and stable and sustainable development. China and Viet Nam have established and signed many mechanisms, such as the Working Group on Cooperation on Infrastructure and Working Group on Monetary Cooperation; the agreement on extending and supplementing the five-year development plan for economic and trade cooperation between Viet Nam and China for 2017–2021; the Amended Border Trade Agreement (2016); and many cooperation memoranda of understanding on developing infrastructure cooperation plans, cooperation in production capacity, etc., thereby continuing to create a framework to strengthen and promote bilateral economic and trade cooperation (Nhan Dan, 2022).

Viet Nam and China are also members of the Greater Mekong Subregion (GMS). On the initiative of the Asian Development Bank (ADB), the GMS was established in 1992 with six members – Cambodia, China (Yunnan Province and Guangxi Zhuang Autonomous Region), the Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam. The GMS identified 10 priority areas for cooperation. Amongst them, infrastructure connectivity is the top priority. The GMS countries have approved large infrastructure projects, including three economic corridors (the North–South Economic Corridor, the East–West Economic Corridor, and the Southern Economic Corridor), amongst many others.

The GMS Economic Cooperation Program Strategic Framework, 2012–2022, adopted in 2011, was anchored in the development of economic corridors and expanded the GMS Program from conventional infrastructure to multisectoral investments designed to foster economic corridor development. In 2014, GMS members ratified the GMS Cross-Border Transport Facilitation Agreement and agreed on a memorandum of understanding for 'Early Harvest'² implementation of the agreement, allowing subregional movement of commercial vehicles and containers to begin. In 2017, a midterm review of the Strategic Framework, 2012–2022 was conducted to ensure the programme's continued effectiveness and responsiveness. The review called for the expansion of economic corridors to boost connectivity between countries and within rural and urban centres to ensure that the benefits of economic growth are more broadly distributed (Nguyen, Dinh, and Vo, 2020).

The Mekong–Lancang Cooperation (MLC) framework includes six countries – Viet Nam, Cambodia, China, the Lao PDR, Myanmar, and Thailand. It was established at the First MLC Leaders' Meeting in China on 23 March 2016, and the Sanya Declaration on Mekong–Lancang Cooperation was adopted at this event, which defined the '3+5' cooperation framework, i.e. three cooperation pillars³ and five key priority areas.⁴ Within 4 years, the MLC cooperation framework had achieved impressive outcomes, including the completion of all 45 Early Harvest projects in the priority areas.

The MLC has been highly institutionalised, with the holding of a Leaders' Meeting every 2 years, and the annual Foreign Ministers' Meeting and Senior Officials' Meeting. Member states also set up national secretariats for the MLC in 2017. The second MLC Summit in January 2018 adopted two important documents: the Phnom Penh Joint Declaration and the Plan of Action on the MLC, 2018–2022, which focused on strengthening sectoral cooperation planning and implementing small and medium-sized cooperation projects. The MLC's characteristics of 'pragmatism, high efficiency, [and a] focus on concrete projects' are considered the key factors for the impressive outcomes of the MLC mechanism (Lancang–Mekong Cooperation, 2017). The MLC had provided financial support for about 214 projects and reports in the Mekong region as of January 2018 (Le, 2018).

² The memorandum of understanding allows each GMS country to issue up to 500 GMS road transport permits and temporary admission documents for goods and passenger vehicles registered, owned, and/or operated in that country (GMS, 2018).

³ The three cooperation pillars are (i) political and security issues, (ii) economic and social areas, and (iii) sustainable development and humanities.

⁴ The five key priority areas are (i) connectivity; (ii) production capacity; (iii) cross-border economic cooperation; (iv) water resources; and (v) agriculture, and poverty reduction.

With regards to the challenging new regional and international context, MLC leaders have reaffirmed their focus on consolidating coordination between countries in handling regional challenges; bringing about long-term benefits for people; raising the technological capacity of businesses; improving market stability; and pushing the implementation of the MLC Plan of Action, 2018–2020 on regional connectivity, production capacity, water resources, trade, and agriculture. Most recently, the Fifth MLC Foreign Ministers' Meeting in Vientiane in February 2020 emphasised important areas of cooperation in the coming period, including (i) enhancing trade connectivity, firstly focusing on promoting synergies between the MLC and the Belt and Road Initiative; the Master Plan on ASEAN Connectivity, 2025; and the Ayeyarwady–Chao Phraya–Mekong Economic Cooperation Strategy Master Plan, 2019–2023; (ii) advancing cooperation in public health; (iii) deepening water resources cooperation; (iv) promoting agricultural cooperation, in particular promptly implementing the MLC Three-Year Action Plan on Agricultural Cooperation, 2020–2022; (v) promoting efforts to improve people's livelihoods; (vi) actively conducting non-traditional security cooperation, enhancing exchanges over governance, sharing development experiences, and jointly defending peace and tranquillity in border areas; and (vii) facilitating coordinated development of subregional mechanisms such as the GMS, the Mekong River Commission (MRC), and the Ayeyarwady–Chao Phraya–Mekong Economic Cooperation Strategy to produce a greater effect.

3. Key issues and lessons for effective design and implementation of the ACFTA

3.1. General

First, the current ACFTA settings lack harmonisation with other ASEAN FTAs. The ACFTA appears to lack significant harmonisation with the RCEP (Table 6.8). It should be noted that the RCEP resembles an effort to harmonise the ASEAN Plus One FTAs (including the ACFTA, AANZFTA, AKFTA, and others). However, the RCEP does not mark the end of regional economic integration. Indeed, the entry into force of the RCEP arguably induced efforts to promote the upgradation of existing ASEAN Plus One FTAs (such as the AANZFTA, AKFTA, and ACFTA). In this regard, the revision of the ACFTA, should preserve the approach towards harmonisation. For instance, the ACFTA should consider adding provisions related to areas already incorporated in other FTAs, such as textiles and garments, sanitary and phytosanitary (SPS) measures, technical barriers to trade (TBTs), and SMEs.

Table 6.8 Content of Viet Nam’s FTAs

Item	RCEP	EVFTA	CPTPP	AFTA	ACFTA	AKFTA	AJCEP	AIFTA	AANZFTA	AHKFTA
Tarif reduction	x	x	x	x	x	x	x	x	x	x
RoO	x	x	x	x	x	x	x	x	x	x
Textile and garment	x	x	x						x	
Customs procedures and trade facilitation	x	x	x	x	x	x	x	x	x	x
Trade remedies	x	x	x		x	x	x	x	x	
SPS	x	x	x	x			x		x	x
TBT	x	x	x	x					x	x
Services	x	x	x	x	x	x	x	x	x	x
Financial services	x	x	x	x		x			x	
Investment	x	x	x	x	x	x	x	x	x	
ISDS			x	x	x	x		x	x	
Temporary entry for business persons	x	x	x	x					x	
Telecommunication	x	x	x						x	
Electronic commerce	x	x	x						x	
Government procurement	x	x	x							
Competition policy	x	x	x						x	
SOEs		x	x							
Intellectual property	x	x	x						x	
Labour		x	x							
Environment		x	x							
SME	x									
Cooperation and capacity building	x	x	x	x	x		x		x	x
Dispute settlement	x	x	x	x	x	x	x	x	x	x

AANZFTA = ASEAN–Australia–New Zealand Free Trade Area; ACFTA = ASEAN–China Free Trade Area; AFTA = ASEAN Free Trade Area, AHFTA = ASEAN–Hong Kong, China Free Trade Agreement; AIFTA = ASEAN–India Free Trade Area; AJCEP = ASEAN–Japan Comprehensive Economic Partnership; AKFTA = ASEAN–Korea Free Trade Area; ASEAN = Association of Southeast Asian Nations; CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership; EU = European Union; EUFTA = European Union Vietnam Free Trade Agreement; FTA = free trade agreement; ISDS = investor–state dispute settlement; RCEP = Regional Comprehensive Economic Partnership; RoO = rules of origin; SME = small and medium-sized enterprise; SOE = state-owned enterprise; SPS = sanitary and phytosanitary; TBT = technical barrier to trade.

Source: CIEM (2022).

Second, new-generation FTA issues may be incorporated in the revised ACFTA, which can be supported by the experience of some AMS. As a signatory of new-generation FTAs such as the CPTPP and EVFTA, Viet Nam has already made commitments on several relatively new issues such as intellectual property, e-commerce, and competition policy. It should be noted that although RCEP is not a new-generation FTA, it also attempts to incorporate newer content such as e-commerce and competition (CIEM, 2021). For instance, the structure of the E-Commerce Chapter in the RCEP Agreement is similar to that of the CPTPP Agreement, but with lower levels of commitment. A key lesson would thus be to try exploring the possibility of incorporating new-generation issues in the revised ACFTA.

3.2. Trade

Despite rapid export growth to China and ASEAN, Viet Nam can only enjoy limited tariff preference under the ACFTA and the ASEAN Free Trade Area (AFTA)/ASEAN Trade in Goods Agreement (ATIGA). Under both frameworks, Viet Nam could see its FTA utilisation rates improve over 2006–2021. However, these utilisation rates are more limited than those of other FTAs (e.g. the AKFTA/Viet Nam–Korea Free Trade Agreement (VKFTA), and Viet Nam–Chile Free Trade Agreement (VCFTA)), while being higher than those of new-generation FTAs (the CPTPP, EVFTA, and United Kingdom–Viet Nam Free Trade Agreement (UKVFTA)) (Table 6.9). This brings about two major considerations. On the one hand, ASEAN and China should consider reviewing rules of origin to ensure more adequate ACFTA utilisation. In this regard, ASEAN and China may learn from the design of the AKFTA, which allows for sufficient flexibility that can enable traders (including those from Viet Nam) to benefit from tariff preference. On the other hand, Viet Nam should investigate the issues that prevent its utilisation of FTAs in general and the ACFTA in particular. Such issues may include the capacity to meet rules of origin, lack of information, limited incentives (due to small trade volume and small differences between normal and preferential tariffs), and complicated certificate-of-origin procedures.

Table 6.9 FTA Utilisation Rate
(%)

Country	2006	2007	2008	2009	2010	2011	2012–2014	2015	2016	2017	2018	2019	2020	2021
ASEAN	7.1	9.4	12.8	11.4	14.1	20.2	-	24.2	30.0	30.0	34.0	35.2	38.8	40.0
ACFTA	8.9	6.3	9.8	21.7	25.2	23.1	-	32.2	31.0	26.0	29.0	31.6	31.7	33.9
AKFTA VKFTA				79.1	65.8	90.8	-	59.6	56.0	51.0	35.0	49.8	52.1	50.9
AANZFTA					8.9	15.9	-	28.1	34.0	33.0	34.0	38.2	40.2	39.2
AJCEP VJEP				27.8	30.5	31.2	-	34.0	35.0	35.0	30.0	38.1	37.9	34.7
VCFTA							-	56.9	64.0	69.0	67.0	67.7	65.5	61.8
AIFTA					2.4	7.4	-	32	43.0	48.0	72.0	65.1	70.0	68.7
VN-EAEU FTA							-		6.0	22.0	28.0	31.0	29.6	39.0
AHKFTA													0.1	0.1
CPTPP												1.7	4.0	6.3
EVFTA														20.2
UKVFTA														17.2
Overall									36.0	34.0	39.0	37.2	33.1	32.7

AANZFTA = ASEAN–Australia–New Zealand Free Trade Area; ACFTA = ASEAN–China Free Trade Area; AHKFTA = ASEAN–Hong Kong, China Free Trade Area; AIFTA = ASEAN–India Free Trade Area; AJCEP = ASEAN–Japan Comprehensive Economic Partnership; AKFTA = ASEAN–Korea Free Trade Area; ASEAN = Association of Southeast Asian Nations; CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership; EVFTA = European Union–Viet Nam Free Trade Agreement; FTA = free trade agreement; UKVFTA = United Kingdom–Viet Nam Free Trade Agreement; VCFTA = Viet Nam–Chile Free Trade Agreement; VJEP = Viet Nam–Japan Economic Partnership Agreement; VKFTA = Viet Nam–Korea Free Trade Agreement; VN-EAEU = Viet Nam–Eurasian Economic Union Free Trade Agreement.

Source: VCCI (2023)

Besides, to support more efficient trade flows, ASEAN and China should consider making more explicit commitments related to trade facilitation. Specific areas where additional commitments may be needed include border trade and customs clearance, paperless trading, SPS measures, and TBTs. In addition, the commitments should be accompanied by parallel efforts to build capacity for selected AMS (e.g. Cambodia, the Lao PDR, Myanmar, and Viet Nam). An example is paperless trading, where ASEAN and China could consider the adaptation of available frameworks such as the Framework Agreement on Cross-Border Paperless Trade in Asia and the Pacific or Digital Economy Partnership Agreement amongst Singapore, China, and New Zealand.

In parallel, enhancing mutual trust between ASEAN and China in the areas of SPS measures and TBTs is crucial. An alternative would be to strengthen the dispute settlement mechanism related to these chapters. It should be noted that while the RCEP incorporates SPS and TBT chapters, the dispute settlement mechanisms are still lacking for these chapters. However, pursuing this alternative may take time, as AMS and China have diverse non-economic objectives that justify the need for SPS and TBT regulations. Another alternative would thus be to enhance the good regulatory practices of ASEAN and China. At a minimum, this requires more effective implementation and resourcing of the enquiry points under the WTO. Still, ASEAN and China could do more to ensure that the traders could be informed (at best, consulted) and prepared for changes in SPS and TBT regulations. This should require not only government-to-government efforts, but also government-to-business programmes that engage and support the firms within each country.

Several lessons can be summarised from Viet Nam's experience with Decrees 248 and 249 of China. These decrees were issued by China in April 2021 and entered into force on 1 January 2022. From April to September 2021, exporters in Viet Nam were barely aware of the content of these decrees, despite notifications of these documents via the SPS Office of Viet Nam (serving as the WTO Enquiry Point on SPS). Issues with these decrees were only discussed in various fora and workshops in Viet Nam in the last quarter of 2021. At that time, Vietnamese exporters were concerned about the lack of capacity to meet requirements under the decrees, and thus missing the opportunities induced by the RCEP (supposedly at the time to enter into force in early 2022). However, after nearly 1 year of implementation, by 5 December 2022, 2,426 product codes were licensed to be imported into China. Of these, 1,236 product codes belonged to the group of 18 items registered through the competent authority (accounting for 50.9%), while the remaining 1,190 product codes were not on the list that must be registered through the competent authority. Amongst these two groups, seafood products are approved by China Customs the most, followed by nut products (cashew nuts, coffee, etc.) and vegetable oil products, flour cakes, etc. Underlying these results were the efforts of Viet Nam's SPS Office in implementing Decrees 248 and 249, which presents a typical example of inter-sectoral coordination in the state management of food safety in the face of new developments in the requirements of importing countries. This case highlights two important lessons. First, building awareness for firms in terms of keeping track of potential regulatory changes in importing markets in general and in China in particular is essential. Second, there needs to be a clear and unambiguous delineation of the responsibility and authority of the functional agencies of ministries and branches in coordinating the preparation and adaptation of firms amid foreign regulatory changes.

3.3. Investment

In terms of investment, ASEAN and China should consider revising investment measures in a way that makes FDI work for local economic prosperity. In particular, the presence of FDI within the ACFTA region should promote and be accompanied by the transfer of technology and know-how for GVC participation. It should be noted that FDI enterprises and Vietnamese enterprises, in general, have not yet established a robust linkage in the value chain due to various reasons. First, when investing in Viet Nam, most FDI enterprises already have a network of supporting industry enterprises in the GVC, which could compete in export markets. Second, low labour skills are hindering SMEs from linking together and maintaining business relations with FDI enterprises. Third, domestic suppliers lack formal channels to collect information on the purchasing strategies of FDI enterprises, thus failing to create business relationships (World Bank, 2017). The lack of information on the quality, cost, delivery, and management standards of FDI enterprises leaves domestic firms at a disadvantage in terms of linkage opportunities. Fourth, the ability of domestic enterprises to receive technology transfer is limited, partly because of the popularity of short-term supply contracts for FDI enterprises.⁵ Finally, Vietnamese government programmes to improve the competitiveness and innovation of the domestic private sector, including technological innovation, market development, technical training, and independent financial packages (guarantee funds, business support funds, etc.), are all unclear in terms of effectiveness due to the lack of a comprehensive monitoring and evaluation system (CIEM, 2020).

Furthermore, ASEAN cooperation in FDI will be essential to avoid race-to-the-bottom competition. As the global minimum tax mechanism will be implemented in 2024, this may reduce the possibility of excessive tax incentives offered by AMS in a race to attract FDI. AMS could also consider alternative measures, instead of tax incentives, to support the operations of foreign invested enterprises. While competition is not necessarily undesirable, AMS should be reminded that they are also striving for a single production base in line with the ASEAN Economic Community Blueprint. Cooperation in terms of FDI policy would thus be an area that requires joint efforts by AMS. In this regard, the amendment of the ACFTA should foster those joint efforts.

⁵ Foreign invested enterprises also often participate in longer-term contracts with foreign suppliers. Some 89.5% of enterprises in the Enterprise Census survey signed only short-term contracts (terms of less than 3 years) with component suppliers (Nguyen, 2018).

3.4. Development cooperation

In past development cooperation projects, the Chinese government provided financial support to the Vietnamese government in the form of concessional loans and loans that focus mainly on areas such as railways, thermal power, and industrial production. Compared with other foreign loans of the Vietnamese government, loans from China arguably had binding conditions and low preferences, leading to relatively high capital costs. The procurement method under Chinese loans is to select a contractor from the list of Chinese contractors offered, which by nature reduces competition. In addition, the regulations on investment and construction management of Viet Nam and China still exhibit differences. On the other hand, as a loan condition, most goods and equipment must be purchased from China. This arguably increases dependence on Chinese goods, affecting the progress and quality of works. For instance, the Cat Linh–Ha Dong sky train project experienced further delays⁶ during the COVID-19 pandemic as the mobilisation of experts and personnel from China was disrupted.

Meanwhile, despite the diversity, ongoing Mekong-related cooperation mechanisms involving Viet Nam and China exhibit some limitations. First, such cooperation mechanisms present a complex web, which may be prone to duplication and inefficient use of resources. For instance, GMS cooperation covers transportation, energy, environment, tourism, telecommunications, trade, investment, human resources development, agricultural and rural development, and urban development along economic corridors – many of which may be similar to the three pillars and five priority areas under the MLC. Dr An Pich Hatda, head of the MRC Secretariat, acknowledged that ‘overlapping is unavoidable, but what is vital is to create a more coherent and effective coordination mechanism that ensures joint efforts’ (MRC, 2019b). Consequently, any new initiatives in the Mekong Subregion will have to address the explicit question of potential duplication and coordination with existing cooperation mechanisms.

Second, the existing mechanisms are yet to sufficiently improve efficiency in water use and management. The MRC (2017: 2) noted that:

The absence of joint planning and collaboration between border provinces has resulted in inappropriate infrastructure development in the Mekong Delta. Uncoordinated development of flood control and irrigation systems, such as dykes and embankments, could cause floods and drought in other areas of the floodplain and may result in water pollution and shortages, and less agricultural production.

More recent analysis and data also show that the natural flow of water in the Mekong River has been adversely affected by various infrastructure projects along the river (Nguyen et. al., 2020). According to the MRC (2019a), the water level in Thailand’s Chiang Saen was 2.10 metres during June–July 2019, 0.92 metres lower than its long-term average (3.02 metres).

⁶ The project was already delayed for years before the COVID-19 pandemic due to various reasons.

Third, notwithstanding the range of cooperation mechanisms, the diversity of their funding sources has not been improved significantly. For instance, Cambodia, the Lao PDR, Myanmar, and Thailand (the CLMV) and Thailand are yet to fund activities under the MLC. Vannarith (2016) asserted that the main challenge for the MRC during 2016–2020 was the mobilisation of funding. Given the COVID-19 outbreak, which may drain the fiscal space of Mekong Subregion countries and external donors, ensuring sufficient funds for Mekong projects may become no easy task.

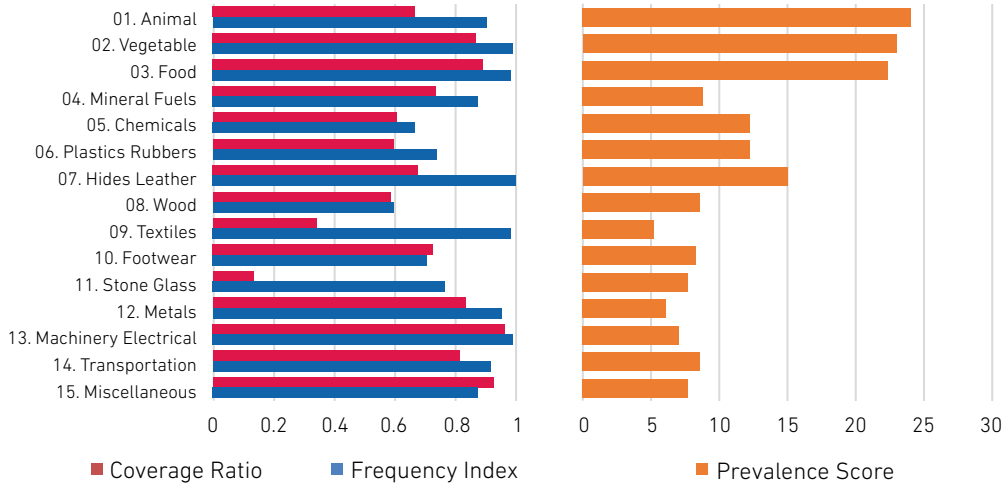
4. Renewing the ACFTA: potential benefit and cooperation measures

From a Vietnamese perspective, the amendment of the ACFTA could focus on some key cooperation measures that would bring potential benefits to concerned member economies. First, traders may benefit from more flexible rules of origin, which may reduce compliance costs for firms and improve the utilisation of the ACFTA. As the first scenario, if the rules of origin under the ACFTA could be adapted to attain the same trade utilisation level as under the ASEAN Trade in Goods framework (2021 baseline, Table 9), tariff preferences could apply for at least an additional 6.1% of Viet Nam's exports to China. This could equal more than US\$3.5 billion each year if the calculation were based on export values in 2022.⁷ Alternatively, if ASEAN and China could modify the rules of origin to attain similar flexibility to the AKFTA/VKFTA (Table 9), the scope of Vietnamese exports to China that could enjoy tariff preferences would be even bigger, amounting to up to US\$9.8 billion each year (based on export values in 2022).

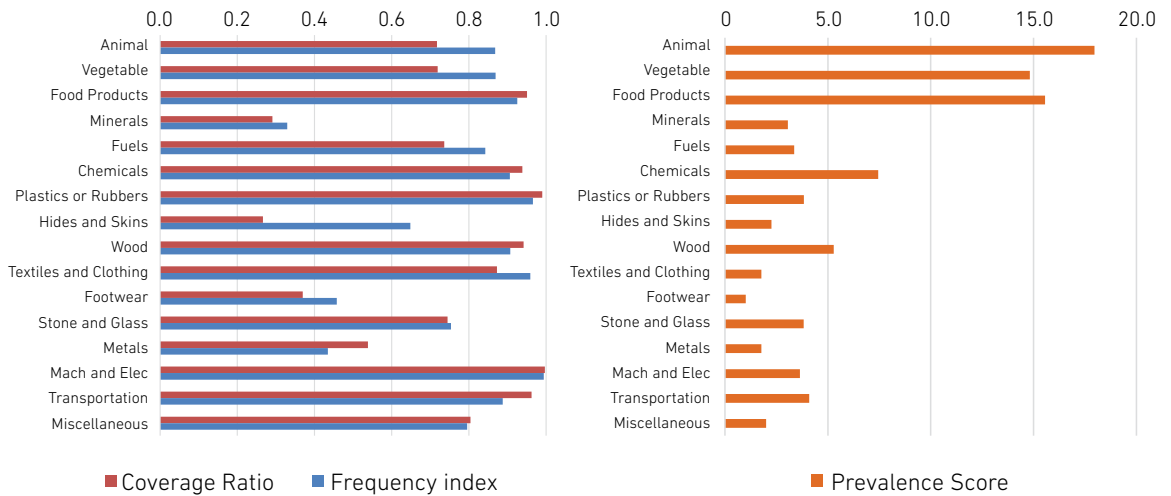
Second, trade facilitation measures should be emphasised in the revised ACFTA. Such measures may cover those related to the transparency of trade regulations, border trade and customs clearance, paperless trading, etc. Such measures could help reduce trade costs and improve supply chain resilience, especially in the post-COVID-19 pandemic era. As e-commerce platforms have expanded operations in cross-border trade between ASEAN and China, cooperation in the modernisation of customs and paperless trading could be crucial to complement and facilitate firms' efforts.

⁷ No detailed calculation of the benefits from the tariff reduction level because of rules of origin compliance

Figure 6.5 NTM Indicators of China and Viet Nam
China



Viet Nam



NTM = non-tariff measure.

Source: Ing and Hadiwidjaja (2022) and Nguyen et al. (2019).

Third, Viet Nam and China have enormous scope to streamline SPS and TBT regulations (Figure 6.5). The non-tariff measure (NTM) coverage ratio suggests that technical regulations could be streamlined towards less burden for machinery and electrical appliances, animal, vegetable, and food products. Meanwhile, the NTM prevalence scores are high for imports of animal, vegetable, and food products into both China and Viet Nam. This comparison shows that streamlining efforts could at the minimum work for animal, vegetable, and food products.

Fourth, ASEAN and China should consider explicit provisions that enable capacity building for trade and investment promotion in line with new contextual needs. On the one hand, such trade and investment promotion should be more aligned with digital transformation and sustainable development. On the other hand, ASEAN and China should make joint efforts for human resources development. This direction requires concrete programmes to upskill and reskill labour to meet the standards and related requirements of GVC participation, and the development of new products and sectors (e.g. the creative economy and e-commerce). In this area, the ACFTA could induce more innovative and resilient growth and GVC development in the ASEAN–China region.

Finally, the ACFTA should promote dialogue on issues related to the impacts of crisis on the legal infrastructure for trade, relaxing foreign ownership limits in finance and banking, trade in essential goods, etc. While the focus may be on trade in goods, which can be easier and advance more rapidly, the agreement should create a pull factor for more progressive efforts towards services liberalisation by ASEAN and China. On another note, China already operates online dispute resolution in Guangzhou to help resolve cross-border business-to-business disputes, including those under the RCEP. Therefore, fostering dialogue on structural reform issues to promote online dispute resolution could be beneficial for SME-targeted policymakers in ASEAN and China. At the same time, ASEAN and China should continuously share best practices and experiences in the rule-making process, especially for trade-related regulations concerning health standards, essential products, etc. Only by this approach can ASEAN and China foster mutual understanding, strengthen regulatory transparency, and devise concrete joint and/or individual plans to streamline the concerned regulations.

5. Recommendations

The authors make several recommendations as follows.

First, ASEAN and China should consider favourably the possibility of negotiating an amended version of the ACFTA. In doing so, ASEAN and China should quickly and, at the same time, carefully devise a tentative timeline and scope for negotiation, to facilitate the domestic buy-in process. Besides, the ACFTA should preserve the harmonisation approach embodied under the RCEP and existing ASEAN FTAs. This requires coordination by and cohesion of ASEAN in the negotiation process. Key areas that may need strong focus are rules of origin, SPS measures, TBTs, new-generation FTA issues, development cooperation, and a concrete mechanism to facilitate dialogue and sharing of experience.

Second, Viet Nam should adopt a set of concrete policies that enable harmonised implementation of the amended ACFTA with existing FTAs, especially the CPTPP, EVFTA, and RCEP, while supporting the multilateral trading system (i.e. the WTO). The country should thus continue reforms of the microeconomic foundation, including competition policy, the business environment, and markets for production factors. These reforms must be within a policy framework to maintain macroeconomic stability and strengthen economic resilience. Investment policy must have a central role, guiding and incentivising the development of (a few) prioritised industries, leaving others for free competition. The investment policy must also target deeper participation in the global and regional value chains, and autonomy in attracting and utilising FDI from ASEAN and China. Trade policy should be consistent with investment policy, thereby contributing to more effective and harmonious handling of trade deficits and imports of intermediate goods, and simultaneously be consistent with the participation of domestic enterprises in regional value chains. In addition, Viet Nam needs to address the bottlenecks in infrastructure and human resources, with appropriate engagement of foreign investors and partners.

Third, Viet Nam should improve mechanisms and policies on import and export management and administration. It should also strengthen import and export management mechanisms, aiming towards international best practices (especially under the CPTPP and EVFTA), while ensuring sufficient flexibility for agencies and enterprises to adjust when implementing ASEAN FTAs in general and the ACFTA in particular. Viet Nam should coordinate closely with other AMS to implement related programmes and activities, including the AEC Blueprint 2025 and the Master Plan on ASEAN Connectivity 2025. It should harmonise standards of product quality, food hygiene and safety, environmental standards in trade, NTMs, safeguard and emergency measures, antidumping duties, special sales tax, etc., consistent with ACFTA implementation.

Fourth, Viet Nam should leverage efforts to enhance the competitiveness of Vietnamese products. The country needs to identify potential products with comparative advantages when implementing the ACFTA. In ACFTA value chains, goods cover not only final ones, but also inputs and intermediate components. To that extent, trade policy must be consistent with industry policy when looking into goods. Furthermore, promoting competitiveness must consider the value chain characteristics, including price, quality, ability to fulfil large orders, just-in-time and/or just-in-case delivery, distribution channels, and resilience to natural disasters. On that basis, Viet Nam should formulate and implement a strategy to manufacture products that have competitive advantages to penetrate ASEAN–China markets. In this respect, participation in and building of competitiveness in the ACFTA region must fit in the broader consideration – making Vietnamese products competitive at the global level. Besides, Viet Nam should focus on building strong national brands. Exploiting competitive advantages must be via product differentiation. Effective trade promotion could be through the network of overseas Vietnamese in general and in ACFTA markets in particular.

Fifth, Viet Nam should build capacity for promoting exports in combination with aligning import activities. In doing so, the policy mindset should avoid the perception that imports are unfavourable. The country should carefully study and identify policies to penetrate ACFTA markets to create a pulling effect on Vietnamese goods from customers and importers abroad. At the same time, it should exploit the existing advantages of Vietnamese exports in major non-ACFTA markets to promote re-entry into ACFTA markets. It should also consider the statutory upgradation of quality standards required for agricultural exports, in close consultation with the business community and farmers. Furthermore, it should study and review mechanisms to guide import activities to enable enterprises to participate more deeply in the value chain.

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Chapter 7

Malaysia's Perspective

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1. Introduction

The world is bracing for a further slowdown in the global economy. Even though projections have improved, the pace of global growth will still fall in 2023 compared with 2022, but by a smaller margin than predicted in October 2022. The International Monetary Fund forecast an annual growth rate of 2.9% for 2023 – up from a 2.7% forecast in October 2022 – versus 3.4% growth in the previous year (IMF, 2023). This revision was made due to several factors, including the resilience in demand in the United States (US) and European markets, easing of energy costs, and the reopening of China's economy after Beijing abandoned its coronavirus disease (COVID-19) restrictions. In developing and emerging Asia, growth rates since 2022 have been higher than in counterparts in other regions. In 2024 and 2025, growth rates are projected to be 5.3% and 5.2% in the region – the highest in the world.

Economic integration has been a pillar of the Association of Southeast Asian Nations (ASEAN). Over the past 3 decades, its Member States have undertaken efforts towards a more comprehensive form of integration through several different agreements and partnerships, all of which seek to promote trade and investment for mutual benefits and regional cooperation. However, it is critical that economic integration and growth are inclusive and deliver sustainable economic growth, especially in times of crisis. With the global economy slowing down as early as the last quarter of 2022 due to the war in Ukraine, soaring energy prices, and inflationary pressures, ASEAN can use existing platforms to combat issues related to supply chain bottlenecks and food security instead of adopting inward-looking measures to combat these externalities.

2. Impacts of the ACFTA on ASEAN Economic Development Since 2003 and the Implications for ASEAN–China Relations

Trade is very important for the growth of ASEAN economies as it leads to employment and hence social stability. As a small open economy, Malaysia is party to many bilateral and multilateral agreements. To date, it has ratified both the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). It is important to note that while China is a member of the RCEP, ASEAN and the ASEAN centrality mechanism drove its negotiation.

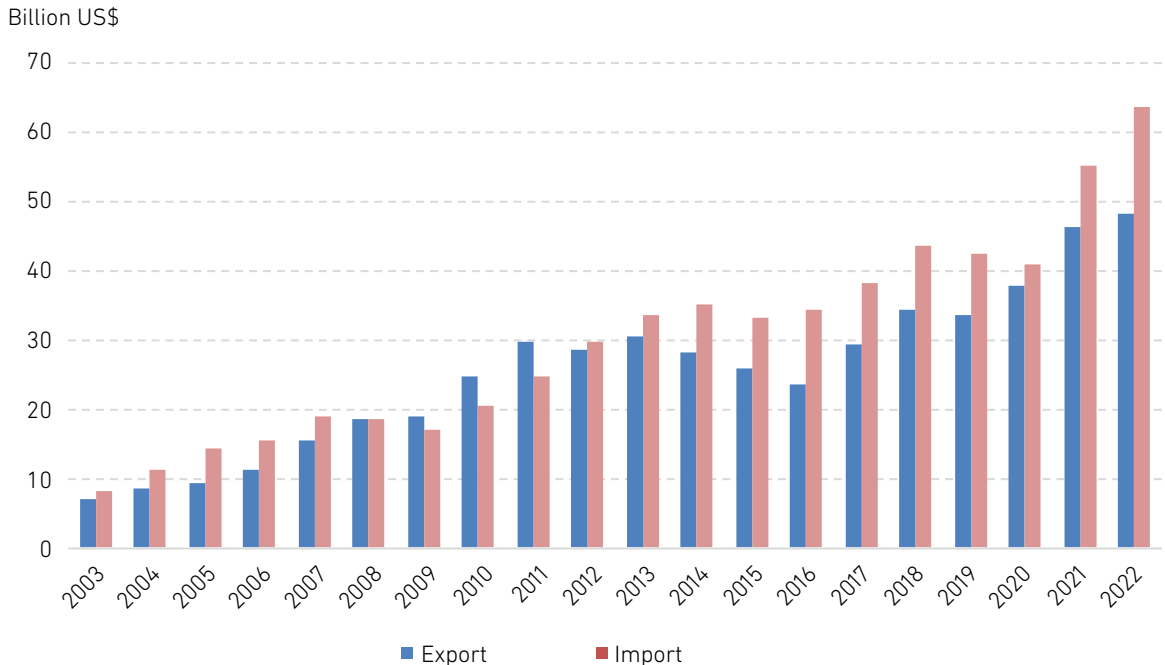
As a small open economy, these free trade agreements (FTAs) are important for Malaysia to attract foreign direct investment (FDI). Additional FDI will in turn help the country transition to the Fourth Industrial Revolution, supported by automation and digitisation solutions. Malaysia would like to transition from producing low value-added products to higher value-added products, and from depending on unskilled workers and trying to attract skilled workers to support its industries in the medium term.

Stability is key to attracting FDI – not just in the country, but also in the region. The trade tensions between China and the US are not new to Malaysia, so it tries to manoeuvre by not choosing sides as both countries are close trading partners of Malaysia. This sentiment is similar to that of most countries in the region. Given that China is the biggest trading partner of most ASEAN Member States (AMS), further cooperation and reforms on both sides could lead to increased trade and investment activities in the medium to long term. This partnership was established more than 2 decades ago.

The ASEAN–China Free Trade Agreement (ACFTA) has been hailed as a significant step towards boosting economic ties between China and the 10 AMS. This mega trade agreement was signed at the Sixth ASEAN–China Summit in 2002 and officially came into effect in 2010 (MITI, n.d.). Since then, it has played a vital role in strengthening trade and investment relations between ASEAN and China, helping to create new opportunities for businesses and bolstering economic growth in the region.

Figures from the China International Import Expo (2022) demonstrated the growing importance of ASEAN as a key economic partner for China. In the first quarter of 2022 alone, China's trade with ASEAN amounted to an impressive \$212 billion. This highlights the significant role that ASEAN plays in China's global trade network, accounting for 14.4% of total foreign trade value. This is a clear indication of the immense potential of the ASEAN–China economic partnership, which has provided numerous benefits for both sides in terms of increased trade flows, greater investment opportunities, and deeper regional integration.

China has been an important trading partner to Malaysia for decades, as portrayed in Figure 7.1. From 2003 to 2022, we can observe that Malaysia's exports and imports to China steadily increased. However, the gap between exports and imports continues to widen due to factors such as domestic income and demand for imports (Chan, 2016).

Figure 7.1 Malaysia trade with China, 2003–2022

Source: www.ASEANstat.org (n.d.)

According to ASEANstat (n.d.), Malaysia, Viet Nam, and Thailand were the top three trading partners of China in ASEAN in 2021. The Department of Statistics Malaysia (DOSM) reported that China remained Malaysia's most significant export destination and origin of imports in the same year. Malaysian exports to China reached a value of US\$41 billion, while imports from China amounted to US\$49 billion (DOSM, 2022).

Despite the challenges posed by the pandemic, bilateral trade between China and ASEAN has continued to grow. In nominal terms, the total trade between China and ASEAN increased by almost 4% from January to August 2020 compared with the same period in the previous year, amounting to US\$416.5 billion and accounting for almost 15% of China's total trade. Furthermore, FDI outflows from China to ASEAN grew by about 53% in the same period, indicating the increasing investment cooperation between the two parties.

As the RCEP has entered into force, the trade relationship between ASEAN and China is expected to intensify in the medium term (Mohamad and Cheng, 2020). The RCEP serves as an upgrade to the existing ACFTA by including areas beyond trade in goods, trade in services, and investments, such as intellectual property, e-commerce, and competition policy. Therefore, it is expected that the RCEP will provide new opportunities for ASEAN and China to deepen their economic cooperation, enhance their competitiveness, and further integrate into the global economy.

Nevertheless, as the RCEP commitments are somewhat diluted due to the inclusion of all 15 countries (the 10 AMS, Australia, China, Japan, the Republic of Korea, and New Zealand), an ASEAN–China FTA upgrade will provide an opportunity for ASEAN to commit to higher standards with China in selected sectors.

2.1. A brief history of the ACFTA and the Upgraded Protocol

The ACFTA has had a positive impact on the trade relations between ASEAN and China. In 2021, despite the challenges posed by the pandemic, the total bilateral trade volume reached US\$878.82 billion, with ASEAN being China's largest trading partner for the second year consecutively. Moreover, the ACFTA has facilitated ASEAN's efforts towards regional integration and economic development. By creating a more liberalised trade environment, the agreement has allowed for increased cross-border trade, investment, and economic cooperation. In addition, the ACFTA has helped improve the competitiveness of ASEAN's economies and enhance their production capacity, particularly in manufacturing and agriculture.

Moving forward, there is potential for the ACFTA to deepen and broaden its scope. For instance, discussions on upgrading the ACFTA are under way, with both sides exploring the possibility of expanding the agreement to cover new areas such as e-commerce, intellectual property rights, and environmental protection (Xinhua, 2021). This could lead to greater economic integration and benefits for both ASEAN and China.

The Protocol to Amend the Framework Agreement on Comprehensive Economic Cooperation and Certain Agreements thereunder between ASEAN and China (2015), hereinafter referred to as the 'Upgraded Protocol' of the ACFTA, will affect several areas of economic cooperation between ASEAN and China. These include trade in goods, trade in services, investment, and economic and technical cooperation. In terms of trade in goods, the Upgraded Protocol aims to increase market access by reducing tariffs and non-tariff barriers. The agreement also includes provisions on customs procedures, rules of origin, and trade remedies. With regard to trade in services, the Upgraded Protocol seeks to liberalise the services sector by removing barriers to entry and promoting cooperation between ASEAN and China. In addition, the agreement covers investment, including provisions on investment promotion and protection, as well as dispute settlement mechanisms. Finally, the Upgraded Protocol emphasises the importance of economic and technical cooperation in areas such as agriculture, energy, transportation, and information technology.

Despite the progress made by the Upgraded Protocol, challenges remain to be addressed in the ASEAN–China economic relationship. For instance, the unequal distribution of benefits amongst the parties poses concerns, with some countries benefiting more than others. The impact of the agreement on certain sectors, such as agriculture and small and medium-sized enterprises, is also an area of concern. Furthermore, discussions are ongoing about the inclusion of new areas of cooperation, such as e-commerce and intellectual property. Considering these challenges, it is important for ASEAN and China to continue working towards a more balanced and inclusive economic partnership.

Nevertheless, it is important to note that the Upgraded Protocol will affect the following areas:

- (i) Simplifying rules of origin and certificate of origin procedures
- (ii) Liberalising trade in services to enhance sectors such as engineering, construction, sports, securities, travel agencies, and tour operators
- (iii) Strengthening investment promotion and facilitation
- (iv) Building e-commerce capabilities (focusing on micro, small, and medium-sized enterprises (MSMEs))

With the rapid growth in e-commerce and digital technologies, the Upgraded Protocol emphasises the need to support the digital economy and facilitate the participation of MSMEs in cross-border transactions. Creating a favourable environment for e-commerce is crucial in unlocking the potential of MSMEs and empowering them to compete in the global market.

To achieve this, Article 7(3) of the Upgraded Protocol outlines the sharing of information, best practices, and dialogue on e-commerce related concerns amongst ACFTA members. This provision allows for the exchange of knowledge on laws and regulations to ensure a conducive environment for e-commerce development. In addition, MSMEs can participate in e-commerce workshops and training programmes to enhance their capabilities and overcome hurdles related to cross-border transactions.

The focus on MSMEs in the Upgraded Protocol is particularly significant as they play a vital role in the growth and sustainability of the economy, particularly in developing countries. By enhancing their access to e-commerce opportunities, MSMEs can expand their market reach and increase their contribution to the economy. Therefore, the Upgraded Protocol's emphasis on e-commerce and MSME development is a step towards creating a more inclusive and equitable trading environment.

Despite the significant progress made by the previous ACFTA Upgraded Protocol in promoting trade and investment between ASEAN and China, several challenges and uncertainties remain in the global trade and e-commerce landscape. These challenges include issues such as intellectual property rights protection, data privacy, cybersecurity, and cross-border data flows (World Economic Forum, 2023). In addition, the COVID-19 pandemic and geopolitical tensions have created new challenges and disruptions to supply chains and trade flows, affecting economic activity (Mohamad and Jefri, 2022). To ensure that the ACFTA continues to facilitate economic growth and development for all its members, the next upgrade of the agreement should address these challenges and uncertainties, which will be discussed in the next section.

2.2. Malaysia's imports and exports from China by product

To examine bilateral trade relations between Malaysia and China, it is not only important to examine how trade with China has grown in terms of nominal value but also in terms of its products. In 2021, the top three products exported were electronic integrated circuits (SITC 7764), palm oil and its fractions (SITC 3431), and magnetic tapes for sound recording (SITC 8984), with the first being consistently the top exported product since 2010, albeit on a decreasing trend after 2014. In 2014, it constituted about 30% of total exports, but only 20% in 2011. On the other hand, palm oil and its fractions (SITC 4222) and storage units (SITC 7527) were amongst the top five exported products from 2010 to 2016 and from 2010 to 2018, respectively. However, the contribution of palm oil and its fractions to total exports declined from 11% in 2011 to 4% in 2015 and has stayed below 5% since then.

From 2010 to 2021, electronic integrated circuits and micro-assemblies (SITC 7764) and electrical apparatus for line telephony or line telegraphy (including such apparatus for carrier-current line systems) (SITC 7641) have consistently been amongst the top three imported products in terms of value. Petroleum oils and oils from bituminous minerals (other than crude), and products containing 70% (by weight) or more of these oils, except waste oils, not elsewhere specified (SITC 3346) experienced a significant increase in import volume in 2016, causing it to become the third most imported product from China. This surge represented a 300% rise from the previous 5-year average of US\$1,171 million. Since then, this product has consistently maintained its position amongst the top five imported products. The top exported product from Malaysia between 2010 and 2021 was electronic integrated circuits and micro-assemblies (SITC 7764), which was also the top imported product during the same period. Despite this, Malaysia maintained consistent net exports of electronic integrated circuits and micro-assemblies (SITC 7764) over the years. On the other hand, parts and accessories for use solely or principally with office machines, except photo- or thermo-copy, and automatic data processing machines (SITC 7599) witnessed a decline in import value since 2010. Although it was the most imported product in 2010, it consistently remained in the top five until 2015.

Looking at the manufacturing subsectors, DOSM (2022) highlighted the significant total imports of China by commodity section in Malaysia, which amounted to US\$49 million. The highest import value was recorded for machineries and transport, contributing a substantial US\$26 million to overall imports in 2021. The second-highest import category was manufactured goods (US\$7.1 million). Chemicals also constituted a significant share of imports (US\$5.3 million). Other significant imports from Malaysia to China included miscellaneous manufactured articles (US\$4.6 million) and mineral fuels (US\$2.8 million), both of which have contributed significantly to the bilateral trade between the countries. These statistics demonstrate the positive economic relations between China and Malaysia, with potential for growth and diversification in various sectors.

2.3. Chinese FDI in Malaysia

In terms of Chinese FDI flows to Malaysia, DOSM (2021) showed that the net FDI inflows to Malaysia from China mainly targeted the manufacturing sector, which absorbed more than one-third of Malaysia's FDI inflows from China in 2021. What is interesting to note is that other non-traditional sectors also receive investment from China, such as the agriculture, mining, and construction sectors, in the same year of observation.

Despite renewed commitments from the ACFTA Upgrade to liberalise the services sector, net FDI from China to Malaysia flows have decreased tremendously since 2017. The net FDI flows picked up again from 2018, but the trend was reversed in 2020 due to the pandemic (DOSM, 2021).

Other non-traditional sectors also receive investment from China, such as the agriculture, mining, and construction sectors. Even though the net flow of investments has been volatile since 2021, the value has increased again, showing renewed interest from China.

According to the data presented in Table 7.1, China held 28th position in terms of FDI in Malaysia in 2010. However, it can be argued that due to the implementation of the ACFTA and other factors, China's ranking in terms of FDI has significantly improved over time. In fact, as indicated in Table 7.2, China has climbed the ranks and held ninth position in 2021 with regard to total FDI in Malaysia. This substantial jump in China's FDI position highlights the growing economic ties and business relations between Malaysia and China.

Table 7.1 Top 10 Sources of FDI in Malaysia, 2014

Rank	Country	Total investment (US\$ million)
1	Singapore	11,283
2	Japan	8,012
3	United States	7,352
4	Netherlands	5,862
5	United Kingdom	3,915
6	British Virgin Islands	3,553
7	Germany	2,649
8	Hong Kong	2,497
9	Switzerland	2,386
10	Bahamas	2,365
28	China	214,293,000

FDI = foreign direct investment.

Source: DOSM (2015).

Table 7.2 Top 10 Sources of FDI Positions in Malaysia, 2021

Rank	Country	Total investment (US\$ million)
1	Singapore	36,110
2	Hong Kong	18,316
3	Japan	17,739
4	United States	16,401
5	Netherlands	13,079
6	Switzerland	6,881
7	United Kingdom	6,410
8	British Virgin Islands	6,053
9	China	5,445
10	Republic of Korea	4,216

FDI = foreign direct investment.

Source: DOSM (2022).

3. Good Practices and Lessons in Implementing the ACFTA, Including the Update

Malaysia has always believed that attracting FDI is a key element in boosting the country from an agriculture-based economy to an industrialised economy. From 2017 to 2021, net FDI inflows have remained above 2% of GDP (DOSM, 2022). Even though Malaysia is concerned about attracting and retaining FDI in critical sectors, it is also very open in renewing the ASEAN Trade in Goods Agreement (ATIGA) and the ACFTA, while embarking on newer FTAs such as the RCEP and the CPTPP.

Malaysia looks forward to the upgrade of the ACFTA, especially as the upgrades could lead to further growth in trade and investment and technology transfer in the medium to long term. With the ratification of both the ACFTA and the ACFTA 2.0, trade and investment activities between China and Malaysia and between China and the region have flourished in nominal terms in the past 2 decades. This is emphasised by China's rising ranking of the sources of FDI in Malaysia.. With further cooperation in new areas such as e-commerce and digital trade and the environment between China and ASEAN, regional and global value chains in the region can be repaired and bolstered, and the Asia-Pacific may emerge once again as the engine of growth for the region and the world (Mohamad and Jefri, 2022). This may be vital for the next few years, especially as the slowdown of the global economy started as

early as the last quarter of 2022 amongst countries within the region. The new upgrade, or the ACFTA 3.0, should include commitments in non-traditional trade chapters such as e-commerce, digital free trade zones, and the environment, applying discipline to the activities of trade and investment in the long term.

This is very much in line with the direction of new FTAs and new commitments made through the CPTPP and the higher standards set by the European Union (EU) through its Regulation on Deforestation-free products. With the private sector stepping up to be certified under environmental, social, and governance efforts to cater to trading partners' needs, ASEAN and China should take this opportunity to upgrade the ACFTA to include discipline chapters that would lead to higher standards being adopted in the region.

Another area to improve upon is non-tariff measures (NTMs). According to the Asian Development Bank Institute (Menon and Melendez, 2019), the two upgrades of the ACFTA have not led to the elimination of NTMs. This needs to be remedied through transparent announcements and the introduction of NTMs in a one-stop centre before implementation. A single window platform will be key to progress in this area. As highlighted in the CPTPP agreement, businesses that are impacted by changes in policies related to NTMs can raise the issue to the implementer for justification.

For the ACFTA to remain relevant in uncertain times, there should be cooperation between the two blocs instead of adopting protectionist measures. A case in point is the pandemic, where NTMs were erected in 2020 by RCEP member countries. While such NTMs are easily introduced, 2 years later, those barriers were still used amongst a few of the countries observed (Mohamad and Jefri, 2022).

4. Evolution of ASEAN's Regional Policy Towards China from both the Regional and Country Perspectives

As a small trading nation, Malaysia is party to many FTAs and partnerships within the region and beyond. The two recently ratified FTAs, which have entered into force, are the RCEP and the CPTPP.

Even though the RCEP and the CPTPP are both mega regional FTAs involving the Asia-Pacific region, they are unique in their own ways. There are large overlaps in membership between the two trade agreements, but the RCEP is ASEAN centred while the CPTPP involves mostly upper-middle and high-income economies, including North and South American countries such as Canada, Mexico, Chile, and Peru.

Although China is a ratified member of the RCEP, it is not yet a member of the CPTPP despite applying at about the same time as Taiwan. While Taiwan is ready to be a ratified member of the CPTPP, as its policies and laws are very much in line with the standards outlined by the agreement, some experts have doubted China's intention and its readiness to conform to the very high standards in the labour, government procurement, and environment chapters. It is important to note that to be a member of the CPTPP, all the ratified members need to accept the new members unanimously.

Additionally, while there has been one upgrade to the ACFTA, another platform within the region has not included China or is used by major powers to contain China. This new platform is the Indo-Pacific bloc. To date, there are at least six interpretations of the Indo-Pacific. In 2018, ASEAN published its own take on the framework through the ASEAN Outlook on the Indo-Pacific (AOIP). Despite the lack of attention given to the AOIP and its progress, cooperation and collaboration on the pillars of the AOIP have continued incrementally through different ASEAN platforms such as the ASEAN Economic Community (AEC) targets, the ASEAN Defence Ministers' Meeting, and the ATIGA upgrade talks.

From ASEAN's perspective, the AOIP would not derail targets set out in the AEC blueprint or the ATIGA commitments. It is hopeful that the progress of the AEC and other ASEAN-led reforms can be expedited by achieving the targets set within the AOIP framework, as the AOIP 'involves the further strengthening and optimization of ASEAN-led mechanisms, including the East Asia Summit (EAS), the ASEAN Regional Forum (ARF), the ASEAN Defence Ministers Meeting Plus (ADMM-Plus), the Expanded ASEAN Maritime Forum (EAMF) and others such as the relevant ASEAN Plus One mechanisms' (ASEAN, 2019: 2). Nevertheless, some experts doubt that the AOIP by itself can help expedite the realisation of the AEC 2025 Vision. As it stands, leadership within ASEAN is needed to change the status quo.

While the AOIP is inclusive in terms of cooperation and membership, this is less true for the Indian and US definitions of the Indo-Pacific region. Given China's relationship with ASEAN in terms of investment and trade, it is difficult not to include China in any ASEAN-led platforms, including the AOIP. Even though ASEAN has taken a more diplomatic view of the Indo-Pacific, 'there was a sense that ASEAN should have maintained its emphasis on the Asia-Pacific region rather than respond to the Indo-Pacific nomenclature' (Wau and Tay, 2020: 1).

Nevertheless, ASEAN's publication of the AOIP is a positive sign that showcases the ASEAN centrality and the ASEAN voice mechanism at play not just on trade-related issues but on security and maritime issues, which are important in 'maintaining peace and stability' within the region (ASEAN, 2019).

Other than these platforms, the Belt and Road Initiative (BRI) championed by China has also had impacts on host countries within the region and beyond. However, even though the BRI has led to better access to funding for countries in need of critical infrastructure, BRI projects are linked to non-transparent bilateral dealings and governance gaps such as opaque procurement evaluations, lack of transparency in feasibility studies, and cost overruns and project delays, amongst others. Nevertheless, it is important to note that ASEAN counterparts need to step up in setting their own terms to ensure that such investments are safe and transparent. Accountability needs to be improved upon on both sides.

5. Areas to Be Prioritised in Promoting Free Trade and Closer Cooperation Between China and ASEAN

5.1. Digital economy and e-commerce

The digital economy could be a key growth area for Malaysia and China. According to the DOSM Digital Economy 2018 report, Malaysia's digital economy, which includes the e-commerce and information and communication technology sectors, was estimated to be valued at about US\$57.6 billion, or about 18.5% of GDP. Due to the rapid growth of digital trade activities, some estimates projected that this share of GDP would reach more than 20% by the end of 2020 (DOSM, 2019). In reality, due to the pandemic, its share only reached about 12.15% based on published 2020 data.

In comparison with China, Gong and Yeung (2022) argued that Malaysia shares similar priorities in terms of its digital economy plans. For example, the Chinese government is focusing on three overarching areas of the digital economy: cloud computing, the industrial internet, and data. Meanwhile, the Malaysian government's aspirations set out in the Malaysia Digital Economy Blueprint (MyDigital) also include data, cloud computing, and the Fourth Industrial Revolution.

The next area of collaboration to target is the digital economy through the introduction of an e-commerce chapter that is more comprehensive than the CPTPP and RCEP combined. Though the e-commerce chapter may highlight market access to certain subsectors, it should highlight discipline on how to navigate matters on data transfer, data localisation, data ownership, and equal access to the digital economy.

This is important so that data protection and data governance guidelines can be spelled out clearly. Before collaborating further on the e-commerce sector, such discipline needs to be well thought out as it may or may not be in line with the aspirations highlighted in bigger and more advanced FTAs such as the CPTPP and the Digital Economy Agreements (DEAs) signed by Australia and New Zealand. The development of the e-commerce chapter should ideally lessen NTM issues within digital economy activities, but the new upgrade should aggressively tackle the elimination of NTMs between ASEAN and China in the medium to long term. This goes back to ASEAN's readiness and willingness to reform by eliminating the usage of unjustified NTMs.

Additionally, Malaysia needs to prepare itself beyond the commitments in the MyDigital Blueprint. Malaysia's Personal Data Protection Act (PDPA), 2010 needs to be upgraded for several reasons, including conformance with certain commitments highlighted by the CPTPP and RCEP agreements and other DEAs that it aspires to be part of in the next few years. Other issues on cybersecurity also need to be examined and addressed within the e-commerce chapter.

5.1.1. Taxing the digital economy

Taxing the digital economy is complicated for Malaysia and other AMS. Since 2020, the Malaysian government has introduced and proposed a series of taxes directly or indirectly targeting the digital economy to increase its revenue in an otherwise unregulated new sector. The justifications for introducing or proposing such taxes are to (i) ensure Malaysia's taxation framework remains adequate for the digital economy, and (ii) level the playing field for local businesses. Recently implemented or proposed taxes targeting the digital economy can be broken down into direct and indirect taxation (Said, Shamsunahar, and Mohamad, 2022). These taxes include the Sales Tax (Amendment) Bill, 2022 and the Service Tax on Digital Service and Tourism Tax (Amendment) Act, 2021, amongst others. In an engagement session with selected stakeholders in Malaysia, some raised a variety of concerns about digital taxes either already proposed or introduced in Malaysia over the last few years. These concerns include confusion over double taxation, lack of transparency in implementation plans, and the increasing cost of doing business. Even though such taxation is needed, clarity over its impact on both local and international players and its implementation is key to keep all the stakeholders informed in a timely manner.

Apart from implementation, the taxation regimes of different AMS will also impact how goods and services are to be taxed. To grow the e-commerce industry healthily, provisions on taxation need to be discussed and addressed clearly for the next upgrade to be beneficial.

5.1.2. Personal data protection

Malaysia has two data classification regimes where obligations for cybersecurity are in accordance with the data user. For the private and commercial sector, the PDPA states that data management should be in line with the seven principles of data protection: (i) the general principles, (ii) the principles of notice and choice, (iii) the disclosure principle, (iv) the principles of safety, (v) the retention principle, (vi) the data integrity principles, and (vii) the access principle. Data classification for the government differs from that of the commercial sector, with the central document for the classification being the OSA 1972.

Under the PDPA, data localisation requirements are not imposed (Said, Shamsunahar, and Mohamad, 2022). The PDPA states that transfers to third countries should only be possible if the country is approved or whitelisted. However, potential updates to the PDPA are leaning towards a 'blacklist' approach instead, which could address differences in data management. Data managed by the government takes a data residency approach, where the department opting for cloud computing needs to know the 'source of origin' for the cloud computing services. This includes understanding data flows and data residency processes to ensure that the information and strategic data cannot be accessed by foreign powers.

Furthermore, Malaysian government departments are encouraged to anchor approaches with data sovereignty, whereby departments refer to the legal requirements and jurisdictions where the data will physically reside. Additionally, data sovereignty considerations should include (i) data management and stakeholders in the relevant department; (ii) data security; (iii) the physical geographical location and residency of the data; (iv) rules, procedures, and laws; (v) security risks; (vi) data classification; (vii) ownership of data; and (viii) data flows.

With its complexity and requirements, enforcement will be a challenge. As the laws will be enforced under different agency jurisdictions, this may cause confusion for investors, users, and players. Enforcement of data-related issues in the public sector will be under the purview of the chief government security officer, the Malaysian Administrative Modernisation and Management Planning Unit, and the police, while that of the private sector will be under the purview of the Personal Data Protection Department, the police, and the Malaysia Communications and Multimedia Commission.

Given the complexity and expansion of the cybersecurity and e-commerce environment, ASEAN needs to think hard about setting its own standard when it comes to data transfer and data protection. This could be done before negotiations on the upgrade take place. As uniformity of standards is key, ASEAN needs to agree on whether data localisation policies are needed in this region to enable the digital economy to grow in a safe way.

5.2. Eliminating unjustified NTMs

There is evidence that the introduction of NTMs may lead to higher costs of doing business. As Korwatanasakul and Baek (2021) points out, while both NTMs and tariffs have negative effects on global value chain participation, NTMs have a far greater impact than tariff measures. In certain instances, NTMs can attract FDI to a country because strong intellectual property rights make it easier for foreign investors to protect their interests in the domestic market, particularly when it is challenging for others to imitate their products. On the other hand, the implementation of NTMs can also discourage FDI if the measures introduced will drive up the cost of trade. Additionally, in a survey conducted by the International Trade Centre in Indonesia, about 37% of respondents said they had experienced burdensome regulations imposed by the government of the importing countries. (ITC, 2013)

Another issue related to NTMs is that they are very hard to retract once they are introduced, as was the case during the pandemic (Mohamad and Jefri, 2022). From February to October 2020, RCEP countries introduced 66 new trade measures, of which more than 50% were classified as restrictive. Lockdown measures were put in place to curb the spread of COVID-19, adversely affecting economic activity and disrupting supply chains.

Despite being a global supplier of personal protective equipment (PPE), China restricted its supplies, causing supply shocks in countries around the world. Other governments adopted similar emergency measures by restricting exports of food products, medical goods, and PPE. Liberalising imports while restricting exports of essential goods are key ingredients for supply chain bottlenecks.

In 2022, a few years into the pandemic, certain restrictions that were introduced during the pandemic remained active. Most of these restrictions involve essential goods such as food supplies or medical supply products. RCEP countries, including China, still struggle in their efforts to liberalise because the supply of goods, though rising, still fails to meet the rapid growth in local demand.

Table 7.3 Product Restrictions Introduced During the Pandemic

Enacting country	Type of measure	Products	Details	Status
China	Export restriction	<ul style="list-style-type: none"> Medical supply products Test kits 	<ul style="list-style-type: none"> Certification and inspection requirement Export prohibition 	Active
	Import liberalisation	<ul style="list-style-type: none"> Medical supplies Raw materials Agricultural products Meat 	<ul style="list-style-type: none"> Tariff reduction Temporary decrease in import tariffs Facilitate agricultural administrative processes 	Active
Indonesia	Import liberalisation	<ul style="list-style-type: none"> Onions and garlic 	<ul style="list-style-type: none"> Temporary elimination of import certification requirements 	Terminated
	Import liberalisation	<ul style="list-style-type: none"> Masks and PPE 	<ul style="list-style-type: none"> Temporary elimination of import certification requirements 	Active
	Export restriction	<ul style="list-style-type: none"> Ethyl alcohol Raw materials for masks and PPE Medical supply products Sanitisers 	<ul style="list-style-type: none"> Temporary export prohibition 	Active
	Liberalisation	<ul style="list-style-type: none"> White crystal sugar 	<ul style="list-style-type: none"> Temporary suspension of mandatory Indonesia national standard for white crystal sugar 	Active
	Liberalisation	<ul style="list-style-type: none"> Wheat flour 	<ul style="list-style-type: none"> Temporary exclusion to the addition of fortifying substances to wheat flour 	Active

Enacting country	Type of measure	Products	Details	Status
Malaysia	Import liberalisation	<ul style="list-style-type: none"> • PPE • Medical supplies • Face masks 	<ul style="list-style-type: none"> • Elimination of import duties and sales taxes • Exemption from import duties and sales taxes 	Active
	Export restriction	<ul style="list-style-type: none"> • Masks 	<ul style="list-style-type: none"> • Temporary ban on the export of masks to meet local demand 	Active
Philippines	Export restriction	<ul style="list-style-type: none"> • Rice 	<ul style="list-style-type: none"> • Bukidnon province stops exporting rice to ensure food security during lockdown 	Active
	Import liberalisation	<ul style="list-style-type: none"> • Healthcare equipment and supplies 	<ul style="list-style-type: none"> • Tariff reduction • Imports exempted from import duties, taxes, and other fees 	Terminated (May 2020)
Singapore	Import liberalisation	<ul style="list-style-type: none"> • Hand sanitisers • Masks • Thermometers • Protective gear 	<ul style="list-style-type: none"> • Temporary relaxation of import licensing requirements 	Active
	Import liberalisation	<ul style="list-style-type: none"> • Medical, hygiene, pharmaceutical, and agricultural products 	<ul style="list-style-type: none"> • Elimination of import tariffs and other duties on essential goods 	Active
Thailand	Import liberalisation	<ul style="list-style-type: none"> • Medical supply products 	<ul style="list-style-type: none"> • Exemption of customs duty • Import VAT exemption • Exemption from tariffs 	Active
	Export prohibition	<ul style="list-style-type: none"> • Masks 	<ul style="list-style-type: none"> • Export ban on masks 	Active
	Export prohibition	<ul style="list-style-type: none"> • Eggs 	<ul style="list-style-type: none"> • Export ban on chicken eggs 	Terminated (April 2020)

PPE = personal protective equipment, VAT = value-added tax.

Source: International Trade Centre (n.d.), COVID-19 Temporary Trade Measures. <https://www.macmap.org/covid19>

As mentioned in the previous section, the development of the e-commerce chapter could go hand in hand with eliminating NTM issues within digital economy activities and leveraging and improving on the usage of national single windows and the ASEAN Single Window. The new upgrade should aggressively tackle the issues of eliminating NTMs between ASEAN and China in the medium to long term.

6. Conclusion

Economic integration has been a pillar of ASEAN, and Malaysia has benefited from this membership since its inception. Over the past 3 decades, AMS have undertaken efforts towards a more comprehensive form of integration through several different agreements and partnerships, all of which seek to promote trade and investment for mutual benefit and regional cooperation. However, it is critical that economic integration and growth are inclusive and deliver sustainable economic growth, especially in times of crisis. Malaysia looks forward to the upgrade of the ACFTA, especially as the upgrades could lead to further growth in trade and investment and technology transfer in the medium to long term. With the ratification of both the ACFTA and the ACFTA 2.0, trade and investment activities between China and Malaysia and between China and the region have flourished in nominal terms in the past 2 decades. This is evident in the ranking of investors in Malaysia, with China consistently being one of the top 10 investors in the country.

Nevertheless, for the upgraded ACFTA to remain relevant in uncertain times, there should be cooperation between the two blocs instead of adopting protectionist measures. Additionally, a strategic area of collaboration is the digital economy through the introduction of an e-commerce chapter that is more comprehensive than the existing CPTPP and RCEP agreements. Although the e-commerce chapter may highlight market access to certain subsectors, it should highlight discipline on how to navigate matters on data transfer, data localisation, data ownership, and equal access to the digital economy. These should be the priorities of the ACFTA upgrade discussion.

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Chapter 8

Cambodian Perspective

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1. Introduction

China proposed the idea of a free trade area with the Association of Southeast Asian Nations (ASEAN) in November 2000. In response, the leaders of ASEAN Member States (AMS) and China explored measures aimed at economic integration within the region. In Brunei Darussalam in 2001, both parties endorsed the establishment of an ASEAN–China Free Trade Area (ACFTA). Finally, the framework agreement was signed on 4 November 2002 in Phnom Penh, Cambodia by 10 heads of ASEAN governments and China’s Premier.

The first stage of the ACFTA (or ACFTA 1.0) committed six AMS (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) to eliminate their tariffs on 90% of their products by 2010. According ASEANstats¹, between 2003 and 2008, trade between China and ASEAN grew from US\$59.6 billion to US\$192.5 billion. China’s strong economic transformation led to an increase in foreign investment via the bamboo network, a network of overseas Chinese businesses operating in the markets of Southeast Asia that share common family and cultural ties. AMS and China had a combined nominal gross domestic product of about US\$6 trillion in 2008. On 1 January 2010, the average tariff rate on Chinese goods sold in AMS decreased from 12.8% to 0.6%, pending implementation of the free trade area by the remaining AMS. Meanwhile, the average tariff rate on ASEAN goods sold in China decreased from 9.8% to 0.1%. By 2015, ASEAN’s total merchandise trade with China reached \$346.5 billion (15.2% of ASEAN’s trade), and the ACFTA accelerated the growth in direct investment from China and commercial cooperation. (ASEANStat)

The first ACFTA upgrade negotiations (i.e. ACFTA 2.0 upgrade negotiations) were launched in 2014, signed in 2015, and entered into force for all parties in 2018.

The second ACFTA upgrade negotiations (China–ASEAN FTA 3.0 upgrade negotiations) were announced at the 25th ASEAN–China Summit in Phnom Penh on 11 November 2022 to seize development opportunities and promote cooperation and shared long-term development in AMS and China. The negotiations are scheduled to conclude by the end of 2024 (Xinhua, 2023).

ASEAN and China are strategic partners in trade and investment. Official data show that bilateral trade increased from about US\$100 billion in 2004 to US\$975 billion in 2022. China has been ASEAN’s largest trading partner for 14 consecutive years, while ASEAN has been China’s largest trading partner for 3 consecutive years (Global Times, 2023b). Cumulative bilateral investment between China and ASEAN increased more than 11 times from US\$30 billion in 2004 to USD340 billion in October 2022 (Global Times, 2023a).

¹ www.aseanstats.org

At the 24th ASEAN–China Summit in 2021, the leaders of ASEAN and China endorsed the official launch of negotiations for the upgrade of the ACFTA. The upgrade negotiations intend to ensure that the ACFTA contributes to the further deepening and broadening of ASEAN–China economic relations and to both regions' post-pandemic economic recovery (Xinhua, 2021).

The upgraded ACFTA (or ACFTA 3.0) will cover areas of mutual interest, including the digital economy; green economy; supply chain connectivity; competition; consumer protection; and micro, small, and medium-sized enterprises.

2. Significance of the ACFTA

The ACFTA is the cornerstone of China–ASEAN relations. The agreement is significant as the ACFTA is ASEAN's first free trade agreement (FTA) with an external Dialogue Partner, and China's first FTA.

The ACFTA comprises three different agreements – the Trade in Goods Agreement, the Agreement on Trade in Services, and the Investment Agreement. The three agreements entered into force in 2005, 2007, and 2009, respectively; collectively, the ACFTA entered into force in 2010.

The ACFTA seeks to facilitate trade in goods and services, as well as investment between China and ASEAN. For example, the ACFTA eliminates tariffs on 94.6% of tariff lines for exports to China that originate in AMS. It contains commitments that create market access and ensures a more predictable operating environment for services suppliers. The agreement also provides investors and investments with protection, by establishing a more transparent, facilitative, and secure environment for investors.

The ACFTA underwent one upgrade round that was launched in 2014, signed in 2015, and entered into force for all parties in 2018. The first upgrade made improvements to rules of origin, customs procedures and trade facilitation, market access for services, as well as enhanced economic and technical cooperation.

3. What Should/Could the ASEAN–China FTA 3.0 Aim For?

The second round of ACFTA upgrade negotiations (i.e. ACFTA 3.0 upgrade negotiations) will be comprehensive in scope to ensure the agreement remains relevant and commercially meaningful to businesses in the region.

The ACFTA 3.0 aims to minimise barriers and deepen economic linkages between the parties, lower costs, increase intra-regional trade and investment, increase economic efficiency, create a larger market with greater opportunities and larger economies of scale for the businesses of the parties, and enhance the attractiveness of the parties to capital and talent.

The upgrade negotiations will cover the following elements: (i) trade in goods (tariff reduction; tariff elimination, where possible; non-tariff measures (NTMs), customs procedures and trade facilitation; standards, technical regulations, and conformity assessment procedures; sanitary and phytosanitary (SPS) measures, and transparency); (ii) investment liberalisation and protection; (iii) economic cooperation in areas of the digital economy, the green economy, supply chain connectivity, competition, consumer protection, and micro, small, and medium-sized enterprises; and (iv) enhanced economic and technical cooperation in other areas of cooperation, where possible.

Details for each element to be reviewed for negotiation should be as follows:

3.1. Trade in goods

- **Tariff reduction and elimination:** The upgrade negotiations will aim at enhancing the level of tariff liberalisation.
- **NTMs:** The upgrade negotiations will help ensure that NTMs are not used or developed to impede trade between ASEAN and China. This would contribute to ensuring the effective implementation of market access commitments under the ACFTA and preserving supply chain connectivity between the parties.
- **Customs procedures and trade facilitation:** The upgrade negotiations will build upon the World Trade Organization's Trade Facilitation Agreement to facilitate trade between the parties, while ensuring effective customs controls.

- **Standards, technical regulations, and conformity assessment procedures:** The upgrade negotiations will seek to enhance transparency and strengthen cooperation, consultation, and information exchange to facilitate trade and improve mutual understanding of parties' standards, technical regulations, and conformity assessment procedures.
- **SPS measures:** The upgrade negotiations will seek to enhance cooperation, including collaboration for capacity building; strengthen consultations; and facilitate trade through science-based measures, including risk analysis, while not creating unnecessary barriers to trade.

3.2. Investment

- **Investment liberalisation and protection:** The upgrade negotiations will enhance investment liberalisation and protection, following up on the Future Work Programme under the Upgrading Protocol of the ACFTA, while taking into account existing agreements including the Regional Comprehensive Economic Partnership (RCEP) agreement.

3.3. Economic cooperation

- **Digital economy:** The upgrade negotiations will explore provisions to develop cooperation in areas such as digital trade and services (e.g. e-commerce, paperless trade); data governance (e.g. online personal data and consumer protection, data sharing, data exchange and big data utilisation, electronic transferable records, and cross-border data flows); and other trade-related aspects of digital economy cooperation, including cybersecurity, artificial intelligence, smart city development, upgrading technology and innovation, digital transformation, and management.
- **Green economy:** The upgrade negotiations will include commitments on strengthening collaboration, including through the sharing of knowledge, best practices, and technology in the low-carbon and sustainable economy (e.g. green finance, sustainable consumption and production, the circular economy, and green skills development); green technology (e.g. low-carbon technologies, sustainable and green infrastructure, environmental industry, and green industry); and sustainable energy (e.g. smart energy solutions, energy storage systems, renewable energy, and conservation).
- **Supply chain connectivity:** The upgrade negotiations will explore ways to strengthen the resilience and sustainability of regional supply chains, giving priority to the continued and smooth cross-border flow of essential goods and services.

3.4. Enhanced economic and technical cooperation in other areas

- Many other areas of economic and technical cooperation, which are not highlighted in the documents, could be included if all parties agree.

The ACFTA 3.0 upgrade negotiations will review the topics set out in the table. AMS and China will also address trends such as supply chain connectivity, digitalisation, and sustainability through the ACFTA 3.0. Rules of origin, product-specific rules, and services are not within the scope of the ACFTA 3.0 upgrade negotiations as these areas were reviewed during the ACFTA 2.0 upgrade negotiations.

Table 8.1. Topics to be Reviewed in the ACFTA 3.0 and Related Documents

Topics to be reviewed	Link to existing documents and main points
Trade in goods	Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China (29 November 2004) Protocol to Amend the Trade in Goods Agreement of the Framework Agreement on Comprehensive Economic Co-operation between the Association of Southeast Asian Nations and the People's Republic of China (8 December 2006)
Tariff liberalisation	Annex 1: Modality for tariff reduction and elimination for tariff lines placed in the normal track Annex 2: Modality for tariff reduction/elimination for tariff lines placed in the sensitive track
Customs procedures and trade facilitation	Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation and Certain Agreements thereunder between ASEAN and China (21 November 2015 (Section B of the protocol)
Technical barriers to trade Sanitary and phytosanitary measures	Protocol incorporating ASEAN–China Technical Barriers to Trade and Sanitary and Phytosanitary Measures Chapters (2012)
Investment	Agreement on Investment of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China (implemented 15 February 2010)
Micro, small, and medium-sized enterprises	Not applicable
Economic and technical cooperation	Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation and Certain Agreements thereunder between ASEAN and China (effective 1 July 2016) (Chapter 4)

Topics to be reviewed	Link to existing documents and main points
Digital economy	The upgrade negotiations will explore provisions to develop cooperation in areas such as digital trade and services (e.g. e-commerce and paperless trade); data governance (e.g. online personal data and consumer protection; data sharing, data exchange, and big data utilisation; electronic transferable records; and cross-border data flows); and other trade-related aspects of digital economy cooperation, including cybersecurity, artificial intelligence, smart city development, upgrading technology and innovation, digital transformation, and management.
Green economy	The upgrade negotiations may include commitments on strengthening collaboration, including through sharing knowledge, best practices, and technology in a low-carbon and sustainable economy (e.g. green finance, sustainable consumption and production, the circular economy, and green skills development); green technology (e.g. low-carbon technologies, sustainable and green infrastructure, environmental industry, and green industry); and sustainable energy (e.g. smart energy solutions, energy storage systems, renewable energy, and conservation).
Supply chain connectivity	The upgrade negotiations will explore ways to strengthen the resilience and sustainability of regional supply chains, giving priority to the continued and smooth cross-border flow of essential goods and services.

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

Source: Ministry of Trade and Industry, Singapore (2023).

4. Urgent Problems to Solve

Scholars have highlighted several urgent challenges that need to be solved regarding the ACFTA.

4.1. Non-tariff barriers

Although the ACFTA has come into force, difficulties persist in exporting products to China – especially from new AMS, including Cambodia, the Lao People’s Democratic Republic (Lao PDR), and Myanmar – due to non-tariff barriers such as complicated procedures, import documentation, and customs regulations in China. Therefore, this issue is an urgent problem to solve.

4.2. Standardisation

China has become an important participant and leader in international standardisation, providing Chinese solutions in new energy technology, electric vehicles, and other industries. Therefore, strengthening cooperation between China and ASEAN in international standardisation is of great significance and an urgent task. Consequently, the establishment of China–ASEAN standardisation cooperation and a knowledge exchange platform should be an urgent task.

4.3. Building trust

Due to geopolitics and South China Sea issues, a trust deficit remains between ASEAN and China. ASEAN's main concern is China's rise – both economically and militarily – which creates competition and security concerns. China is concerned about neighbouring countries leaning too much on powers outside the region, which would impede its own rise. Therefore, building trust is a very important issue to solve.

The Belt and Road Initiative (BRI) should take trust building as its central task in advancing cooperation between China and AMS (Huang, 2017). To achieve this goal, China should not only consider the benefits of the initiative but also how to increase interdependence rather than unilateral dependence in China–ASEAN relations.

5. China–Cambodia FTA (CCFTA)

Cambodia and China established diplomatic relations on 19 July 1958. Cambodia is one of the China's closest allies in the region. With a neutral stance on South China Sea disputes and the One China policy, Cambodia has become an ironclad friend to China.

Cambodia has negotiated and signed the following 19 FTAs (Asia Regional Integration Center, n.d.):

1. East Asia Free Trade Area (ASEAN+3) (proposed/under consultation and study)
2. ASEAN–European Union (EU) Free Trade Agreement (proposed/under consultation and study)
3. Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6) (proposed/under consultation and study)
4. ASEAN–Pakistan Free Trade Agreement (proposed/under consultation and study)
5. ASEAN–Eurasian Economic Union Free Trade Agreement (proposed/under consultation and study)
6. ASEAN–Gulf Cooperation Council Free Trade Agreement (proposed/under consultation and study)

7. Cambodia–Eurasian Economic Union FTA (proposed/under consultation and study)
8. ASEAN–Canada FTA (negotiations launched)
9. Cambodia–United Arab Emirates Comprehensive Partnership Agreement (signed but not yet in effect)
10. RCEP (signed and in effect)
11. ASEAN Free Trade Area (signed and in effect)
12. ASEAN–Republic of Korea (henceforth, Korea) Comprehensive Economic Cooperation Agreement (signed and in effect)
13. ASEAN–Japan Comprehensive Economic Partnership (signed and in effect)
14. ASEAN–India Comprehensive Economic Cooperation Agreement (signed and in effect)
15. ASEAN–Hong Kong Free Trade Agreement (signed and in effect)
16. ASEAN–China Comprehensive Economic Cooperation Agreement (signed and in effect)
17. ASEAN–Australia and New Zealand Free Trade Agreement (signed and in effect)
18. Cambodia–Korea Free Trade Agreement (signed and in effect)
19. Cambodia–China Free Trade Agreement (signed and in effect)

China and Cambodia signed an FTA on 12 October 2020, which became effective on 1 January 2022. According to the agreement, over 90% of tariff lines in trade in goods for both parties will enjoy zero tariffs, and the service market commitment represents the highest level amongst the two parties' agreements with their free trade partners. At the same time, both parties agreed to strengthen investment cooperation and carry out in-depth cooperation on the BRI, e-commerce, economic technologies, etc.

The CCFTA is a new milestone in the development of bilateral economic relations and trade and will improve the well-being of companies and people in both countries. The negotiations were conducted in two stages, as detailed below.

On 20–21 January 2020, the first round of negotiations for the CCFTA was held in Beijing. Assistant Minister of Commerce Ren Hongbin and Cambodia State Secretary of Commerce Sok Sopheak attended the opening ceremony and announced the official launch of CCFTA negotiations. During the 2-day meeting, the two parties carried out substantial negotiations on trade in goods, rules of origin, customs procedures and trade facilitation, technical barriers to trade, SPS measures, investment cooperation, trade in services, transparency, economic and technical cooperation, cooperation under the BRI, e-commerce, and related legal matters (China FTA Network, 2020a). According to the consensus reached by the leaders of China and Cambodia, the two parties had completed the joint feasibility research by the end of 2019. The conclusion of the joint feasibility research was positive, prompting the start of the negotiations. The signing of the CCFTA was a concrete measure to deepen bilateral economic and trade connections, develop a comprehensive bilateral strategic partnership, and promote the joint construction of a China–Cambodia community with a shared future, reflecting the traditional amity and profound friendship between China and Cambodia.

On 9 April 2020, the second round of negotiations on the CCFTA was held virtually. During this round, the two parties reached a broad consensus on the content of the agreement; and completed consultations on BRI cooperation, investment cooperation, economic and technological cooperation, e-commerce, and some legal issues. Important progress has been made in the fields of trade in goods, rules of origin, customs procedures and trade facilitation, technical barriers to trade, SPS measures, trade in services, transparency, and relevant laws. The two parties agreed to continue to speed up the negotiations through various means, including video conferences, and to take practical actions to promote free trade, stabilise the regional economy, safeguard supply chains, and fight the coronavirus disease (COVID-19).

Negotiations on and the signing of the CCFTA were important measures to implement the consensus reached by the leaders of the two countries. This was conducive to deepening the economic and trade ties between the two parties, developing the comprehensive strategic partnership between the two countries, and promoting the joint construction of the China–Cambodia community with a shared future (China FTA Network, 2020b).

On 9 September 2021, Cambodia's National Assembly ratified the bilateral FTA with China, which aims to increase trade in goods by reducing and eliminating tariffs and non-tariff barriers. The CCFTA extends across a wide range of sectors, including trade, tourism, investment, transportation, and agriculture. China provides duty-free status to 98% of imports from Cambodia whereas Cambodia has agreed to exemptions of up to 90% of imports from China. Although most of Cambodia's exports to China are tariff-free through the ACFTA, the CCFTA extends tariff-free trade to over 340 products, such as seafood, garlic, cashew nuts, and dried chilli.

6. Impacts of the ACFTA on Cambodian Economic Development Since 2003

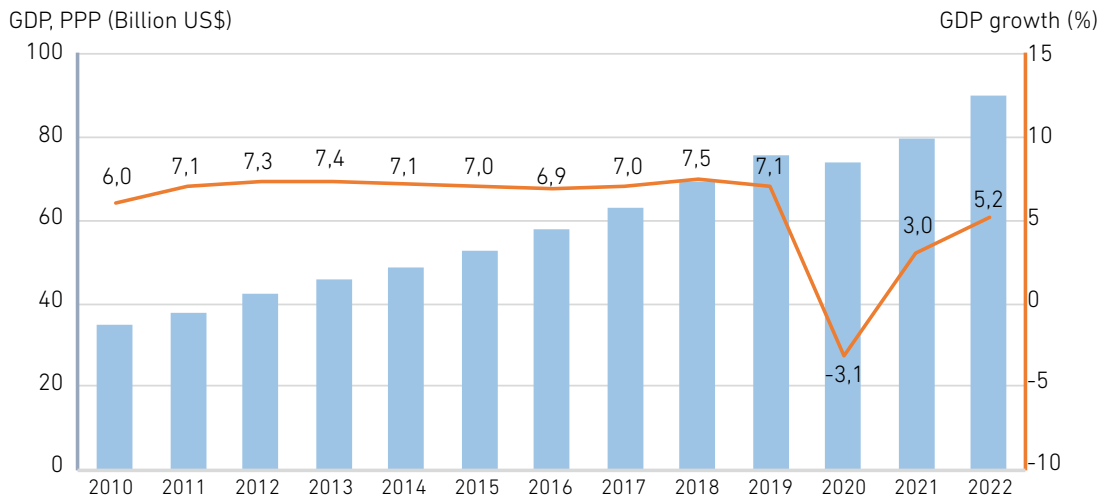
Cambodia has long been a partner of China. This partnership has accelerated in recent years as BRI projects have begun to take hold, with China reaching out to Southeast Asia to develop infrastructure and trade relations and upgrade local wealth. Cambodia's development has been an interesting example of how, in conjunction with the ACFTA and the recent RCEP agreement – Cambodia is a member of both – China has been combining development with free trade.

Despite some negative impacts, such as flooding the Cambodian market with Chinese products and investment and creating land speculation in some areas (especially Sihanoukville), the ACFTA has had a huge positive impact on the Cambodian economy as detailed below.

6.1. Economic development

Although the impact is difficult to quantify, it is assumed that the ACFTA has contributed to the economic development of Cambodia. Cambodia's gross domestic product (GDP) growth averaged 7% per year from 2014 to 2022 – except in 2020 due to the impact of the COVID-19 pandemic (Figure 8.1).

Figure 8.1. GDP Growth of Cambodian Economy, 2014–2022



GDP = gross domestic product, PPP = purchasing power parity.

Sources: For 2013–2022: Focus Economics (n.d.), Cambodia GDP. <https://www.focus-economics.com/country-indicator/cambodia/gdp/> (accessed 25 January 2024). For 2023: IMF (2024), 'IMF Executive Board Concludes 2023 Article IV Consultation with Cambodia', Press release No. 24/31, 31 January. <https://www.imf.org/en/News/Articles/2024/01/30/pr2431-cambodia-imf-executive-board-concludes-2023-article-iv-consultation>

6.2. Trade promotion

The ACFTA has contributed to trade promotion in Cambodia. As a result, China–Cambodia bilateral trade reached US\$11.2 billion in 2021.

Through the ACFTA and CCFTA, Cambodia managed to increase bilateral trade with China to US\$10 billion by 2023, up from US\$8 billion in 2020 (The Phnom Penh Post, 2024). This is a timely development for Cambodia as businesses continue to reel from the EU's withdrawal of the Everything but Arms (EBA) status in 2020. The EBA status was withdrawn because of what the EU perceived as serious and systemic violations of human rights in Cambodia. The EBA provides 49 of the world's poorest countries with duty-free access to EU markets (ASEAN Briefing, 2021).

6.3. Investment promotion

During 2012–2017, China invested over US\$15 billion, including US\$11 billion in the energy sector alone, in building infrastructure in Cambodia. The infrastructure also included roads/expressways, ports, and airports. The US\$1.9 billion expressway linking Phnom Penh and Sihanoukville, a port town and vacation destination, is located 12 kilometres from Sihanoukville Autonomous Port, Cambodia's sole international and commercial deep seaport (ASEAN Briefing, 2022).

Chinese investment in Cambodia increased significantly in 2021 despite the negative effects of the COVID-19 pandemic. Cambodia attracted fixed asset investments of US\$2.32 billion from China in 2021, up 67% from US\$1.39 billion in 2020. China was also the top foreign investor in Cambodia in 2020, accounting for 53.4% of the total investment of US\$4.35 billion (ASEAN Briefing, 2022). A case study from Chinese investment projects is highlighted in the box below.

Box 8.1 Sihanoukville Special Economic Zone

Sihanoukville Special Economic Zone (SSEZ) is a positive case study of China's Belt and Road Initiative (BRI) and Cambodia–China economic cooperation. The megaproject was jointly developed and constructed by private companies from both Cambodia and China, with a commitment to building a multinational investment platform for companies around the world.

The overall planning area is 11.13 square kilometres. The first phase of the project will focus on textiles and garments, luggage and leather goods, wood products, solar panels, etc. as the main development industries. The second phase will take advantage of the port's advantages and focus on introducing hardware machinery, building materials, home furnishings, auto parts and tyres, new photovoltaic materials, and fine chemicals. When completed, the SSEZ will form an ecological model park with comprehensive supporting functions for 300 enterprises and employment for 80,000–100,000 industrial workers.

In 2023, although Cambodia had just recovered from the impacts of the coronavirus disease (COVID-19), the SSEZ attracted 175 companies from China, Europe, the United States, the Association of Southeast Asian Nations, and others, creating about 30,000 jobs in total. The SSEZ's total exports reached US\$2.49 billion, or 4.8% of the country's total exports, in 2023.

Source: Author's visit to SSEZ on 20 November 2023.

6.4. Attracting Chinese tourists

Cambodia's tourism industry is a key contributor to economic growth (21% of GDP in 2019), and the country has significant potential to develop the ecotourism subsector. In 2020, Cambodia attracted 1.31 million foreign visitors, a decline of 80% from 2019.

Despite the downturn, Cambodia is pegging the resurgence of this sector on Chinese tourists. In 2015, the government launched the 'China Ready for Cambodia Tourism' policy to attract more Chinese tourists. Two million Chinese tourists visited the country in 2019, although this dropped to 329,000 in 2020 due to the pandemic. After the COVID-19 related downturn of 2020, the two countries targeted a goal of reaching 5 million tourists by 2025 and 8 million by 2030 (ASEAN Briefing, 2022).

6.5. Boosting trade in agricultural products with China

Through the CCFTA, Cambodia can leverage and better develop its agriculture industry in return for Chinese efficiency in manufacturing or products, such as electronic devices that local producers cannot make.

From January to May 2021, Cambodian exports to China were valued at US\$558 million, an increase of 56% from the same period in 2020. This increase was attributed to the rising demand for Cambodian agricultural products in China. Beijing has been Cambodia's top source of development aid since 2010, reaching a cumulative total of US\$5.8 billion in the period up to 2018. Through this, China has financed major irrigation projects, rice mills, and agricultural schools. Some 17% of the 100 projects funded by China over the past 20 years have been agricultural-related (ASEAN Briefing, 2021).

Cambodia also saw a 200% surge in fruit exports in the first 5 months of 2021. Such exports could help Cambodia gradually chip away at the country's large trade deficit with China. Cambodian exports accounted for only US\$1 billion of the US\$8 billion in bilateral trade in 2020 (ASEAN Briefing, 2021).

Exports of fresh Cambodian mango were made possible because both countries finalised sanitary requirements for fresh fruit in June 2020. This arrangement allows Chinese regulators to certify that specific Cambodian packing factories and orchards meet quality standards. This was previously not the case, and Cambodian exporters had to ship their produce to Viet Nam before entering China. Cambodian bananas received similar approval in 2018, with exports rising to US\$121 million in 2020 from US\$8 million in 2019.²

² www.aseanstats.org

Cambodia's agriculture sector is highly fragmented and dominated by smallholders. Therefore, the government needs to develop policies to support small and medium-sized farmers to create efficiency in the sector. Quality standard compliance also poses one of the biggest challenges for boosting agricultural exports. In addition, Cambodia needs better infrastructure and investment, such as processing facilities, in the downstream segments.

6.6. Covering losses caused by EBA revocation

From the initial estimates of the CCFTA, the trade pact will add income to Cambodia's economy, whereas the withdrawal of Cambodia's EBA status will impact the country's exports to the EU. The sectors most impacted are textile, garment, and footwear manufacturing, which account for 80.0% of Cambodia's total exports, compared with only 5.4% for agriculture (ASEAN Briefing, 2021).

7. Conclusion

The ACFTA is ASEAN's oldest FTA amongst its Dialogue Partners. Upgrading the ACFTA sends a signal to the private sector and all stakeholders that both ASEAN and China are committed to make the ACFTA more relevant to businesses, future-ready, and responsive to global challenges.

The ACFTA 3.0 aims to minimise barriers and deepen economic linkages between the parties; lower costs; increase intra-regional trade and investment; increase economic efficiency; create a larger market with greater opportunities and larger economies of scale for the businesses of the parties; and enhance the attractiveness of the parties to capital and talent.

The ACFTA has created huge positive impacts to AMS, including Cambodia, especially in trade and investment promotion, technology transfer, and job creation.

Building trust amongst the parties will create more benefits from cooperation between AMS and China, and reduce obstacles to the implementation of the FTA.

8. Policy Recommendations

The ACFTA could be made more relevant and beneficial through the following policy recommendations for ASEAN and China on concrete measures and areas of interest between the parties.

8.1. Reduce non-tariff barriers to trade

The ACFTA should deepen the inspection and quarantine cooperation between countries and explore cross-border information exchange through national single windows while deepening cooperation in animal and plant quarantine and food safety, and speeding up negotiations on quarantine protocols for the export of ASEAN's quality agricultural products and food products to China.

8.2. Carry out domestic reforms

The ACFTA provides opportunities for parties to reap the benefits of trade in goods and services, which also creates competition amongst them. Individual AMS should carry out domestic reforms to create opportunities to promote trade, investment, technology transfer, and job creation. Domestic reforms should be made in line with protocols related to the ACFTA and other bilateral and regional FTAs, especially those related to investment liberalisation, facilitation, and protection; mutual recognition of standards and conformity (e.g. qualification and mobility of professionals), etc.

8.3. Build trust

Building trust amongst the parties is crucial to promote regional cooperation in realising the BRI and ACFTA as win-win achievements. It could also smoothen relations between some AMS and China to improve mutual understanding. Geopolitical tensions could be lessened by highlighting the economic benefits of the ACFTA through building trust between China and AMS.

8.4. Build capacity in Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV)

Human capital is constrained in the new AMS (CLMV). To reap economic gains from the ACFTA 3.0, China and the six original member states of ASEAN (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) should provide more capacity building in CLMV countries, especially in new emerging areas such as the digital economy, the green economy, and research and development in science and technology.

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Chapter 9

China's Perspective

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Introduction

China and the Association of Southeast Asian Nations (ASEAN) are geographically close, with good economic complementarity and interdependence. After the Asian financial crisis, the China–ASEAN Free Trade Area (ACFTA) marked the beginning of economic integration in East Asia and laid the foundation for ASEAN to put forward the Regional Comprehensive Economic Partnership (RCEP) agreement. The establishment of the ACFTA has created significant trade, attracted investment, and improved employment, achieving a win–win situation and forming a ‘golden’ decade of China–ASEAN cooperation. At present, China and ASEAN aim to further enhance cooperation via the upgraded version of the ACFTA and the implementation of the RCEP.

1. Impacts of ACFTA on China's Economic Development

The ACFTA was the first free trade agreement (FTA) in East Asia and drove Japan, the Republic of Korea (henceforth, Korea), Australia, New Zealand, and India to sign FTAs with ASEAN. China has started to implement a free trade zone strategy, expedite the negotiation and construction of a free trade zone network, promote the liberalisation and facilitation of trade and investment, and stimulate the integrated development of the regional economy.

1.1. Background of China–ASEAN Free Trade Area

The ACFTA was established to naturalise the trend of regional integration as well as regional cooperation and integration development after the Asian financial crisis.

The ACFTA is still the largest free trade area amongst developing countries in the world and is China's first FTA. In November 2002, the heads of China and ASEAN signed the Framework Agreement on Comprehensive Economic Cooperation Between China and ASEAN during the Sixth China–ASEAN Summit and reached an agreement to formally establish the ACFTA by 2010. The signing of the agreement marks the beginning of the establishment of a free trade area between China and ASEAN and is the legal basis of the ACFTA, as the agreement defines the basic framework for all-around economic cooperation in the ACFTA (Government of China, 2013). In the Framework Agreement on Comprehensive Economic Cooperation Between China and ASEAN, bilateral cooperation on the

economy, trade, and investment is proposed. Goods and services trade were to be promoted, and the liberalisation of trade in goods and services was to be accelerated. A fairer, freer, more transparent, and convenient investment mechanism was to be created to achieve closer economic cooperation amongst the contracting parties (FTA Center, 2002). China has steadily promoted bilateral cooperation with ASEAN, signing a series of agreements – the Agreement on Trade in Goods, the Agreement on Dispute Settlement Mechanism, the Agreement on Trade in Services, the Agreement on Investment, and other related protocols – and has started to implement the tax reduction plan. In November 2022, China and ASEAN announced the launch of negotiations on the ACFTA Version 3.0. The consensus is that the negotiations will cover trade in goods, investment, the digital economy, the green economy, etc.; and create a more inclusive, modern, comprehensive, and mutually beneficial China–ASEAN Free Trade Area.

1.2. Development of China–ASEAN Relations Since 2003

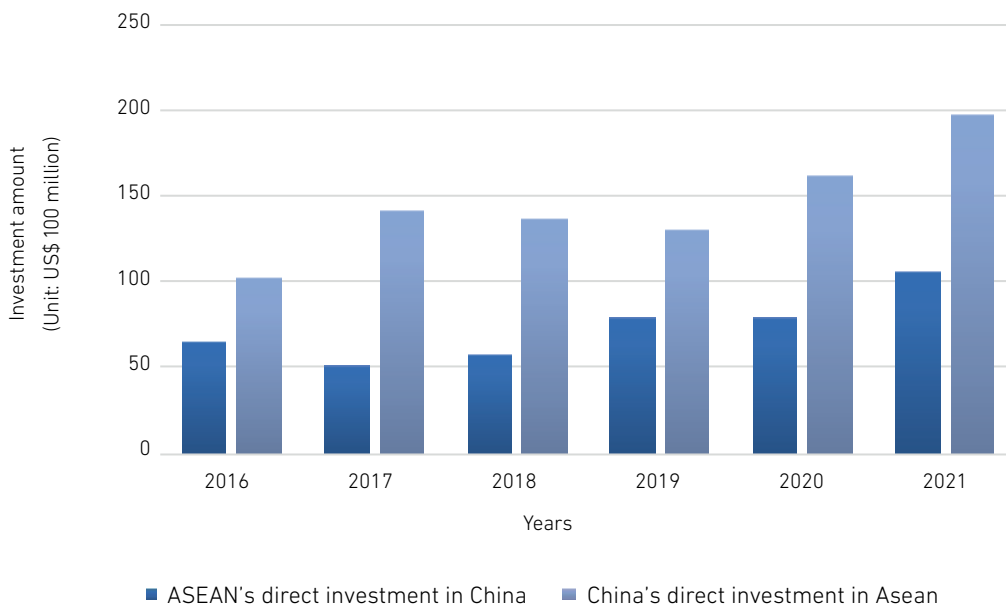
1.2.1. Trade: China and ASEAN and moving towards being largest mutual trading partners

ASEAN Member States (AMS) are rich in tropical crops and mineral resources, while China and ASEAN have trade complementarity in natural resources endowments. Taking agricultural products as an example, most of China's territory is located in a temperate zone, while ASEAN is almost in a tropical zone. The exports of different fruits and vegetables meet the various needs of consumers. In terms of bilateral trade between China and ASEAN, the China–ASEAN trade index increased in 2021 to 298.0, up 56.9 from 2020. In terms of trade volume, the total trade volume between China and ASEAN was US\$54.8 billion in 2002 and reached US\$78.2 billion in 2003, achieving the goal of exceeding US\$100 billion in 2004 and US\$200 billion in 2007. In 2022, the total trade volume between China and ASEAN reached US\$975.34 billion, with an increase of 11.2% from the previous year, of which exports reached US\$567.3 billion (up 17.7%) and imports reached US\$408.0 billion (up 3.3%). In 2002, China was ASEAN's third largest trading partner. With the bilateral agreement, China had become ASEAN's largest trading partner for 13 consecutive years by 2022. ASEAN also became China's largest trading partner for two consecutive years (2021 and 2022), up from the fifth largest trading partner in 2002 (Zhang et.al., 2021).

1.2.2. Investment: China’s cumulative investment in ASEAN ranks first in emerging markets

In terms of China–ASEAN investment, both parties are important mutual investment destinations. At the end of 2002, the total bilateral investment between China and ASEAN was US\$30.1 billion; by 2013, it had tripled to over US\$100 billion. From 2005 to 2013, ASEAN’s foreign direct investment (FDI) in China exceeded China’s FDI in ASEAN. Later, with the Belt and Road Initiative (BRI) and international production cooperation, China’s FDI in ASEAN increased rapidly and soon exceeded that of ASEAN in China. By the end of 2021, the cumulative amount of bilateral investment between China and ASEAN was over US\$280 billion – ASEAN investment in China was US\$10.58 billion in 2021, with a year-on-year increase of 33%, while China’s FDI in ASEAN was US\$19.735 billion, with a year-on-year increase of 22.8%. Under the weak global economic recovery following the coronavirus disease (COVID-19) epidemic, investment between China and ASEAN keeps growing (Figure 9.1).

Figure 9.1 Investment Between China and ASEAN, 2016–2021



ASEAN = Association of Southeast Asian Nations.

Source: Foreign Investment Department of Ministry of Commerce.

1.2.3. Bilateral cooperation: project contracting and labour service cooperation have reached a new level

From the perspective of bilateral cooperation, ASEAN is an important market for China's overseas project contracting and labour service cooperation. Major cooperation projects are being discussed involving infrastructure construction, agriculture, manufacturing, and processing industries. Financial institutions in China have also provided various financing facilities. In 2021, Chinese enterprises signed project contracts worth US\$60.64 billion in ASEAN, accounting for 23.46% of China's total new contracts for foreign-contracted projects. The completed turnover was US\$32.69 billion, accounting for 21.10% of the total turnover of China's foreign-contracted projects. Meanwhile, the overseas economic and trade cooperation zone is an important carrier of China–ASEAN economic and trade cooperation and innovation and development. With the establishment of the ACFTA, China has accelerated the construction of economic and trade cooperation zones amongst Southeast Asian countries, driving more trade and investment exchanges and boosting regional economic integration. China is committed to establishing overseas economic and trade cooperation zones in AMS, which is also an essential step for the economic and trade cooperation of domestic regions and ASEAN. Local governments and private enterprises in Guangdong, Guangxi, Zhejiang, and Jiangsu, etc. have also played a significant role.

1.2.4. China–ASEAN Comprehensive Strategic Partnership continuously improves

With the progress of the ACFTA and related agreements and plans, China has achieved closer interaction with AMS. In 2003, China and ASEAN announced the establishment of 'the strategic partnership oriented to peace and prosperity' (ASEAN, 2018). In 2013, while celebrating the 10th anniversary of the establishment of the China–ASEAN strategic partnership, China proposed jointly building the 21st Century Maritime Silk Road and working together to build a closer China–ASEAN community of destiny. The joint efforts make contributions to closer international cooperation, deeper trust, and more dialogue. Since 2008, China has established an active, friendly, and cooperative partnership with AMS, which also helps expand China's influence in the global economy.

1.3. New development perspective of China–ASEAN Free Trade Area

1.3.1. Digital economy and cross-border e-commerce

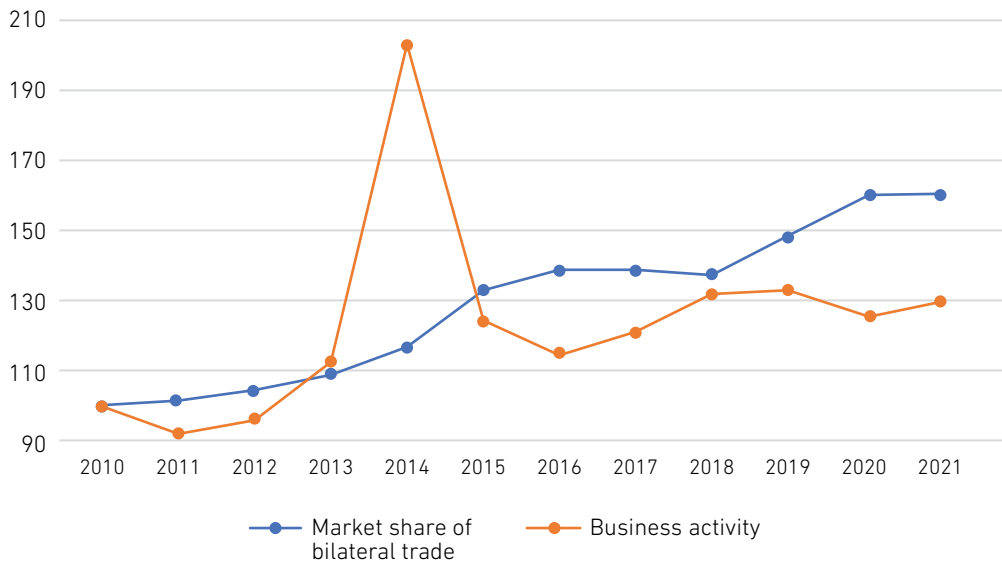
The digital economy is a new area for cooperation and development between China and AMS. On the one hand, both China and ASEAN attach importance to and develop the digital economy. In 2021, the scale of the digital economy in China reached CNY45.5 trillion, with a nominal year-on-year increase of 16.2% (China's State Council Information Office, 2022). According to the forecast of the ASEAN Secretariat, the proportion of the ASEAN digital economy in gross domestic product (GDP) will increase from 1.3% in 2015 to 8.5% by 2025, ranking amongst the top five digital economies in the world (ASEAN, 2021). On the other hand, in the development of the ACFTA, China–ASEAN bilateral cooperation is no longer limited to the traditional economy, with digital economy cooperation becoming an important development highlight between China and ASEAN. Cross-border e-commerce, overseas warehouses, and financial technology have become new modes, new models, and new sources of power for China–ASEAN economic and trade cooperation. According to Yang and Li (2019), the Asia-Pacific has the best cross-border e-commerce performance in the world, accounting for 53.6% of the global market size, with China and ASEAN contributing significantly. In the first half of 2022, China's exports to ASEAN via cross-border e-commerce increased by 98.5%. Thanks to the establishment of the ACFTA and the promotion of relevant agreements on e-commerce in the RCEP, China and ASEAN continued to be each other's largest trading partners in 2022, as well as important investment partners and economic and trade partners, which creates excellent favourable conditions for the bilateral cooperation and development of the digital economy and brings great business opportunities.

1.3.2. Global value chains and East Asian production networks

Strong complementarity exists between the economies and resources of China and ASEAN, which enables the two sides to concentrate on cooperation and promote development in advantageous areas of the global supply chain and global value chain cooperation. The establishment of the ACFTA has formed trade creation effects and investment creation effects, reduced trade and investment restrictions, increased bilateral trade vitality, expanded investment, and deepened the division of labour and cooperation. In 2021, the market share index of China–ASEAN bilateral trade reached a new high at 161.37; China invested US\$19.73 billion in AMS, with a year-on-year increase of 22.8%; and the foreign capital actually used in China was US\$173.48 billion, with a year-on-year increase of 14.9%, of which the actual investment from ASEAN increased by 29% year on year. These effects not only help China and ASEAN to form a mutually beneficial and win–win situation economically, but also accelerate regional economic integration and the formation and development of production networks in Southeast Asia, and deepen regional value chain cooperation in Southeast Asia, which is also in line with the development and

requirements of global value chains. Furthermore, the establishment of the free trade zone has brought about trade transfer effects and investment transfer effects, and some outer trade and investment have been replaced by inner trade and investment, which also continues to strengthen global value chain cooperation between China and ASEAN (Figure 9.2).

Figure 9.2 Market Share Trend of China–ASEAN Bilateral Trade, 2010–2021



ASEAN = Association of Southeast Asian Nations.

Source: Zhang et al. (2021).

1.3.3. Low-carbon green economy and sustainable development

China and ASEAN share common interests in achieving the 17 Sustainable Development Goals (SDGs) outlined in the 2030 Agenda, continuously injecting new vitality into their bilateral cooperation. For instance, the China–ASEAN Environmental Cooperation Centre is the official coordinator for bilateral cooperation in this area. During the 25th China–ASEAN Summit in November 2022, China and ASEAN put forward statements and visions aimed at promoting regional sustainable development, and issued a joint statement on strengthening China–ASEAN common sustainable development. This is not only to achieve sustainable economic development, but also to realise the sustainable development of bilateral relations, which helps China and ASEAN maintain a long-term, stable, positive, and healthy cooperative relationship. The ongoing upgrade of the ACFTA claims that the green economy and green development should constitute important negotiation content.

2. Experience of China–ASEAN Free Trade Area Construction

When building the ACFTA, China and AMS carried out extensive economic and trade cooperation under the framework of the China–ASEAN Free Trade Agreement (ACFTA) and performed good practices in goods and services as well as investment. This plays an important role in implementing the FTA and the enhancement of economic and trade cooperation.

2.1. Good practices in the construction of the ACFTA

2.1.1. Good practices in trade

When building the ACFTA, good trade practices were embodied in both trade in goods and services. Good practices in trade in goods mainly include eliminating tariffs and removing non-tariff barriers, while those relating to services trade are mainly manifest in the gradual liberalisation of the service trade market.

1. Trade in goods

The ACFTA is committed to reducing and gradually eliminating tariff barriers, i.e. reducing tariffs step by step, separately, according to the negative list mode. According to the Early Harvest Programme of the agreement, tariffs for more than 500 kinds of agricultural products in Chapter 1–8 and tariff lines in a few other chapters were reduced from 1 January 2004, including live animals, meat and edible offal, fish, dairy products, other animal products, edible fruits and nuts, edible vegetables, palm oil, and coconut oil and vegetable oil.

Due to the different stages and speeds of economic development between China and the original six AMS and the new four AMS (the Lao People's Democratic Republic (Lao PDR), Myanmar, Cambodia, and Viet Nam), special and differential treatment is given to the four new AMS. The tariffs on these products in China and the six AMS were reduced to zero in 2006 and then extended to Cambodia, the Lao PDR, Myanmar, and Viet Nam in 2010.

Apart from the Early Harvest products with tariff reduction arrangements, the Agreement on Trade in Goods divides the remaining products into normal products and sensitive products. China lists iron and steel products, including automobiles and some petrochemical products, as sensitive products, while AMS consider sugar and vegetable oil as sensitive products. The list of sensitive products has a maximum of 500 products, while the list of highly sensitive products has a maximum of 150 products (no more than 100 items for China and the six original AMS (Table 9.1).

Table 9.1 Tariff Reduction Mode of Sensitive Products in China and ASEAN

Country category	Sensitive products	Highly sensitive products
China and the original ASEAN Member States	Tariff rate reduced to 20% from 1 January 2012 and to less than 5% from 1 January 2018	Tariff rate reduced to less than 50% for highly sensitive products from 1 January 2015. The list of highly sensitive products has a maximum of 100 items (HS six-digit).
New ASEAN Member States	Tariff rate reduced to 20% from 1 January 2015 and to less than 5% from 1 January 2020	Tariff rate reduced to less than 50% for highly sensitive products from 1 January 2018. The list of highly sensitive products has a maximum of 150 items (HS six-digit).

ASEAN = Association of Southeast Asian Nations, HS = Harmonized System.

Source: Enterprise Singapore (n.d.), Modality for Tariff Reduction and Elimination for Tariff Lines Placed in the Normal Track. <https://www.enterprisesg.gov.sg/-/media/esg/files/non-financial-assistance/for-companies/free-trade-agreements/ASEAN-China-FTA/Legal-Text/Agreement-on-Trade-in-Goods-of-the-Framework-Agreement-on-Comprehensive-Econ-Coop/Annex-1-Modality-for-tariff-reduction-and-elimination>

The ACFTA is also committed to weakening non-tariff barriers. In addition to continuously facilitating customs procedures, cancelling import quotas, and unifying technical standards and health and quarantine regulations, the criteria for determining the origin have been upgraded. The regional value component (RVC) and the change in tariff classification (CTC) standards are now used to identify the origin of products.

Before the upgrade of the ACFTA in 2019, the China–ASEAN origin principles were mainly a single standard of RVC40 (40% of regional value added), with complicated identification of origin. After the upgrade, the RVC40 standard and the CTC standard of 4-digit tax items applied to more than 3,500 commodities jointly, and the 10% trace standard was added to simplify the determination procedure for rules of origin.

2. Trade in services

Trade in services have been liberalised in a 'positive list' mode. The contracting parties exerted three concessional commitments in 2007, 2011, and 2015, amongst which the opening up of the financial and tourism sectors is particularly noteworthy.

1) Finance

Financial cooperation measures consist of monetary cooperation and market cooperation. China's financial cooperation is mainly with Singapore, with which cooperation relevant to clearing banks and clearing agreements has developed rapidly.

In terms of cooperation on financial markets, China–ASEAN cooperation in capital markets is carried out informally under a memorandum of understanding and has achieved significant effects.

In terms of financial and monetary cooperation, the China–ASEAN UnionPay has been established, and cross-border e-payment have developed rapidly.

At the same time, bilateral cooperation in financial supervision and financial institutions has been deepened, and the existing effects are mainly reflected in two aspects: promoting the internationalisation of the renminbi and boosting the construction of the BRI.

2) Tourism

Before the COVID-19 epidemic, China had become the largest source of overseas tourists in ASEAN. In 2019, there were nearly 60 million tourists travelled between China and ASEAN, and more than 4,500 round-trip flights took place every week. In 2020, the number of Chinese tourists to ASEAN dropped to 18.6 million, but still accounted for more than 17% of the total number of tourists.

At the same time, cooperation between China and ASEAN on tourist visas has been deepened, as shown in Table 9.2.

Table 9.2 Visa Waiver Agreement Between China and ASEAN Member States

Agreement country	Types of visa-free documents	Effective date
Philippines	Chinese diplomatic passports and service passports (temporary visitors only); Philippine diplomatic passports and service passports (temporary visitors only)	28 February 2005
Cambodia	Diplomatic passports and service passports	14 September 2006
Lao PDR	Chinese diplomatic passports, service passports, and passports for public affairs; Lao PDR diplomatic passports, service passports, and ordinary passports with valid official visas	6 November 1989
Malaysia	Chinese diplomatic passports, service passports, and passports for public affairs; Malaysian diplomatic and service passports	18 May 2011
Myanmar	Chinese diplomatic passports, service passports, and passports for public affairs; Myanmar diplomatic and service passports	5 March 1998
Thailand	Chinese diplomatic passports, service passports, and passports for public affairs; Thai diplomatic and service passports	18 October 2003
Brunei	Chinese diplomatic passports, service passports, and passports for public affairs; Bruneian diplomatic and service passports	18 June 2005
Singapore	Diplomatic passports, service passports, and passports for public affairs	17 April 2011

Agreement country	Types of visa-free documents	Effective date
Indonesia	Diplomatic passports and service passports (temporary visitors only)	14 November 2005
Viet Nam	Diplomatic passports, service passports, and passports for public affairs	15 March 1992

Source: Ministry of Foreign Affairs, China (2024), List of Visa Exemption Agreements Between China and Foreign Countries. https://www.mfa.gov.cn/wjzwwfwpt/kzx/tzgg/202110/t20211029_10403855.html

2.1.2. Good practices in investment

The ACFTA is committed to lowering the entry threshold of the investment market. Specific provisions include fair and just treatment of investment, compensation for loss, transfer of technologies, and repatriation of profits and dispute settlement. The ACFTA also aims to improve information transparency in China and ASEAN, strengthens information exchange, and enhances bilateral cooperation in investment promotion and facilitation.

By the end of 2020, China had established 25 overseas economic and trade cooperation zones in AMS such as Malaysia, Cambodia, Thailand, Viet Nam, and Indonesia, attracting more than 600 enterprises. Guangdong, Guangxi, and Fujian, amongst others, have promoted initiatives such as the China–Viet Nam (Shenzhen–Haiphong) Economic and Trade Cooperation Zone, China–Malaysia Qinzhou Industrial Park, and the China–Indonesia ‘Two Countries, Two Parks’. Particularly, private enterprises from Jiangsu and Zhejiang have played a prominent role in the construction of overseas economic and trade parks such as Qingshan Park in Indonesia, Xigang Special Economic Zone in Cambodia, Luo Yong Industrial Park in Thailand, Longjiang Industrial Park in Viet Nam, and Damora Oil Refining Industrial Park in Brunei.

2.1.3. Good practices in infrastructure

Infrastructure construction is an important part of China–ASEAN cooperation, as well as a key way to promote the development of trade and investment. China–ASEAN land, sea, and air transportation infrastructure has been continuously improved to promote trade facilitation. Highways include the Nanyou Expressway, the first expressway connecting China and AMS; and the Kunman Highway, connecting China, the Lao PDR, and Thailand. Railways include the China–Lao PDR Railway, the first overseas railway project directly connecting with China’s railway network; the China–Thailand Railway, Thailand’s first standard-gauge high-speed railway; and Indonesia’s Yawan High-Speed Railway, China’s first overseas high-speed rail project. In terms of air routes, China has signed bilateral air transport agreements with AMS, and the route networks of major cities have been established. In terms of sea routes, China, the Lao PDR, Myanmar, and Thailand have officially opened for service, and major breakthroughs have been made in the Lancang–Mekong River international shipping cooperation project.

Regarding China–ASEAN cooperation in clean energy, in 2020, nearly half of China's newly signed projects were with AMS, accounting for 47% of its total actual foreign investment projects. In 2022, the China–ASEAN Clean Energy Capacity Building Plan carried out multi-phase exchange projects with the theme of photovoltaic and sustainable hydropower development, and continued to deepen cooperation in new energy.

2.1.4. Good practice in the RCEP

The implementation of the RCEP in 2022 has opened a new space for China–ASEAN Free Trade Area cooperation. For trade in goods, tariff barriers will be further reduced by combining an immediate tariff reduction with a gradual tariff reduction within 10 years. To open the service trade market and broaden investment access, the negative list mode was put into practice. For investment facilitation, rules of origin, customs procedures, inspection and quarantine, and technical standards were unified; customs clearance and commodity circulation procedures were simplified; an e-commerce chapter was included in the agreement; and the level of interconnection was improved. Meanwhile, the China Council for the Promotion of International Trade and the RCEP Enterprise Service Centre have been established to facilitate the implementation of the RCEP. Post-border measures, such as competition policy, government procurement, intellectual property protection, and e-commerce, have laid a solid foundation for expanding the scope of the 3.0 negotiations.

2.2. Lessons in China–ASEAN Free Trade Area construction

The implementation of the ACFTA has led to good practices in many fields, but still encounters practical problems and challenges.

2.2.1. Keep reducing trade costs

1. Rules of origin and certificate acquisition

The average tariff of the ACFTA has already been reduced by 90%–95%, but problems persist. These include complicated and changeable rules of origin, and cumbersome trading procedures and approval procedures, which seem to discourage business from applying the preferential rates, leading to the relatively low rate of utilisation of the ACFTA (Table 9.3). Enterprises have little knowledge of preferential tariffs and cannot avail of the full benefits of FTAs. Rules of origin still need to be improved and optimised, especially for some industrial products, so that businesses can fully benefit from tariff incentives.

Table 9.3 Thresholds and Utilisation of China's FTAs

FTA	Effective date	Threshold (%)	China customs utilisation rate, 2013 (%)	Estimated utilisation rate, 2013 (%)	Estimated utilisation rate, 2018 (%)
China–Chile	2006	21.00	6.55	10.59	10.35
China–Costa Rica	2011	20.00	1.30	3.99	23.48
China–Singapore	2009	16.00	13.45	12.42	12.93
China–Iceland	2014	16.00	-	-	18.26
China–ASEAN	2005	15.50	34.95	32.69	35.18
China–New Zealand	2008	14.10	31.67	28.92	24.78
China–Australia	2015	12.40	-	-	25.00
China–Switzerland	2014	11.00	-	-	2.96
China–Peru	2010	9.00	5.49	34.60	76.53
China–Rep. of Korea	2015	6.00	-	-	17.08
China–Pakistan	2007	2.90	71.97	73.15	69.57
Average	-	13.08	23.63	28.05	28.74

ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, - = data not available

Sources: China General Administration of Customs

2. Enhancement of customs

According to the World Bank (2020), amongst ACFTA members, Singapore got the highest score for border transportation trade facilitation indicators (0.98 out of 1.00), followed by Malaysia (0.76) and China (0.68). The customs mechanism needs to be optimised, and existing tariffs need to be unified to clearly stipulate the tariff treatment of various products, enhance the transparency of relevant information, and prevent arbitrary tariff changes. Furthermore, customs procedures should be simplified, existing agreements should be refined, and trade facilitation should be promoted.

2.2.2. Improve the openness of service trade

China and AMS are developing economies with a relatively low service level and service capacity. According to the RCEP, the positive list of service trade between China and seven other countries will be replaced by a negative list after 6 years.

2.2.3. External shocks to global supply chain

Due to the lockdown and isolation caused by the shock of the COVID-19 pandemic, industrial and supply chains were broken, so it is necessary to build new supply chains. With the rising cost of labour in China, some industries need to be relocated to ASEAN to gain more efficiency.

Since 2020, multinational companies from the United States (US) and Western countries with operations in China have started implementing a 'China Plus One' strategy, i.e. setting up other factories in Southeast Asian countries with lower wages to reduce costs and avoid the 'punitive tariffs' imposed by Europe and the US on products from China. In the name of national security, the US and Western countries request their enterprises to exit China, leading to negative impacts on supply chain cooperation between China and ASEAN.

3. China's Foreign Policy and How China–US Trade Impacts the China–ASEAN Value Chain

3.1. China's Foreign policy

China pursues a foreign policy of 'real non-alignment'. When dealing with international issues, China tends to make independent decisions that are conducive to maintaining world peace, developing friendly relations with other countries, and promoting mutual development. China's diplomacy is in accordance with the Five Principles of Peaceful Coexistence. It actively develops friendly relations with neighbouring countries and emerging nation states, and strengthens friendly relations with Asian and African countries under the policy of 'seeking common ground while reserving differences'.

Peace and development have become the theme of the 21st century, and seeking peace, development, and cooperation has become indispensable. China has taken an active part in international cooperation and acts as a responsible power. Since the 18th National Congress of the Communist Party of China, the 'top-level design' and 'bottom-line thinking' of China's diplomacy have been continuously innovating in theory and practice – advocating for and promoting the construction of the BRI; participating in the reform and construction of the global governance system; defending national sovereignty, security, and development interests; and strengthening the centralised and unified leadership of the Communist Party's foreign affairs work.

China concentrates on promoting economic diplomacy. While promoting the internationalisation of domestic enterprises and industries, it is also of great importance to bring in foreign advanced technologies and high-quality products, and to promote exports, foreign investment, domestic employment, and people's livelihoods through diplomacy.

3.2. Regional Policy of China Towards ASEAN

China's Southeast Asia policy since the Cold War is an important part of the 'good-neighbourly' foreign policy. This policy has changed from simply maintaining harmonious and friendly relations with neighbouring countries to promoting relations with neighbouring countries through regional cooperation, i.e. regional cooperation and regional economic integration (Wang and Hu, 2006).

China and some Southeast Asian countries have historical disputes pending political resolution. On 16 December 1997, the leaders of China and AMS met informally for the first time to determine the principles guiding the relations and to confirm 'building a good-neighbourly partnership of mutual trust oriented to the 21st century' as the strategic development direction. In addition, a multilevel regular dialogue and consultation mechanism has been established. China has maintained frequent interactions with AMS; conducted in-depth exchanges at all levels, including inter-party, parliamentary, and social organisations; and demonstrated the sincerity of cooperation to ASEAN through practical actions. Current China–ASEAN relations have transcended historical misunderstandings and succeeded in embarking on cooperative development.

In addition to the comprehensive improvement in political relations, economic ties have become increasingly closer and trade cooperation has been rapidly developed and upgraded. In November 2002, the ACFTA was officially launched and the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China was subsequently signed. Since 2010, when the ACFTA was established, trade between China and ASEAN has maintained a good growth trend.

Subregional cooperation has been continuously promoted and deepened. China participated in the Greater Mekong Subregion (GMS) Program and then proposed the Lancang–Mekong Cooperation Mechanism. It also promoted the construction of cross-border economic cooperation zones and boosted the construction of the China–Indochina Peninsula Economic Corridor in China.

On 1 January 2022, the RCEP came into effect as the largest regional economic cooperation agreement in the world. Under this institutional arrangement, regional economic integration in East Asia has taken an important step forward, which will strengthen economic and trade cooperation amongst Asian countries and boost regional trade development to a new level (Global Textile Network, 2022).

3.3. How China–US trade tensions impact the China–ASEAN value chain

To date, bilateral trade cooperation between China and AMS has focused on intermediate products, which account for 60% of the total trade, and their growth rate is far faster than that of primary and final products. Most of the intermediate products come from intra-company trade in the regional production network of multinational companies. However, China–ASEAN economic and trade relationships, which are dominated by the value chain trade of multinational companies, will be unavoidably affected by the consequences of the US–China trade tensions. For example, some multinational companies have gradually moved their main factory production from China to AMS in response to the US trade barriers imposed on Chinese goods and services.

The regional economic environment has been changing due to the increasing US–China trade tensions. In 2018, the US announced that it would raise tariffs on the steel and aluminium products of various countries, which brought a series of direct or indirect impacts on the steel and aluminium product markets of China and ASEAN. The production of similar products has been moved to the ASEAN market in the context of increasing US tariffs on Chinese goods. It is evident that steel and aluminium products exported from China to ASEAN have increased significantly. In 2019, Indonesia, Malaysia, and Viet Nam began to impose anti-dumping duties on China.

4. Policy discussion

4.1. Challenges facing the ACFTA

4.1.1. Market competition

China and ASEAN have comparative advantages in labour-intensive products. On the one hand, the high similarity between China and ASEAN's export markets has intensified competition. In 2021, the European Union, ASEAN, the US, and Japan were all common export markets for China and ASEAN, so China and ASEAN are competing for the export market share.

On the other hand, China and ASEAN share a similar export product structure. In 2021, of the top 10 commodities exported globally, mechanical and electrical products were the leading products for both China (59% of exports) and ASEAN (45% of exports) (Table 9.4). This reflects the strong competition between China and ASEAN in the mechanical and electrical industry

Table 9.4 Top 10 Products of China and ASEAN in Global Exports, 2021

China			Top 10 products of ASEAN's exports to the world		
Name of commodity	Amount (CNY100 million)	Proportion	Name of commodity	Amount (US\$ million)	Proportion
Automatic data processing equipment and parts thereof	16,488.1	7.59	Electrical and electronic equipment	489,650.6	28.6
Clothing and clothing accessories	11,000.0	5.06	Mechanical equipment	179,256.5	10.5
Integrated circuit	9,929.6	4.57	Mineral fuel, mineral oil, asphalt	155,514.6	9.1
Mobile phone	9,447.1	4.35	Animal and vegetable oils, fats, waxes, etc.	56,125.6	3.3
Textile yarn, fabric, and its products	9,384.3	4.32	Plastics and its products	53,723.5	3.1
Plastic products	6,396.9	2.94	Rubber and its products	53,592.6	3.1
Household appliances	6,382.4	2.94	Vehicles and their parts and accessories	52,413.6	3.1
Steel products	5,289.0	2.43	Optical, photographic, and other instruments and metres	46,976.4	2.7
Automobile and its parts and accessories	4,883.9	2.25	Steel	44,069.0	2.6
Furniture and its parts	4,771.9	2.20	Natural or cultured pearls, precious stones, etc.	42,003.1	2.5

ASEAN = Association of Southeast Asian Nations.

Source: WITS (n.d.), <https://wits.worldbank.org/> (accessed 25 March 2024).

4.1.2. Development of the digital economy

China–ASEAN cooperation in developing the digital economy faces many challenges, the biggest of which is the huge gap in the level of development and the digital divide amongst countries, urban and rural areas, and even social groups. Some AMS (Viet Nam, Myanmar, and Cambodia) are facing severe difficulties such as a shortage of energy, talent, and digital infrastructure in promoting digital economy construction, while others (Singapore) are similar to other developed economies in the world. Malaysian and Thai GDP per capita is close to that of China.

The digitalisation of most enterprises in AMS is still in its infancy, as is information and communication technology development. Zhu and Tan (2022) showed that 56% of enterprises in Southeast Asia seldom use digital tools, the digitalisation of these enterprises is still in the primary stage, and digitalisation has not been deeply integrated. The development of communication technology in each country is uneven. For example, communication technology in Singapore, Malaysia, and China mostly involves network communications, while other AMS are still using telephone and manual operations. The informatisation and standardisation of logistics are not unified, and the timely transmission of information affects the improvement of trade facilitation. It is still difficult for ports in China and ASEAN to realise standard information interactions. In addition, the government online service index of AMS and the development of information and communication technology for inter-business trade are quite inadequate (Sun, 2022).

4.1.3. Territorial disputes in the South China Sea

The tensions in the South China Sea are becoming increasingly heightened. The Indo-Pacific Strategy attempts to bypass the ASEAN-centred Asia-Pacific cooperation and development mechanism and block and contain China. In principle, ASEAN is seeking a strategic balance between China and the US, but in practice, some countries seem to make a pro-US and anti-China strategic choice. In the field of non-traditional security, the US also makes every effort to suppress China. Compared with the US, the import and export volume between China and ASEAN accounts for a higher proportion in trade, but in the field of investment, the share of the US in ASEAN is huge. In 2021, US investment in ASEAN reached US\$40 billion, accounting for 22.5%, while China only accounted for 7.7%, posing severe challenges to China in terms of economic influence and penetration.

4.1.4. Insufficient infrastructure development

Many AMS still face connectivity problems in terms of trade and development. Taking port infrastructure as an example, few ports in the region, other than those in China, Singapore, and Malaysia, have reached international standards. The lack of capital investment has seriously limited the level of port infrastructure. As for China and ASEAN cooperation in bilateral investment, the Asian Infrastructure Investment Bank estimated that annual investment in ASEAN infrastructure was US\$60 billion (ASEAN, 2023). Actual demand was significantly inconsistent with actual investment. Moreover, trade between China and Myanmar, the Lao PDR, and Viet Nam is mainly overland. In addition, the China–Southeast Asia Railway has not yet opened, further restricting the level of trade facilitation in the ACFTA.

4.2. Improving trade facilitation of the ACFTA

The improvement of trade and investment facilitation of the ACFTA should emphasise the following aspects. First, the CAFTA 3.0 negotiations will facilitate the implementation of a higher level of institutional arrangements for economic and trade cooperation, for which the CPTPP could be the benchmark.

Second, the ACFTA 3.0 should help strengthen the bilateral multilevel dialogue mechanism. China and ASEAN have maintained good communication and cooperation under mechanisms such as ASEAN–China–Japan–Korea (10+3) cooperation, the East Asia Summit, the ASEAN Regional Forum, Asia Cooperation Dialogue, and Asia-Pacific Economic Cooperation (APEC); and jointly responded to regional realities and potential challenges. The BRI and the ASEAN Master Plan on ASEAN Connectivity 2025 have gradually achieved their final goals. With the support of financing platforms such as the Asian Infrastructure Investment Bank and the Silk Road Fund, many cooperation projects have been successfully implemented. On this basis, China and ASEAN could seek to establish a long-term cooperation mechanism to provide a political, diplomatic, and business environment conducive to economic and trade cooperation.

Third, the ACFTA 3.0 aims at improving the business environment in the region. For AMS with less developed infrastructure, equipment such as warehousing and port joint inspection should be upgraded in port facilities construction. In view of the poor development of port logistics, ASEAN and China should implement a seamless connection between sea transportation and land transportation, and sea transportation and air transportation, in the free trade zone. In the case of insufficient investment funds, China and ASEAN should broaden financing channels and encourage their own financial institutions to participate in infrastructure construction. The financing mode could be either build–operate–transfer or build–own–operate. The government could give the green light to enterprises to participate directly in infrastructure construction through bidding. After construction, the enterprises would be managed for a given period and then returned to the government of the host country.

When formulating policies, governments need to collect information from multiple public channels to ensure the accuracy, timeliness, and fairness of information; consider the practical needs of enterprises; solve the problems encountered by enterprises in domestic imports and exports; and absorb the feedback opinions and suggestions from various industries and departments. A business-friendly environment requires not only efficient and transparent policies, but also timely implementation of these policies. Moreover, bilateral cooperation should provide back-up solutions when disputes occurred.

It is not enough to formulate efficient and transparent policies; they must also be implemented successfully in a timely manner. Where implementation is difficult, support should be provided, and bilateral coordination and communication should be enhanced.

4.2.1. Build the BRI systematically and with high quality, and tap the potential of trade and investment

The tensions in the South China Sea are becoming increasingly heightened. The Indo-Pacific Strategy attempts to bypass the ASEAN-centred Asia-Pacific cooperation and development mechanism and block and contain China. In principle, ASEAN is seeking a strategic balance between China and the US, but in practice, some countries seem to make a pro-US and anti-China strategic choice. In the field of non-traditional security, the US also makes every effort to suppress China. Compared with the US, the import and export volume between China and ASEAN accounts for a higher proportion in trade, but in the field of investment, the share of the US in ASEAN is huge. In 2021, US investment in ASEAN reached US\$40 billion, accounting for 22.5%, while China only accounted for 7.7%, posing severe challenges to China in terms of economic influence and penetration.

4.2.2. Accelerate the cultivation of economic and trade talents

Synergies amongst governments, enterprises, and think tanks should be harnessed to deepen China–ASEAN cooperation in training youth and talent in the digital economy. Various institutions should be supported to carry out multilevel and multi-form human resources training exchanges and help ASEAN strengthen its talent pool. China and ASEAN need to continuously increase investment and cooperation in education investment in the digital economy to ensure that all social groups and enterprises can participate in the digital process and to narrow the digital divide..

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ASEAN–China relations play a pivotal role in shaping the future of the Asian economy. This ERIA report delves into the challenges arising from the evolution of the digital economy, the restructuring of Global Value Chains (GVCs), and Asia’s transition to a green economy, while envisioning the emergence of ASEAN–China Free Trade Area 3.0.

Within these pages, regional experts offer insights into the primary trends reshaping the global landscape. Building upon these observations, they present key policy recommendations that should be on policymakers’ radar when undertaking the task of upgrading the existing ACFTA. Notably, these policy suggestions hold relevance beyond ASEAN–China relations and are equally applicable to other ASEAN Free Trade Agreement negotiations.

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