

## ASEAN FEATURES

### ASEAN-CHINA F.T.A.: TRADE OR TRIBUTE?

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There is a need for strong institutions to further the development of economic integration between the Association of Southeast Asian Nations (ASEAN) and China. Institutional theory suggests that before the development of an institution, it is likely that all basic actors are rational and autonomous individuals interact on the basis of rational choice. Governments are only acting in their self interest and thus will look out for their own gains. Honest brokers and impartial arbitrators are therefore needed. While careful not to draw too much from the European Union (EU) model of regional integration, it is submitted that the ASEAN-China Free Trade Agreement (F.T.A.) must have at its heart a system for the institutionalising of the rule of law and a supranational negotiating body. There is a need to place structural limitations on the dominance of China in the Asian region so that China's economic power does not result in a return to its historical overlordship, thus, turning trade into tribute once again.

#### I. INTRODUCTION

In November 2001, the Association of Southeast Asian Nations (ASEAN) and China agreed to launch negotiations for an ASEAN-China Free Trade Area (ACFTA). Then in 2002, ASEAN and China signed the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China (FA)<sup>1</sup> which will serve as a roadmap for the future ACFTA. Negotiations have started on trade in goods, services and investments in the hope that by January 2010, an ACFTA would be realised with the six original ASEAN members<sup>2</sup> (including Singapore) and by 2015, all the ASEAN countries.<sup>3</sup>

It is anticipated that the establishment of the ACFTA will create an economic region with 1.7 billion consumers, regional Gross Domestic Product (G.D.P.) of about US\$2 trillion and total trade estimated at US\$1.23 trillion.<sup>4</sup> The removal of trade barriers between ASEAN and China will indeed lower costs of production through economies of scale, increased intra-regional trade and increased economic efficiency. Simulations conducted by the ASEAN Secretariat using the Global Trade Analysis Project (GTAP)<sup>5</sup> suggest that an ACFTA will

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<sup>1</sup> The full text of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the People's Republic of China ["FA"] is online: ASEAN <<http://www.aseansec.org/13196.htm>>.

<sup>2</sup> The five original members of the ASEAN are Brunei, Indonesia, Malaysia, the Philippines, and Thailand. Cambodia, Laos, Myanmar and Vietnam joined ASEAN subsequently.

<sup>3</sup> See ASEAN and the Republic of China, online: Singapore F.T.As <<http://app.fta.gov.sg/asp/fta/getctry.asp?id=3>>.

<sup>4</sup> See Raul L. Cordenillo, "The Economic Benefits to ASEAN of the ASEAN-China Free Trade Area" online: ASEAN <<http://www.aseansec.org/17310.htm>>.

<sup>5</sup> GTAP is a global network of researchers and policy makers conducting quantitative analysis of international policy issues. The project is coordinated by the Center for Global Trade Analysis, which is housed in the

increase ASEAN's exports to China by 48% and China's exports to ASEAN by 55.1% and could potentially increase ASEAN's G.D.P. by 0.9% or by US\$5.4 billion while China's real G.D.P. could expand by 0.3% or by US\$2.2 billion.<sup>6</sup>

The governments supporting this initiative hope that with the formation of an ACFTA, enterprises in ASEAN and China will become more efficient and further promote specialisation; hence increase productivity and economy welfare as well as attracting more investment into the region.

While free trade agreements (F.T.As) with South Korea<sup>7</sup> and Japan<sup>8</sup> are being negotiated and a F.T.A. with India<sup>9</sup> is also in the works, it has been the ACFTA which has made the most progress. With the huge industrial might and the economic potential of China, it is likely that the ACFTA will be a cornerstone for the proposed East Asian Economic Community (EAEC).<sup>10</sup>

## II. THE LEGAL BASIS FOR THE ACFTA

All F.T.As offer certain special concessions or preferences to the members of the F.T.A. without extending such privileges to non-members of the F.T.A. Hence all F.T.As are, by their nature, contrary to the core principle of the World Trade Organisation (WTO)—the most favoured nation (MFN) principle. Indeed, some academics consider F.T.As as a threat to the WTO's multilateral non-discriminatory approach and fear that they create trade diversion.<sup>11</sup>

Nonetheless, the WTO has recognised that F.T.As can provide alternative stepping stones to global trade liberalisation and Article XXIV of the General Agreement on Trade and Tariffs (GATT) allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met. For example, the regional arrangement has to help trade flow more freely among the countries in the F.T.A. without raising barriers on trade with other WTO members who are not members of the F.T.A. In other words, non-members should not find trade with the F.T.A. members any more restrictive than before the F.T.A. was set up.

However Article XXIV faces implementation difficulties and indeed, since the formation of the WTO, the Committee on Regional Trade Agreements (CRTA) which is tasked

Department of Agricultural Economics, Purdue University. More information on the project is available online: GTAP <<https://www.gtap.agecon.purdue.edu/about/project.asp>>.

<sup>6</sup> *Supra* note 4.

<sup>7</sup> At the ASEAN-Republic of Korea (ROK) Summit held in Bali, Indonesia in October 2003, Korean President proposed that ASEAN and Korea should deepen relations by developing a comprehensive partnership between ASEAN and ROK with the possibility of establishing a Free Trade Area. At the November 2004 Summit, Leaders agreed that (i) negotiations for the AKFTA commence in 2005 and be concluded within two years, and (ii) that ASEAN-6 and Korea eliminate tariffs for 80% of all products by 2009. This information can be found online: Singapore F.T.As <<http://app.fta.gov.sg/asp/fta/getctry.asp?id=203>>.

<sup>8</sup> In November 2002, at the ASEAN-Japan Summit, the leaders of ASEAN and Japan signed a Joint Declaration to realise the AJCEP, including elements of a possible F.T.A. within 10 years. Formal negotiations under the AJCEP were launched in April 2005 and are targeted to be concluded within two years, online: Singapore F.T.As <<http://app.fta.gov.sg/asp/fta/getctry.asp?id=201>>.

<sup>9</sup> The Framework Agreement to Enhance ASEAN-India Trade and Economic Co-operation, incorporating an F.T.A. covering goods, services and investment, was signed on 8 October 2003 by the Leaders at the Bali Summit. Under the Framework Agreement, an ASEAN-India FTA (AIFTA) would be realised with Brunei, Indonesia, Malaysia, Singapore, Thailand and India by 31 December 2011. The remaining ASEAN countries would be included in the AIFTA by 2016, online: Singapore F.T.As <<http://app.fta.gov.sg/asp/fta/getctry.asp?id=202>>.

<sup>10</sup> The EAEC is envisaged to include, in addition to the ten ASEAN members, the three powerhouse economies of North-East Asia, namely, Japan, China and Republic of Korea.

<sup>11</sup> See, e.g., Jagdish Bhagwati, "U.S. Trade Policy: The Infatuation with Free Trade Agreements" in Jagdish Bhagwati & Anne O. Krueger, *The Dangerous Drift to Preferential Trade Agreements* (Washington D.C: AEI Press, 1995).

with reviewing all F.T.As has only in one case been able to come to a consensus as to the consistency with the GATT of all F.T.As it has reviewed.<sup>12</sup>

Theoretically, it is open for every WTO member outside the F.T.A. to argue that, as a result of the formation of the F.T.A, it is more difficult to trade with the countries forming such a F.T.A. For instance, if a country lowers its tariff to the members of the F.T.A., even if the tariff to the imports from countries outside the F.T.A. remains unchanged those external importers would find trade with the F.T.A. more comparatively disadvantageous than it was before and this could result in trade diversion. Some studies have, however, shown that such trade diversion has been limited.<sup>13</sup>

Article XXIV also provides that duties and other trade barriers should be reduced or removed on “substantially all the trade” in the region. The term “substantially all the trade” has yet to be interpreted.<sup>14</sup>

Regardless of the application of Article XXIV, ACFTA members are all either developing or least developed countries (L.D.Cs) which can invoke the Enabling Clause allowing preferential regional trade among developing countries without the limitations imposed by Article XXIV. An analysis of the Enabling Clause must begin with its historical background.

In 1961, Uruguay brought a complaint<sup>15</sup> listing 576 restrictions against almost all the developed members that allegedly nullified and impaired Uruguayan exports. While this complaint was dismissed in three panel reports, it achieved success as an expression of resentment among the developing members about the insufficiency of benefits accrued to them from the GATT regime. This led to the formation of United Nations Conference on Trade and Development (UNCTAD) in December 1964, as a permanent arm of the UN General Assembly. The establishment of UNCTAD fuelled certain steps within the GATT, the first of which was the adoption of Part IV of the GATT to demonstrate a concern (though without formulating any legal right or obligation) for the sake of developing countries.

In 1971, the GATT adopted two waivers for two types of preferences to favour developing countries the second of which allows developing countries to enter into regional or global agreements that include the reduction or elimination of tariff and non-tariff barriers on trade among themselves. In 1979, the waivers were made permanent through this Enabling Clause. In particular, paragraph 2(c) of the Enabling Clause permits preferential arrangements in trade on goods among developing countries in the following terms:

Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another.

Hence the Enabling Clause effected the removal of the “substantially all the trade” test while allowing for preferences between developing economies.

<sup>12</sup> The customs union between Czech Republic and Slovak Republic after the break up of Czechoslovakia is the only case. See Report by the Consultative Board to the Director-General Supachai Panitchpakdi, “Future of the WTO: Addressing Institutional Challenges in the new Millennium”, online: WTO <[http://www.wto.org/english/thewto\\_e/10anniv\\_e/future\\_wto\\_e.pdf](http://www.wto.org/english/thewto_e/10anniv_e/future_wto_e.pdf)>.

<sup>13</sup> See, e.g., Australian Government Department of Foreign Affairs and Trade, Australia, *Appendix A: Note on Measuring Trade Diversion, NAFTA after Five: The impact of the North American Free Trade Agreement on Australia's Trade and Investment* (March 2000) online: Department of Foreign Affairs and Trade <<http://www.dfat.gov.au/geo/americas/nafta/a.html>>.

<sup>14</sup> See Report of the GATT Working Party, “European Communities-Agreements with Portugal,” 19 October 1973, GATT B. I. S. D. (20<sup>th</sup> Supp.) at 171 (1974) where the EC noted that there is no exact definition of the term “substantially all trade”.

<sup>15</sup> Uruguay v. 15 Developed Countries: Recourse to Article XXIII, L/1923 (15 November 1962), GATT B. I. S. D. (11<sup>th</sup> Supp.) 95; L/2074 (30 October 1963), GATT B. I. S. D. (13<sup>th</sup> Supp.) 35; L/2278 (27<sup>th</sup> October 1964) GATT B. I. S. D. (13<sup>th</sup> Supp.) 45.

As all the ASEAN nations and China are considered developing countries, the fact that they can rely on the Enabling Clause removes even that restriction imposed by Article XXIV. It is therefore likely that any F.T.A. between ASEAN and China is unlikely to be held to be in breach of their respective WTO obligations.

### III. THE ECONOMICS OF TRADE

The fact that ASEAN and China may legally enter into a preferential trade agreement which is WTO-compliant does not answer the question whether ASEAN and China should get together in this manner.

The early logic that free trade could be advantageous for countries was based on the concept of absolute advantages in production. Adam Smith wrote in *The Wealth of Nations*,

If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.<sup>16</sup>

The idea here is simple and intuitive. If our country can produce some set of goods at lower cost than a foreign country, and if the foreign country can produce some other set of goods at a lower cost than we can produce them, then clearly it would be best for us to trade our relatively cheaper goods for their relatively cheaper goods. In this way, both countries may gain from trade.

As it turned out, specialisation in *any* good would not suffice to guarantee the improvement in world output. Only one of the goods would work. Ricardo<sup>17</sup> showed that specialisation in each country should be of that good in which the country had a comparative advantage in production. To identify the good in which a country had a comparative advantage requires a comparison of production costs across countries. However, one does not compare the monetary costs of production or even the resource costs (labor needed per unit of output) of production. Instead one must compare the *opportunity* costs of producing goods across countries.

The modern version of the Ricardian model can be illustrated by constructing and analysing an economic model of an international economy which, for the sake of simplicity, assumes two countries producing two goods using labour as the only factor of production. Goods are assumed to be homogeneous across countries while labour is assumed to be homogeneous within a country but heterogeneous across countries. Purely for simplicity, it is assumed that goods can be transported between countries without cost but while labour can be reallocated without cost between industries within a country, labour cannot move between countries. The model then assumes full employment so that the cost of under-utilising labour becomes more apparent. Differences in production technology occur across industries and across countries and are reflected in labour productivity parameters. The labour and goods markets are assumed to be perfectly competitive in both countries. Firms are assumed to maximise profit while consumers are assumed to maximise utility.

What happens when each country moves from autarky (no trade) to free trade with the other country? How does trade effect the prices of the goods in each country, the production levels of the goods, employment levels in each industry, the pattern of trade (who exports and who imports what), consumption levels in each country, wages and incomes, and the welfare effects both nationally and individually?

In autarky, each country will produce some of each good. As a result of the technology differences, relative prices of the two goods will differ between countries. The price of

<sup>16</sup> Adam Smith, *The Wealth of Nations: Book IV-V, Section ii* (London: Penguin Books, 1999) at 12.

<sup>17</sup> David Ricardo, *On the Principles of Political Economy and Taxation*, 3<sup>rd</sup> ed., Chapter 7 (London: John Murray, 1821), online: The Library of Economics and Liberty <<http://www.econlib.org/library/Ricardo/ricP.html>>.

each country's comparative advantage good will be lower than the price of the same good in the other country. If one country has an absolute advantage in the production of both goods then real wages of workers in that country will be higher in both industries compared to wages in the other country. In other words, workers in the technologically advanced country would enjoy a higher standard of living than in the technologically inferior country. As wages are based on productivity, in the country that is more productive, workers get higher wages.

What happens when trade between countries is suddenly liberalised? The initial differences in relative prices of the goods between countries in autarky will stimulate trade between the countries. Since the differences in prices arise directly out of differences in technology between countries, it is the differences in technology that cause trade in the model. Profit-seeking firms in each country's comparative advantage industry would recognise that the price of their good is higher in the other country.

Assuming that transportation costs are zero, more profit can be made through export than with sales domestically. Thus each country would export the good in which they have a comparative advantage and trade flows would increase until the price of each good is equal across countries. Eventually, the price of each country's export good will rise and the price of its import good will fall. The higher price received for each country's comparative advantage good would lead each country to specialise in that good and labour would have to move from the comparative disadvantaged industry into the comparative advantage industry, implying that one industry goes out of business in each country.

However, because the model assumes full employment and costless mobility of labour, all of these workers are immediately gainfully employed in the other industry. One striking and counter-intuitive result here is that even when one country is technologically superior to the other in both industries, one of these industries would go out of business when opening to free trade. Thus, technological superiority is not enough to guarantee continued production of a good in free trade. A country must have a comparative advantage in production of a good, rather than an absolute advantage, to guarantee continued production in free trade. From the perspective of a less developed country, the more developed countries' superior technology need not imply that the less developed country's industries cannot compete in international markets.

Also, even though workers in the technologically inferior country's industry have lower wages, the comparative advantage of technological superiority could ensure that that country's industry survives while the same industry disappears in the other country. In other words, low wages in one country in a particular industry does not provide sufficient information to know which country's industry would perish under free trade. From the perspective of a developed country, freer trade may not result in a domestic industry's decline just because the foreign firms pay their workers lower wages.

The movement to free trade generates an improvement in welfare in both countries both individually and nationally. Specialisation and trade will increase the set of consumption possibilities, compared with autarky, and will make possible an increase in national consumption of both goods. These aggregate gains are often described as improvements in production and consumption efficiency. Free trade raises aggregate world production efficiency because more of both goods are likely to be produced with the same number of workers. Free trade also improves aggregate consumption efficiency, which implies that consumers have a more pleasing set of choices and prices available to them. Real wages (and incomes) of individual workers are also shown to rise in both countries. Thus, every worker can consume more of both goods in free trade compared with autarky. In short, everybody benefits from free trade in both countries. Trade is then truly a win-win proposition.

However, the model assumes only two countries producing two goods using just one factor of production. There is no capital or land or other resources needed for production. That is not the real world. In the real world, many countries produce many goods using many

factors of production where the market cannot be assumed to be perfectly competitive nor can labour productivity be assumed to be fixed. Full employment also cannot be assumed, as workers cannot be immediately and moved at no cost to other industries, nor are all workers identical. The model also assumes that technology differences are the only differences that exist between the countries when climate, culture and a host of other differences can account for the comparative advantages.

It is therefore difficult for some people to accept the conclusions of the model with any confidence, especially when so many of the results are counter-intuitive. Indeed, one of the most difficult aspects of economic analysis is how to interpret the conclusions of models. Models are, by their nature, simplifications of the real world and thus all economic models contain unrealistic assumptions. Therefore, to dismiss the results of economic analysis on the basis of unrealistic assumptions means that one must dismiss all insights contained within the entire economics discipline. This is not practical or realistic. Economic models, in general, and the Ricardian model, in particular, do contain insights that most likely carry over to the more complex real world.

What the Ricardian model shows is that if we want to maximise total output in the world, we must, first, fully employ all resources worldwide; second, allocate those resources within countries to each country's comparative advantage industries; and third, allow the countries to trade freely thereafter. In this way we might raise the well-being of all individuals despite differences in relative productivities. In this description, we do not predict that a result will carry over to the complex real world. Instead, we carry the logic of comparative advantage to the real world and ask how things would have to look to achieve a certain result (maximum output and benefits). In the end we should not say that the model of comparative advantage tells us anything about what will happen when two countries begin to trade, instead we should say that the theory informs us of some things that can happen.

#### IV. TRADE OR TRIBUTE?

In an article published in the *International Herald Tribune*, Eric Teo cited a paper on "China's Security Environment" by Peking University's Institute of International Relations that suggested that the "tributary" mentality has re-emerged not only within China but among its neighbours as well, especially the former tributary states in East Asia.<sup>18</sup> The paper stated that China's tributary system during the Ming and Qing dynasties was based on three cardinal points. First, China considered itself the "central heart" of the region, with the tributary system assuring its overall security environment. Second, China needed a stable external environment, immediately surrounding the Middle Kingdom, to maintain its own internal stability and prosperity. Third, the Chinese emperor, at the "heart", would in principle give more favours to tributary states or kingdoms than receive from them; for his "generosity", the emperor receives their respect and goodwill.

John King Fairbank has written extensively that foreign envoys were received at the imperial court only as envoys bearing tribute from subordinate rulers. Famously, the embassy sent by George III under Lord Macartney in 1793 had been so received, and the ambassador's refusal to prostrate himself in the usual *ketou* undermined Sino-British relations for a long time.<sup>19</sup>

However, John E Wills Jr has suggested that the ideology and institutions of the tribute system do not go very far in explaining Qing dealings with these foreigners. He suggests that

<sup>18</sup> See Eric Teo, "Paying tribute to Beijing: An ancient model for China's new power", *International Herald Tribune*, 21 January 2004, online: International Herald Tribune <[http://www.iht.com/bin/print\\_ipub.php?file=articles/2004/01/21/edteo\\_ed3\\_.php](http://www.iht.com/bin/print_ipub.php?file=articles/2004/01/21/edteo_ed3_.php)>.

<sup>19</sup> See, e.g., John King Fairbank, ed., *The Chinese World Order; Traditional China's Foreign Relations* (Cambridge: Harvard University Press, 1968).

it is more useful to use a general concept of defensiveness; and the main policy was to limit and control all forms of contact between foreigners and Qing subjects. Wills Jr suggests that in all of China's imperial history, it was only during a long Ming century, about 1425-1550, that all foreign relations were managed within a unified set of bureaucratic institutions that fully merits the name "tribute system".<sup>20</sup>

Regardless of the academic controversy about the rationale for the tribute system, it has been generally accepted that during the Ming and Qing dynasties, a system of tributes from regional countries to the Chinese court was established. The geographical regions now known as North and South Korea, Okinawa, Northern Vietnam, Thailand, Southern Philippines, Myanmar and Laos were part of the this system during the Qing dynasty. That much of these geographical regions now include ASEAN countries and potentially countries in the EAEC is indeed a very interesting coincidence. It is therefore important to find out whether China indeed intends to return to a version of its ancient tribute system and whether that system is motivated more by imperial pride or a concern that trade needs to be controlled.

#### V. THE CONTROL OF TRADE

Free trade produces both economic gains and non-economic effects. In the industrial period, the economic gains from trade are enormous owing to the development of markets and technology, while its non-economic effects often are negligible compared to the economic benefits. The situation in the pre-industrial period was different, even opposite. Economic gains from trade might be small, owing to the limits of markets and technology, and the non-economic effects from trade could be substantial. Trade could affect diplomacy, internal politics, and even culture.

The rulers of civilised pre-industrial states attached great importance to border security and to culture. Wars and conquests broke out frequently in the pre-industrial era, and frontiers were far more fluid than in the industrial era. The most important object of diplomacy therefore, was often border security. Trade might be subordinated to diplomacy. In the pre-industrial era, many societies were also closed to alien cultures and ideologies, and people often drew a sharp line between civilised people and barbarians. Trade was an important way to spread alien cultures and ideologies, particularly when other forms of communication were limited. Power elites consequently would administer trade in order to foster the acquisition of high culture and to protect their state from undesirable ideologies.

Gift exchange and trade attendant on tribute traffic occupied a central position under the tribute system. The tribute trade of gift exchange was economically inefficient, but effective in internalising externalities and guaranteeing rulers' power. Trade attendant on tribute traffic was never prohibited, but it had predetermined trading dates, places and participants and avoided certain items so as not to damage rulers' positions and arouse negative externalities.

Private trade that was independent of tribute traffic was more severely limited than trade attendant on tribute because it was more difficult to monitor and posed a threat to the official trade including tribute trade. Independent maritime trade was more severely limited than independent land trade; in fact, it was the main target of prohibition. It was economically efficient and vital to trade development, but it was difficult to superintend, and apt to arouse negative externalities such as information leakage, coastal insecurity owing to pirates, and the rise of a decentralising merchant marine power.

<sup>20</sup> See John E Wills Jr & Jonathan D Spence, eds., *From Ming to Ch'ing: Conquest, Region, and Continuity in Seventeenth Century China* (New Haven: Yale University Press, 1979).

Maritime commercial merchants could also amass great fortunes and threaten state authority, and it was impossible to prevent maritime merchants from interacting with people of foreign, hostile countries. This was particularly true of the Nanyang Chinese and has led historians like Wills Jr to the conclusion that control was important to the Qing dynasty especially since it was a dynasty of Manchu invaders who did not trust nor have the trust of their Han Chinese subjects.

## VI. LESS TRIBUTE, MORE TRADE

Thus, it could be argued that the Chinese tribute system was arguably less about dominance but more about achieving defensive goals—primarily stability. These goals were more political and cultural goals rather than the economic goals as would have been explained by the trade model.

An examination of the FA between ASEAN and China suggests that both economic goals as well as the political goals were behind the initiative for China. As part of the FA, an Early Harvest Programme (EHP)<sup>21</sup> was negotiated. This programme allows for the reduction of tariffs on certain agricultural products before the onset of the F.T.A. China also agreed to extend concessions on 130 specific manufactured goods to Brunei and Singapore being non-agricultural exporting countries. Singapore and Brunei were allowed to enjoy these concessions not only from China but from Malaysia, Thailand and Indonesia as well. A significant aspect of the EHP is that, by allowing ASEAN members access to certain markets not currently open to other WTO members, it gives the ASEAN members a “first mover” advantage over other WTO members.<sup>22</sup>

Could control and stability be a reason for the EHP’s focus on only certain goods — agricultural and electronics mainly? It could be argued that since China lacks natural resources and needs to keep its huge electronic manufacturing industry supplied with components, the EHP’s focus is less about strategic competitive and comparative advantage rationality than about the need to maintain supplies and consequently stability. Indeed, access to food security and natural resources is critical for China and the EHP is focused mainly on agricultural or processed natural resources like vulcanised rubber.

The EHP started on 1 January 2004 and has been fully implemented since January 2006. As an indication of the success of the EHP, as of December 2004, ASEAN agricultural exports to China increased by 38.7% year-on-year and China’s agricultural exports to ASEAN also increased by 33.9% reaching US\$ 270 million.<sup>23</sup>

Nonetheless, while it could be argued a need to maintain stability is present in the structure of the ACFTA, it is not entirely based on the tribute system. Two of the three other elements of the tribute system are not so clearly manifested in the ACFTA.

While the tribute system emphasised the centrality of China as the hegemonic power of the region, the ACFTA does not have this as an emphasis. In its negotiations, a clear Westphalian modality of equality amongst member states has been established. The ASEAN-China Trade Negotiation Committee was established to carry out the programme of negotiations set out in this Agreement and, *de jure*, reports regularly to the ASEAN Economic Ministers (AEM) and the Minister of the Ministry of Foreign Trade and Economic Co-operation (MOFCOM) of China. However, *de facto*, China negotiates with each ASEAN partner individually though there is some commonality of negotiations and cross-ASEAN concessions. This is especially so since the Protocol to the FA allows for accelerated negotiations by individual ASEAN

<sup>21</sup> See Article 6 of the FA, *supra* note 1.

<sup>22</sup> Alyssa Greenwald, “The ASEAN-China Free Trade Area (ACFTA): A Legal Response to China’s Economic Rise?” (2006) 16 *Duke J. of Comp. & Int’l L.* 193 at 199.

<sup>23</sup> See Information Paper on China-ASEAN Free Trade Area (ACFTA), online: Singapore’s F.T.As <[http://app.fta.gov.sg/data/fta/file/ACFTA\\_Info\\_Kit.pdf](http://app.fta.gov.sg/data/fta/file/ACFTA_Info_Kit.pdf)>.



countries.<sup>24</sup> In addition to the negotiation modalities, China has bound itself to a dispute settlement system<sup>25</sup> that makes it an equal Westphalian member rather than a superior by agreeing to subject itself in the ACFTA to international arbitration.

Unlike the tribute system which was based on the idea of China's generosity, the ACFTA trade concessions are based on the principle of reciprocity. While there were some early suggestions that the EHP would be a unilateral gift by China to ASEAN without a reciprocal condition of tariff reduction by ASEAN, eventually, China was insistent on reciprocity as a necessary condition to enable the acceptance of the EHP and the ACFTA by China's business community.

Thus, in structure, the ACFTA is more a trade motivated agreement than a throwback to the tribute system of the past.

## VII. SOCIO-POLITICAL REASONS FOR ASEAN- CHINA TRADE

That the ASEAN-China F.T.A. is more a trade motivated agreement does not detract from the argument that there are socio-political reasons for the ACFTA that is more than just about increasing productivity.

China has always lacked natural resources for a country with such a large population. As the Chinese Ambassador of the People's Republic of China to Australia, has stated:

The rising demand for energy and mineral resources is posing another serious challenge, as our own supply is not adequate to meet the demand. It is estimated that, by 2010, China will have to import one third of its mineral needs. By 2020, half of China's consumption of oil and gas will depend on overseas sources. We clearly need wisdom and farsightedness in managing our growth.<sup>26</sup>

Apart from this poverty of natural resources, the recent history of China has been one of political humiliation. From 1839 to 1949, China suffered more than a century of bullying and encroachment by foreign powers and this resulted in a constant sense of Chinese humiliation at their inability to defend themselves effectively.<sup>27</sup> This has resulted in a real concern that China needed to be sufficiently strong enough to avoid a repetition of this humiliation. Indeed, the founders of the People's Republic were centrally committed to such nation-building and Mao proclaimed in 1949 that "China has stood up."<sup>28</sup>

Nonetheless, in recent years, China has suffered some discomfort at the hands of one of the foreign powers that encroached on its territory in the past – the US. In 1999, the Chinese embassy in Yugoslavia was accidentally bombed.<sup>29</sup> In 2001, a US spy plane landed in Chinese territory<sup>30</sup> and the US also made China's WTO entry negotiations<sup>31</sup> particularly

<sup>24</sup> See Article 4 of the Protocol to Amend the FA, which amends the FA by including a new Article 12A, online: ASEAN <<http://www.aseansec.org/15157.htm>>.

<sup>25</sup> Article 11 of the FA, *supra* note 1.

<sup>26</sup> Her Excellency Madam Fu Ying, Transcript of speech at the Australian National Press Club, 28 July 2004 cited in "China's Emergence: implications for Australia", Foreign Affairs, Defence and Trade References Committee of Australia, (March 2006) at 11. The transcript can be viewed online: Australian Parliament <[http://www.aph.gov.au/senate/committee/fadt\\_ctte/china/report02/report.pdf](http://www.aph.gov.au/senate/committee/fadt_ctte/china/report02/report.pdf)>.

<sup>27</sup> China had to sign unequal treaties with the Western powers by the terms of which Chinese ports were opened to foreign trade and residents, and Hong Kong and Kowloon were permanently ceded to Great Britain. Moreover, almost all foreigners in China were tried by their own judges or at their consulates according to the laws of their own countries.

<sup>28</sup> On October 1, 1949, as Chiang Kai-chek's defeated Kuomintang troops fled for Taiwan, Mao Zedong declared that "China has stood up."

<sup>29</sup> During the 1999 Kosovan conflict, in the course of air strikes by NATO, there was an attack (claimed by NATO to be accidental, although most people in China were not convinced that that was the case ) on the Chinese Embassy which killed 3 people.

<sup>30</sup> After 11 days of negotiations, the US administration was able to secure the release of the crew.

<sup>31</sup> After fifteen years of protracted negotiation, China finally became a member of the WTO in 2001.

difficult by insisting on significant concessions (*e.g.* in agriculture, where it had to accept a limit of 8.5 percent on *de minimis* domestic support, as opposed to the usual 10 percent limit for developing countries). Most recently, despite the end of the Textile quotas,<sup>32</sup> the US has also imposed safeguards on Chinese textiles and apparels.

Eric Teo of the Singapore Institute for International Affairs (SIIA) suggests that China has a fear of “encirclement” by the US and its allies, which could restrict Beijing’s economic growth and access to vital energy routes.<sup>33</sup> The May-June 2004 controversy between the US and China over the presence of American troops patrolling the Malacca Straits is evidence of this.

To attain stability in its immediate area, ensure economic sustainability and social peace, and prevent the strategic encirclement of China, Beijing has deployed a formidable diplomatic effort to build its own system of allies and friends across the Asia-Pacific.<sup>34</sup> The ACFTA can be seen as part of this effort.

From this perspective, Beijing’s efforts to woo its smaller neighbors and build its own “system” in Southeast Asia could suggest that a first outline of a China-style Monroe Doctrine<sup>35</sup> may now be discernable, though it would be far more subtle and discreet than the American version. This coalition-building by Beijing is therefore reminiscent of the mentality of China’s former imperial tributary system, which had effectively stabilised China and Asia all the way from theseventeenth to thenineteenth century.

If so, Sino-US rivalry can thus be expected to increase dramatically in the Asia-Pacific, beyond just the Taiwan issue. Such a rivalry would inevitably spill over from the economic and cultural spheres into the political and strategic arenas, drawing China’s smaller neighbours into great power disputes. The ACFTA then could be seen as part of Beijing’s attempts to assert its pre-eminence within the Asia-Pacific and eventually challenge American presence and influence there by strengthening regional ties as trade, investments and people-to-people exchanges increase regionally and become progressively centered around China. If so, Beijing will want to manage its own Asian system, thus increasingly frowning upon the existing American presence and any American attempt to lead Asia.

An alternative view is offered by Harry Harding, Dean of The Elliott School of International Affairs, who suggests looking at China as a rising liberal power in a new era where countries may be attracted to “nodes” of influence rather than aligned or in opposition to “poles” of power.<sup>36</sup>

Indeed, Deng Xiaoping in 1978 finally concluded that for China to be strong, she needed economic development, and consequently foreign investment. Since then, China has been attempting to enhance its “comprehensive national power,” including not only military

<sup>32</sup> Under the WTO Agreement on Textiles and Clothing, all textile and clothing quotas maintained by industrial countries ceased to operate from 1 January 2005.

<sup>33</sup> Eric Teo, “Asian security and the reemergence of China’s tributary system”, online: Association for Asian Research <<http://www.asianresearch.org/articles/2340.html>>.

<sup>34</sup> China is actively pursuing a series of F.T.As with Hong Kong, Macao, Gulf Cooperation Council, Brazil, Australia *etc.* For an analysis of these F.T.As, see Garry Clyde Hufbauer & Yee Wong, “Prospects of Regional Free Trade in Asia”, Working Paper Series Number WP 05-12 (October 2005), online: Institute for International Economics <<http://www.iie.com/publications/wp/wp05-12.pdf>>.

<sup>35</sup> The Monroe Doctrine was a statement of United States policy on the activities and rights of European powers in the western hemisphere made by President James Monroe in his seventh annual address to the US Congress on 2 December, 1823; it eventually became one of the foundations of US policy in Latin America. It was a mere statement not supported by any legislation or any basis in international law. which initially remained a mere declaration of policy. Its increasing use in the United States elevated it to a principle, although a controversial one.

<sup>36</sup> See the United States-Indonesia Report “China-Indonesia Relations and Implications for the United States”, a Joint Conference co-sponsored by The United States-Indonesia Society and the Sigur Center for Asian Studies of the Elliott School of International Affairs at The George Washington University (7 November 2003), online: USINDO <<http://www.usindo.org/Briefs/2003/China-Indo%20Relation%2011-07-03.htm>>.

power, but also economic and cultural power. Membership to the WTO and the 2008 Olympics are symbols of this desire.

Generational change is also taking place in China and the younger generation of Chinese analysts has been critical of their elders for several years for their overly passive and reactive foreign policy and isolationist policy. The more active foreign policy they favour has been evident in Beijing's more interventionist approach to the problems of the Korean peninsula and its more active role in UN deliberations on Iraq and Iran.

As China becomes more active, it is also increasingly stressing a liberal agenda. This includes endorsing multilateral institutions, supporting freer trade, concerning itself with trans-national issues, and sponsoring cooperative security arrangements. Interestingly, at the same time, the US is widely viewed as backing away from the multilateral approach and, along with Japan, is seen as engaging in more protectionist economic policies.

China's new self-image as a 'responsible great power' raises several choices. If viewed traditionally, China's rising power should logically be counter-balanced. But if China is now a growing liberal power it might be a "node" of attraction rather than a "pole" to be resisted.

If so, then the ACFTA is more a structure for a hub-spoke regional agreement where China as the centre of trade is only a node of attraction rather than a polarising superpower.

### VIII. THE FUTURE OF ASEAN-CHINA TRADE

To prevent China from being an overly dominant and polarising member, perhaps the lessons from the history of ASEAN and the European Union (EU) can be drawn upon.

#### A. *The History of ASEAN*

Prior to the founding of ASEAN in 1967, the prospects for Southeast Asia were not at all bright. In terms of religion, ethnicity, culture and history, Southeast Asia is one of the most diverse regions in the world. There were political disputes among the different nations in the region. In 1963, Indonesia had a military confrontation with the newly formed Malaysia. In 1965, Singapore was separated from Malaysia. There were serious and bloody racial riots between Muslim Malays and ethnic Chinese. The Philippines, Malaysia and Indonesia had unresolved territorial disputes. Domestic communist insurgencies posed a serious challenge to all the countries in Southeast Asia. The war in Indo-China was a real and serious threat to the survival of these young nations. It was these domestic and external dangers that forced the founding members to come together to form ASEAN.

Despite these challenges, Indonesia led the way in building a solid foundation for ASEAN. Being the largest member in terms of geographical size and population, Indonesia took the lead in cultivating the practice of decision by consensus. Refraining from imposing its will on others, Indonesia ensured that this pattern of behaviour became the *modus operandi* of ASEAN. Unique to this organisation, decision by consensus has sometimes been referred to rather jealously by others as "the ASEAN way".

Throughout the period from the fall of Saigon in 1975 and Phnom Penh in 1978 to the Paris Peace Accords on Cambodia in 1991, ASEAN members learnt to work closely with one another towards a common goal. The crucial years of 1975 to 1991 saw not only the consolidation and growth of ASEAN as a credible regional organisation but also the economic development of the region. The ASEAN way, which enhanced confidence and trust among member states, provided the region with the much needed stability for trade and investment.

The machinery for ASEAN cooperation is designed in such a way that decisions are not made by a huge ASEAN standing bureaucracy but by regular contacts between the ministers

and officials of the ASEAN members. The only standing bureaucratic institution is the ASEAN Secretariat. The Secretariat is headed by the Secretary-General, who is appointed by the ASEAN heads of government with the recommendation of the ASEAN foreign ministers. The role of the Secretariat is merely to initiate, advise, coordinate and implement ASEAN activities. It has a total strength of fewer than a hundred professional and support staff.

There are three major meetings of the ministers and two major meetings of the officials. The ASEAN Heads of Government Meeting is obviously the most important institution. It is the highest authority in ASEAN; the meeting takes place once every three years to give policy direction to the Association. An informal summit is to be held in between formal summits to provide more opportunities for the leaders to meet and to provide timely guidance to the Association. Prior to the summit, there is the Joint Ministerial Meeting (JMM), which comprises the ASEAN foreign and economic ministers. The purpose of the JMM is to facilitate cross-sectoral coordination of and consultation on ASEAN activities.

The ASEAN foreign and economic ministers also have their separate meetings. The ASEAN Ministerial Meeting (AMM) performs the key function of making policies and overseeing their implementation. These meetings of the foreign ministers, normally held in July, are convened annually in each of the seven ASEAN countries on a rotational basis in alphabetical order. The other important ministerial meeting, is the ASEAN Economic Ministerial Meeting (AEM), which occurs annually, normally in September, to direct ASEAN economic cooperation. This is complimented by the AEM Retreat, which is also attended by the same ministers but in an informal setting.

Historically, it was a political necessity that initially bound ASEAN together and led it towards closer economic cooperation. The landmark decision to create the AFTA (the ASEAN Free Trade Area) in January 1992, is evidence of a shift in ASEAN modalities from political necessity to economic prosperity. Unlike the EU, which has strict guidelines and directives to achieve a single market, the AFTA is a developing concept arrived at by consensus. The tariff reduction process is carried out through the Common Effective Preferential Tariff (CEPT), which is reviewed regularly by the AFTA Council. All ASEAN member countries have to participate in the CEPT scheme. Compared to the EU, the diverse stages of economic development within ASEAN meant that ASEAN had to find a creative way to achieve economic integration.

However, hiccups have occurred in the development of ASEAN with three main areas of concern – a slowdown in economic liberalisation; the economic differences between the more developed ASEAN members and the recent additions of Cambodia, Laos, Myanmar and Vietnam; and last but not least the on-going political situation in Myanmar. While “the ASEAN way” has helped bring ASEAN to this stage, it is uncertain whether such a non-interventionist consensus building approach<sup>37</sup> is useful and helpful in further regional integration especially when dealing with an economic and political power like China.

### B. *The EU in Contrast to ASEAN*

While acknowledging that comparing ASEAN and the EU is like comparing apples and oranges, perhaps some of the lessons from the development of the EU institutions can inform ASEAN of the way forward.

ASEAN is a pure intergovernmental organisation whereby decisions are taken by the ASEAN members pursuant to “the ASEAN way” — on the basis of consensus or unanimity rather than rules. The EU is a supranational organisation based on a set of rules but where sometimes, political compromise proves to be stronger than rules.

<sup>37</sup> Although, arguably, there is a subtle departure from this approach as evidenced from not allowing Myanmar to accept the chairmanship of ASEAN.

Thus, the EU community is more than an intergovernmental organisation as it has its own special legal status and extensive powers but it is not a true federation to which national parliaments and governments are subordinate in important matters but rather one in which certain areas of harmonisation and standardisation have been coordinated.

Unlike ASEAN, which really lacks long standing and developed institutions, the EU has four main institutions.<sup>38</sup> First the Council of Ministers (European Council), which is both the political as well as the legislative body and therefore is the main decision-making institution of the EU. Unlike ASEAN (where the meeting of ministers are more infrequent), the Council of Ministers meet regularly at least once a month at the level of foreign ministers. The foreign minister is regarded as his country's main representative in the Council, but other ministers in charge of other areas also meet, but less frequently.

The Maastricht Treaty has made the Council responsible for intergovernmental cooperation in the EU, particularly with regard to common foreign and security policy as well as trade. The heads of state or government normally meet twice a year together with the president of the commission at the European Council, accompanied by their foreign ministers. The presidency of the Council rotates among the member states at six-month intervals. There is an equivalent of these bodies in ASEAN, but the council of foreign ministers of ASEAN, the AMM, normally meets only once a year. The AMM may propose common positions to be adopted by member states, but it does not have any legislative function unlike the European Council.

The European Council takes decisions, depending on the subject, upon unanimity or upon qualified majority. When qualified majority is used as the criterion of decision-making, the EU stops being an intergovernmental organisation and acts like a supranational organisation, unlike ASEAN. A balance is then achieved by having other EU institutions that ensure a division of power between the purely national interests voiced in the Council and the interests of the whole EU, normally represented by the Commission.

Thus, the second most important EU institution is the European Commission. Due to the recent EU expansion, the Commission now consists of twenty five members appointed by agreement between the member governments. Throughout their term of office, members of the Commission must remain independent from the governments and the Council. As a check on the power of the European Council, the Council cannot remove any member of the Commission from office. The Commission is insulated from the European Council because the Commission's role is to act as the guardian of the treaties and to serve as the executive arm of the community, to initiate community policy and to defend the community interest in the Council. In the legislative process, the Commission is the sole body with the right to draft a proposal. The European Parliament can, however, pass a motion of censure compelling the Commission to resign as a body. There is no institution equivalent to the European Commission in ASEAN.

This brings us to the third important institution in the EU — the European Parliament, which is elected directly by the citizens of Europe. There are no national sections, only Europe-wide political groups. Both the European Single Act and the Maastricht Treaty have boosted the legislative power of the European Parliament, which used to be limited to some budgetary issues. In some respects, the European Parliament and the European Council now resemble the upper and lower houses of a bicameral legislature. Neither the European Parliament nor the European Council may initiate EU legislation because this, as stated above, has been reserved for the European Commission. However, once a proposal for an EU law or directive has been introduced by the Commission, it must usually receive the approval of both Parliament and Council in order to come into force. Parliament may

<sup>38</sup> Ambassadors Pierre Gramegna & Lim Chin Beng, "European and ASEAN Integration Processes: Similar Models?" (Presentation delivered at a UNU Public Forum held at the United Nations University Tokyo, Japan, 8 May 1997), online: United Nations University <<http://www.unu.edu/unupress/lecture18.html>>.

amend and block legislation in those policy areas that fall under the co-decision procedure, which currently make up the majority of EU legislative acts and the remaining policy areas fall under either the assent procedure (where the Parliament has the power to veto but not amend proposals) or the consultation procedure (where the Parliament has only a right to be consulted). The European Parliament also controls the EU budget, which must be approved by the Council in order to become law. No comparable institutions exist in ASEAN.

Finally, the fourth institution is the European Court of Justice (ECJ). The responsibility of the ECJ is to ensure that the law is observed in the interpretation and application of the Treaties of the EU and of the provisions laid down by the competent authorities. Both institutions and individuals must comply with judgments of the ECJ, which not only settle cases but also interpret and clarify the treaties. The ECJ is also called upon to give preliminary rulings on questions referred to it by national courts. In the Maastricht Treaty, the ECJ was given the power to enforce monetary penalties to oblige member states to comply with the ECJ's rulings. Nothing like this exists in ASEAN. ASEAN's method of dispute resolution is limited to dispute settlement through *ad hoc* tribunals.

## IX. THE ACFTA'S PROBLEMS

Thus, ASEAN unlike the EU, lacks strong institutional structures to manage its economic integration. ASEAN's emphasis on "the ASEAN way" has resulted in ASEAN lacking clearly defined rules and obligations, effective decision-making institutions and sufficient enforcement institutions. Some of these problems have been replicated in some form in the FA to the ACFTA.

### A. *Rules and Obligations*

Like the CEPT's Inclusion and Sensitive Lists, the FA provides for two different tracks — the Normal and the Sensitive Track — for tariff reduction. While the Normal Track provides for clear deadlines for tariff reduction, the Sensitive Track leaves the difficult negotiating to be determined at a future date. This ASEAN penchant for postponing difficult decisions and thereby leaving the rules less than clear will make it difficult to develop those rules later. While there is much to be said for a gradual phasing-in of new initiatives, without clear obligations, politicians may be tempted to cater to local interests in priority over further trade liberalisation and include most of the difficult tariff reductions in the Sensitive Track. However, one advantage the FA has over the AFTA is the absence of a loophole like the CEPT to allow parties to backtrack from previously agreed-upon concessions. It is hoped that such a loophole will be avoided in the final ACFTA.

### B. *Decision-Making Institutions*

The FA envisages a negotiation modality under Article 12 for the establishment of a Trade Negotiation Committee (TNC) with the ASEAN Secretariat and the relevant trade ministries providing the necessary secretarial support. While this structure was inevitable given the lack of an existing supranational institution incorporating the countries that could act as a forum for the negotiations, the lack of an honest broker to alleviate potential negotiation failures will add to the already considerable challenges. This is unlike the EU which has several supranational institutions in particular, the European Presidency and Commission, which could act as honest brokers. While the EU is a completely different creature from ASEAN and care must be taken when comparing the two entities, rational choice institutionalism and game theory suggest that supranational institutions with informational and procedural

resources to set negotiation agendas and to prepare the ground for decision-making, alleviate the risk of negotiation failure by acting as honest brokers.<sup>39</sup>

While the negotiations should ostensibly be between ASEAN and China, in reality, unlike the EU, there is no common ASEAN trade policy. Negotiations are conducted to some extent bilaterally between the ASEAN members individually and China particularly on sectoral concessions. Therefore, there is a possibility for the ASEAN Secretariat to play a bigger role in “neutral” agenda setting and ground work preparation. However, as the ASEAN Secretariat has limited resources, it is hoped that the recognition of the stakes involved in the ACFTA will lead particularly to resources being allocated towards such efforts.

It is, however, interesting to note that ASEAN, having learnt some of the lessons from its own economic cooperation efforts, has tried to incorporate, where possible, clear goals and deadlines so as help the TNC formulate rules which are consistent with those goals. Also incorporated into the FA are guidelines that direct the TNC to the development gaps between countries by making special consideration for the less developed countries by measures such as providing different timelines for the performance of their commitments.

### C. Enforcement Institutions

Article 11 of the FA provides for the establishment of formal dispute settlement procedures within one year of the entry into force of the FA. China has already entered into an Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-Operation Between ASEAN and the People’s Republic of China (ACFTA DSM) which entered into force on 1 January 2005<sup>40</sup> which was actually more than one year from the date of the entry into force of the FA of ACFTA being 1 July 2003.

The ACFTA DSM largely mirrors the ASEAN DSM substantively save for the addition of some procedural details and some differences in the dispute settlement timetable. However, in the absence of an institution like the Senior Economic Officials Meeting (SEOM) in ASEAN to establish a tribunal, the ACFTA DSM resorts to the often used arbitral procedure of allowing each party to appoint its own respective arbitrator with the chair left to mutual agreement. If mutual agreement is not reached, then the ACFTA DSM provides for the chair to be named by an external neutral party such as the Director-General of the WTO (provided that the Director-General is not a national of either party) or the President of the International Court of Justice where one of the parties to the dispute is not a WTO member.<sup>41</sup> This is a disappointing second best option as it hardly provides for an enforcement institution which is perceived to be impartial. Further, as the arbitral tribunal is only established on an *ad hoc* basis, it fails to give the institution any continuity.

The ACFTA also mirrors the ASEAN DSM with regard to penalties for defection from obligations. Under the ASEAN DSM, when a member state does not comply with ASEAN’s rules and obligations, that member faces no punitive measures. All that is required is for the defecting member to enter into negotiations with the party that invoked the DSM with a view to developing mutually acceptable compensation. However, such compensation is merely voluntary and the defector cannot be forced to provide compensation.<sup>42</sup>

When the defector does not provide acceptable compensation, the most severe consequence would be for the complaining party to suspend its obligations to the defector. While

<sup>39</sup> See Jonas Tallberg, “The power of the Presidency: Brokerage, Efficiency and Distribution in EU Negotiations”, (2004) *Journal of Common Market Studies* 42(5) 999-1002.

<sup>40</sup> Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the People’s Republic of China, online: ASEAN <<http://www.aseansec.org/16635.htm>>.

<sup>41</sup> *Ibid.*, Article 7 ACFTA DSM.

<sup>42</sup> See Article 16 of the ASEAN Protocol on Enhanced Dispute Settlement Mechanism, 2004, online: ASEAN <<http://www.aseansec.org/16754.htm>>.

this is a common element of international dispute settlement particularly in the trade area where similar processes can be found in F.T.As and even the WTO, it may be that the DSM is not entirely suitable for the creation of an economic community.

By solely relying on the self-help remedy of suspension of obligations, all that would happen is at best the reversion to the status quo in that area of cooperation and at worst a race to the bottom in other areas.<sup>43</sup> In addition, while the suspension of obligations may act as a deterrent when members of somewhat equal economic strengths are involved as in the case of ASEAN, if such a system were to be implemented for the ACFTA with the incorporation of an economic giant like China, the disparity in economic strength may render the remedy unfeasible for the smaller economies since any suspension of obligations may well affect the smaller economies much more than the larger ones. An alternative enforcement remedy may be found in the power of the ECJ to impose a financial penalty for failure by a member state to comply with a judgment of the ECJ.<sup>44</sup>

Thus, at present, since the DSM cannot mandate financial compensation, it does not reduce the payoffs obtained by the defector through defection. As a result, the DSM fails to adequately reduce the incentives for member states to defect. It is also disappointing to note that the ACFTA DSM also does not provide for mandatory compensation in the absence of implementation. Article 13 of the ACFTA DSM still provides that compensation should be voluntary and if there is a failure to agree upon the compensation, the complaining party may request the original tribunal to assess the appropriate level of suspension of concessions. This is a less preferred enforcement mechanism to the ECJ's ability to award compulsory financial compensation particularly when dealing with disputes between parties of unequal economic strengths.

## X. CONCLUSION

There is a need for strong institutions to further the development of economic integration between ASEAN and China. Institutional theory suggests that before the development of an institution, it is likely that all basic actors are rational and autonomous individuals interact on the basis of rational choice. Governments are only acting in their self interest and thus will look out for their own gains. If however, like the EU, strong institutions are developed, particularly institutions that act as a supranational "honest broker" and those that act as a supranational "impartial arbitrator", it is likely they would secure the interests of all members rather than favouring any particular member or group of members.

For the time being, ASEAN does not have any independent, supranational body and therefore the common positions can only mature through consensus, resulting in the lowest common denominator being the final position. In addition, without an honest broker to set agendas and to help negotiate compromises like the EU Commission, ASEAN issues and ASEAN-China issues cannot make much progress towards non-legal resolutions.

While the AFTA and the ACFTA do incorporate an arbitration process, they lack a permanent supranational impartial arbitrator. This will result in consensus building as the more likely alternative to arbitration. Contrasted with this is the EU governance model which relies heavily on the rule of law. The role of the ECJ is crucial in ensuring a system that is both effective and fair at the same time. The ECJ has a key role to play in ensuring the legal provisions of the Treaty of Rome (and subsequent amending treaties) are upheld by the member state governments, the supra-national institutions, organisations and individuals.

<sup>43</sup> For an analysis of a similar problem faced within the WTO, see Marco Bronckers & Naboth van den Broek, "Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement" (2005) *Journal of Int'l Economic Law* 101-126.

<sup>44</sup> See Article 228 of the Treaty establishing the European Community (consolidated text) *Official Journal C 325* of 24 December 2002.



The ASEAN-China FTA must have, at its heart, a system for the institutionalising of the rule of law and a supranational negotiating body. As China is by far the most dominant amongst the nations forming the ACFTA, it does not appear likely that the initiatives of institutionalisation to place structural limitations on such dominance would come from it and so the ASEAN nations should take a concerted effort to put in place a concrete institutional set-up where legal rules would be the guiding norm. Failure to do this will result in China's superiority turning into hegemony and then perhaps reverting to its historical overlordship, thus, turning trade into tribute once again.

