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Proliferation of Free Trade Areas in East Asia  
in the Context of the European Union and the  
North American Free Trade Agreement-  
Options for the P. R. China

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# Preface

Under the multilateral trade system governed by the GATT/WTO, the existence of regional economic cooperation covered by regional trade agreements (RTAs) is allowed. From the 1950s to the 1980s, the number of RTAs concluded by the contracting parties of GATT 1947 increased gradually. However, since the beginning of the 1990s, the number of RTAs has been proliferating so rapidly that it forms a so-called surge of RTAs.

Obviously, the surge has flowed to East Asia in recent years and further, both before and after Mainland China and Taiwan entered into the World Trade Organisation last year, the surge was reinforced in a network of many activities relating to the possible conclusion or strengthening of RTAs. In particular, it seems that Mainland China has a special interest in these activities. Nevertheless, these activities might be somewhat less than optimal. In my opinion, there is a need to make a comparison between the background of the European Union and the present situation in East Asia. An objective analysis could be helpful in establishing a more healthily cooperation within the territory of East Asia.

In preparing my work, I feel greatly indebted to my supervisor, Professor Hans-Heinrich Vogel. His so kindly and meticulous instruction gave me a very extensive training that I could not have obtained by myself. I am sure what I have learned from him will promote my future career.

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# Abbreviations

AFTA	ASEAN Free Trade Area
AICO	ASEAN Industrial Co-operation
AIA	ASEAN Investment Area
APEC	Asian Pacific Economic Co-operation
ASEAN	Association of Southeast Asian Nations
CBERA	Caribbean Basin Economic Recovery Act
CEE	Central and Eastern Europe (CEE)
CRTA	Committee on Regional Trade Agreements (WTO)
CUSTA	Canada-United States Free Trade Agreement
GDP	gross domestic product
DSB	Dispute Settlement Body (WTO)
DSM	Dispute Settlement Mechanism (WTO)
EAEC	East Asian Economic Caucus
EAEG	East Asian Economic Group
EC	European Community
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Association
EU	European Union
Euratom	European Atomic Energy Community
FDI	foreign direct investment
FTA	free trade agreement
GATT	General Agreement on Tariff and Trade
HKSAR	Hong Kong Special Administrative Region
IMF	International Monetary Fund
MFN	(General) Most-Favoured-Nation (Treatment)
NAFTA	North American Free Trade Agreement
PTA	Preferential Trading Agreements (East Asia)
Quad	EU, US, Japan, and Canada
RTA	regional trade agreement
SAT	substantially all the trade (GATT XXIV)
SEZs	special economic zones (Mainland China)
TEU	Treaty on European Union
TPRM	Trade Policy Review Mechanism (WTO)
USD	US Dollar
WTO	World Trade Organisation

# 1 Introduction

Since the Customs Union was formed in Western Europe in 1968, there has been a considerable stream of regional alliances emerging in different regions in the world. Rather than taking the form of customs unions, most of the countries within the regions concerns chose the free trade area as the form for their co-operation.<sup>1</sup> Among a number of examples, the most notable one could be the North American Free Trade Agreement (NAFTA) which was established in 1994. Parallel to the multilateral trade liberalisation process, this stream evolved so rapidly that until the 1990s it formed a so-called surge. Now, it seems that East Asian countries are the chief followers of this surge and the Mainland of China, after its accession to the World Trade Organisation (WTO) looks like being an especially active one.

Generally, the customs union or the free trade area covered by a regional trade agreement (RTA) is characterised by its intra-union preferential treatment regime where the main instrument is the reciprocal tariff deductions between the member states. This means that those countries outside the agreement can not enjoy the benefits. Examining the economics behind the surge, one sees the phenomenon which was originally illustrated by Viner's (1950) theory, showing that where one has a customs union, intra-union benefits are attainable.<sup>2</sup>

However, according to Viner's model, such benefits can also be obtained under the multilateral trade regime. Why then are those countries still pursuing the free trade area regime even though they are also within the regime of multilateral trade? The following background considerations could be advanced to help interpret the phenomenon.

## *Common Reasons for the Members and Candidates of the free trade area.*

First, under the General Most-Favoured-Nation Treatment laid down in Article 1 of General Agreement on Tariff and Trade (GATT), any favour granted by any contracting party to any product originating in or destined for any other country shall be accorded to the like product originating in or destined for the territories of all other contracting parties. In other words, if a favour granted was not given to all the other parties, this will constitute discrimination. Under a free trade agreement, the tariff within the area is lower than that within the multilateral trade regime. And such a measure, without considering other provisions of GATT, indeed breaches Article I. However, based on the view that the free trade area serves to foster the process of multilateral trade liberalisation, both GATT 1947

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<sup>1</sup> Robert Bejesky, Lecture on International Trade at Thomas M. Cooley Law School (Jan. 22, 2000).

<sup>2</sup> Stephen P. Magee, Hak - Loh Lee, *Endogenous tariff creation and tariff diversion in a customs union*, European Economic Review 45 (2001) p496.

and GATT 1994 in the framework of World Trade Organisation, allow the existence and development of free trade areas as an exception to Article I of GATT<sup>3</sup>.

Second, the World Trade Organisation regime is deemed problematic because there exists unequal representation, inequity of rules and weak institutional capacity in enforceability and dispute resolution. Considering these elements, some countries lack confidence in the regime of the World Trade Organisation. In contrast, within a framework set up by free trade area, the problems are expected to be resolved effectively.

Third, besides the positive aspects of the free trade area, the free trade area itself is seen as an ideal tool for protectionism. But to offset any negative effects, other countries want to have their own!

#### *Individual Reasons in East Asia*

After the Asian Financial Crisis in 1997, the fact that the US left the IMF to deal with the crisis while the latter imposed a stringent conditional loan package on the recipients served to wake up these countries. As similar institutional problems to those of the World Trade Organisation existed in the Asian Pacific Economic Cooperation (APEC), they did not want to resort to its regime to seek for safeguards. Instead, they tried to construct their own new regime to safeguard the health of their economy. Another reason particularly concerns Taiwan: after Mainland China's accession to the World Trade Organisation, those fearing the Mainland's threat are engaged in concluding free trade areas.

#### *Specific Points relating to Mainland China*

Mainland China itself has both advocated the China Free Trade Area in which Hong Kong, Macao and Taiwan are included, while, at the same time, promoting ASEAN plus three negotiations where Mainland China is included but Hong Kong, Macao and Taiwan are excluded. The context of this position could be the result of reasoning using Viner's model, which indicates that the more free trade areas a country participates in, the more benefits it can obtain. The most persuasive examples in this respect could be the European Union and the United States: the former has concluded more than twenty free trade agreements while the latter enjoys at least seven.

Nevertheless, although we can say that the East Asia region has rather good grounds for establishing its own free trade area - and there indeed exists a basis on which the co-operation can rest - the very diversity within this territory will be an obstacle in the way. Reviewing the elements which led to a successful EU, and examining the special situation in this area, the beneficial extent of co-operation planned for the Asian free trade area would be better understood.

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<sup>3</sup> *General Agreement on Tariff and Trade (GATT) XXIV.*  
<http://www.wto.org.com> (viewed March 3, 2002).

# 2 Economic dynamics behind the free trade areas

## 2.1 The original free trade areas and the allure of the benefits of a free trade area

The original regional trade alliance can be traced back to the “uniform duties” set up from 1664 to 1667 in Northern France, but one of the earliest “free trade areas” bearing the essential features of contemporary RTAs is the German Zollverein, formed among eighteen small states in 1834, and functioning “as an important catalyst for a united Germany later in the century”.<sup>4</sup> Nonetheless, these practices were not the subject of theoretical discussion.

The classical theory in this field could be Viner’s (1950) model describing two directions of international trade following the formation of a free trade union, i.e. trade creation and trade diversion. Trade creation implies increasing welfare within the territory of the union, because intra-union trade expands with the abolition of tariffs on imports from member states. So import costs will decrease as a result of the tariff deduction and therefore, importing firms will prefer to look within the union for their new partners. On the other hand, trade diversion means that, as importing firms within the union favor partners who are themselves in the union, the welfare of former external partners will decrease as they lose their opportunities even if they offer lower prices<sup>5</sup>.

After Viner’s theory, Goto-Hamada (1995)<sup>6</sup> further elaborated a theory of the Symmetric Tariff Bloc Model. This model covering four assumed symmetrical countries or four symmetrical groups of countries and demonstrates explicitly by three stages the situation before and after the formation of the union. In the first stage, the situation before the formation of the union is taken into account, where the four countries engage in trade with each other, and all imported products are subject to the same tariff rate. The second stage indicates when the formation of the union is initiated. In this context, country 1 and country 2 formed a union in which the tariffs dropped to zero on trade between the two countries. In contrast, the other two countries, namely country 3 and country 4 are outside the union and they are also independent of each other. Therefore, the trade of country 3 and 4 with the union countries as well as their trade between themselves are still subject to the original tariff rate. The third stage explains the likelihood of alliance between country 3 and country 4. During this stage, as country 3 and country 4 are worse

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<sup>4</sup> Jeffrey A. Frankel, *Regional Trading Blocs in the World Economic System 1*, 1997.

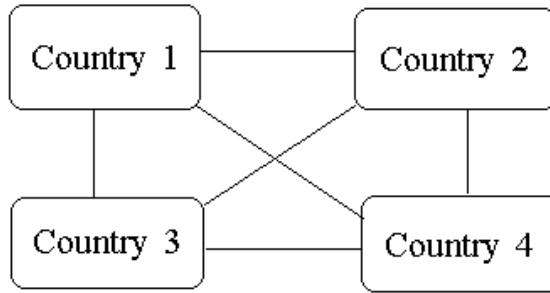
<sup>5</sup> See *supra* note 2.

<sup>6</sup> Junichi Goto Koichi Hamada, *EU, NAFTA, and Asian Responses: a Perspective from the Calculus of Participation*, NEBER working paper series, October 1995.

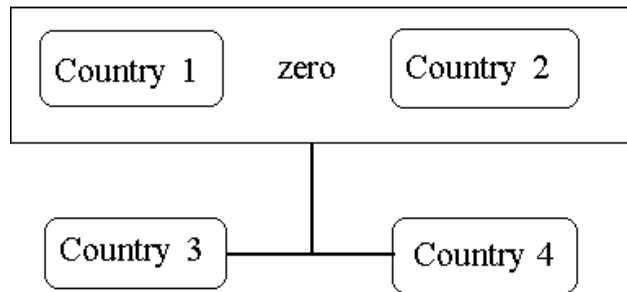


off after the formation of the union between country 1 and country 2, there emerges an incentive between country 3 and country 4 to form another union to counter the first one. Thus the relationship among four separate countries becomes a relationship between the two parallel unions. In this situation, country 1 and country 2 form a union while country 3 and 4 form a second one. Trade within the territory of each individual union is subject to zero tariffs while trade between the two unions is subject to the same common external tariffs. For all this, see Figure I below.

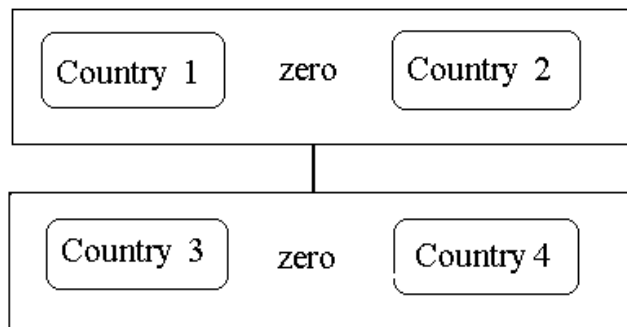
Apparently, here the driving forces pushing countries to enter into a free trade area have two aspects: seeking their own welfare and escaping losses arising from trade diversion.



Stage I: no union exists



Stage II: first union

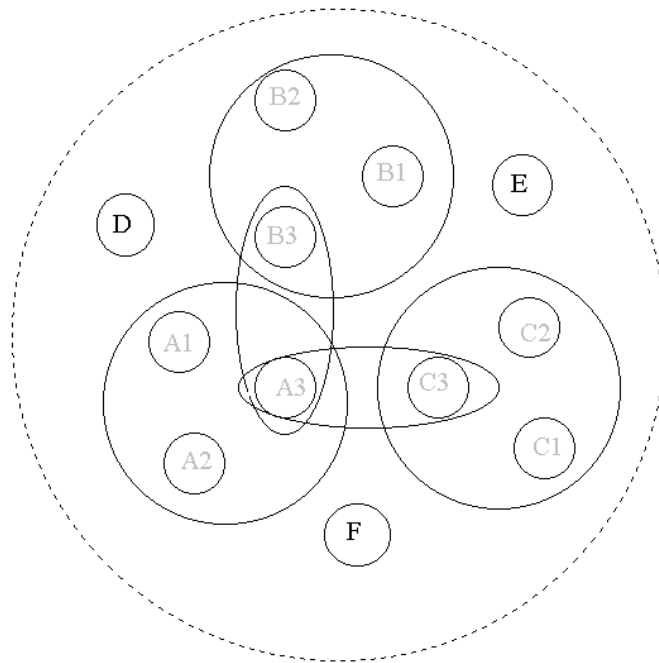


Stage III: second union following

Figure I: process of union formation

Lured by the possibility of benefits, the countries seeking an alliance will compete by way of concluding or entering more free trade areas than others, since the more free trade areas an body is involved in, the more welfare it can get while less

trade diversion will occur. As each of them attempts to benefit to the greatest extent possible, the process of the formation of the union becomes more like the *pattern* given in Figure II. From this figure, we can see that A3 occupies a most advantageous position as a result of its greater number of free trade areas partners than do all the others. Relying on its position, A3 gains preferential treatments from B3, C3, A1 and A2 but these four can not do the same thing. Accordingly, we can say, just these elements constitute the original dynamics to the development of the free trade areas.



1. Assuming  $A1 = A2 = A3 = B1 = B2 = B3 = C1 = C2 = C3$
2. When  $A3 + B3$ ,
  - they are on an equal level;
  - but they each are in a more advantageous position than the others;
3. If A3 wants to be the first, it can invite C3. Then B3 and C3 are at equal level, and A3 is number 1.

Figure II: dynamics pushing countries to aim to the centre

## 2.2 Actions seeking enhanced welfare

### 2.2.1 Various forms of cooperation under free trade

## **agreements**

Although increased benefits are in general a strong inducement, restrictions imposed by existing conditions mean that the individual forms of regional co-operation are different. In accordance with the extent of the economic integration that the agreements cover, they can be roughly classified as follows:

### *Free trade area*

A preferential arrangement where the tariff rates among member states are lower than those between member states and non-member states while the external tariff is charged at different rates determined independently by the member states. Usually the free trade agreement has the aim of totally eliminating customs duties and restrictions among those members.

### *Customs union*

This kind of arrangement introduces a common customs tariff which permits zero duty among member states on imports of goods and services while imposing a common external tariff. In a customs union, the member states no longer have the power to change tariffs separately.

### *Common market*

Within the territory of the common market, besides the common customs tariff, there is also a common commercial policy covering the free mobility of production factors including services, persons and investment.

### *Single market*

Under this kind of arrangement, besides the elements of the common market, all producers and consumers are covered by common rules, meaning that the different geographic parts within the market cannot erect barriers preventing participants of other members from operating.

### *Economic union*

The economic union is a sort of single market where even closer co-operation has materialised; namely, the member states have a common economic and currency policy through co-ordination.

## **2.2.2 Two models: European Union & North American Free Trade Agreement**

### **2.2.2.1 European Union**

West Europe has experienced almost all the above forms of co-operation. After the Second World War, the lasting hope for a unified Europe was strengthened and evolved into a kind of general political aspiration. Based on the consensus that close economic relationship among the states would provide the basis on which real and continuing peace could rest, the Treaty establishing the European Coal and Steel Community (ECSC) was concluded in 1951. Following that, in 1957 two treaties signed in Rome established the European Atomic Energy

Community (Euratom) and the European Economic Community (EEC). These agreements then covered six states: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. In 1967, the Merger Treaty provided that the four institutions created by the ECSC Treaty serve the European Communities jointly. Until then, the preferential tariff arrangement had been in force between the EEC members but competence in introducing external tariffs still remained in the hands of each member. So, during this period, the EEC was at the stage of free trade agreement.

As Council Regulation 950/68<sup>7</sup> entered into force in 1969, the Common Customs Union was formed. All customs duties among the six founding member States of the Community were eliminated and a common external customs tariff was introduced. After the formation of the Customs Union, the Single European Act of 1987 successfully ensured the completion of the single, internal market by the end of 1992. The Treaty on European Union (Maastricht Treaty), which entered into force on November 1, 1993, formed the European Union and provided for “economic, monetary, and political union.” In 1997, the Treaty of Amsterdam was signed, which were a completion of the final preparations for the third stage of economic and monetary union and the introduction of the euro, and the establishment of a new all-Union strategy on employment. It has thus gone through the 4 remaining stages described above.

### **2.2.2.2 North American Free Trade Agreement (NAFTA)**

Looking back on the specific impulses promoting the formation of NAFTA, one element could be the fact that the GATT was not sufficient to satisfy the free trade needs within the territory of North America. It is known that the GATT 1947 did not mandate free trade, but encouraged member states to enter into agreements to reduce trade barriers either through a common market or a free trade zone. However, the situation in North America, especially that between Canada and the United States went beyond what the GATT could cover. The two countries were ready and wanted to establish a union leading to a freer trade union with zero tariffs before further fostering the free exchange of capital and labour between them. Moreover, it was evident that the very stable and successful integration example of the European Community inspired Canada and the United States and drew them to negotiate about a free trade zone for North America. As a first significant step, in the 1980s, the United States and Canada negotiated a trade arrangement to reduce trade barriers between the two countries. Consequently, both countries signed the Canada-United States Free Trade Agreement (CUSTA) in 1988. In June 1990, Mexico entered into negotiations to establish a trilateral free trade agreement with the United States and Canada. The formal negotiations for a free trade agreement began in February 1991. These

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<sup>7</sup> *O.J.L* 172/1, 1968.

negotiations led to the establishment of the North American Free Trade Agreement that entered into force on January 1, 1994. NAFTA is designed to eliminate all trade barriers between the United States, Canada, and Mexico and create the largest “totally free” trade zone in the world.

## **2.2.3 Impact of the European Union and North American Free Trade Agreement**

### **2.2.3.1 Trade creation within the European Union and North American Free Trade Agreement**

#### *European Union*

After the abolition of internal tariffs leading to market optimism, the newly created trade opportunities gave a boost to trade growth between Member States in the Community.<sup>8</sup>

In this respect, the early benefits of the original six EEC Members could be very persuasive. According to Michael Davenport’s analysis, if the net gain of trade creation is taken as trade creation less trade distortion, “the average net gain of trade creation for the studies showing a net gain was almost 9 billion USD” which amounts to “nearly 2 percent of Community GDP”<sup>9</sup>. It is further indicated that within the European Union, “the incumbent bloc countries’ share of the joining country’s trade typically rose by eighteen percentage points...”<sup>10</sup>

Specifically, after the formation of the Single Market, there has been a major expansion of EU import share with very little gain by non-EU producers. Further, competitiveness has also been improved: on average, price-cost margins have fallen by an average of 3.9 percent since 1991 across the fifteen countries studied.<sup>11</sup>

#### *North American Free Trade Agreement*

From 1980 to 1990, the period before the formation of the NAFTA, US exports to Mexico remained around 7.0 percent of all U.S. exports. In contrast they amounted to 11.6 percent of U.S. exports in 1998, the fourth year after NAFTA’s

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<sup>8</sup>[http://europa.eu.int/comm/dg10/publications/brochures/move/douane/customs/txt\\_en.html#1](http://europa.eu.int/comm/dg10/publications/brochures/move/douane/customs/txt_en.html#1) (viewed April 23, 2002).

<sup>9</sup> Timothy Lyons, *EC Customs Law*, 2001, P.4 -5.

<sup>10</sup> Caroline L. Freund and John McLaren, *On the Dynamics of Trade Diversion: Evidence From Four Trade Blocs*. <http://www.federalreserve.gov/pubs/ifdp/1999/637/ifdp637.pdf> (viewed May 10 2002).

<sup>11</sup> [http://europa.eu.int/comm/internal\\_market/studies/stud12.htm](http://europa.eu.int/comm/internal_market/studies/stud12.htm) (viewed May 10, 2002.).

entering into force. Meanwhile, imports from Mexico illustrated a similar pattern. On to the side of Mexico, its share of U.S. imports doubled from 1980 to 1998. From 1993, the share of the U.S. market had increased in great deal.<sup>12</sup>

It is notable that, since January 1, 1994, United States total trade (imports and exports combined) with Canada and Mexico has increased from an annual average of \$269 billion in 1991 to 1993 to an annual average of \$384 billion in 1994 to 1996.

As for NAFTA intra-trade, in 1997, it accounted for 49 percent of all trade by its members, an increase of almost 11 percent a year on average since 1990. At the same time, NAFTA trade to third countries was only growing at 7 percent.

### **2.2.3.2 Trade diversion outside the European Union and North American Free Trade Area**

#### *European Union*

It has been alleged that the Single Market has been trade creating, both for EU and non-EU producers. And, there “is little evidence of any substantial trade diversion of non-EU trade”.<sup>13</sup> But still, some trade diversion stemming from the creation of EU can be seen by way of two examples: Central and Eastern Europe(CEE) and Latin America.

In the socialist era, confronting high tariffs, quantitative restrictions and a wide range of other protection measures, CEE sustained seriously trade diversion in accessing the EU market. One reason for this is that, at that time, CEE ranked at the bottom of the pyramid of trade preferences granted by the EU to various groups of countries. After the EU concluded a trade and co-operation agreement with Hungary in 1988 and even more so, after the promotion of the 1991 “Europe Agreements” providing further preferential arrangements, Hungary and Poland rose to the top of the pyramid of trade preferences. Gradually, trade diversion has been changed to trade creation. From 1988 to 1998, EU imports from a group of seven CEE countries (Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovak Republic) increased fourfold. In contrast, during the same period, EU imports from Latin America just doubled. In 1998, the EU imported 64 percent more from these seven CEE than from all Latin American countries together.<sup>14</sup> Compared with CEE, Latin America suffered a larger extent of trade diversion.

Now EU, where Mainland China is currently the second largest supplier of textile, is entering into talks with Latin America for a free trade area to be establish in

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<sup>12</sup> Anne O. Krueger, *Trade Creation and Trade Diversion under NAFTA* , Working Paper 7429. <http://www.nber.org/papers/w7429m> (viewed May 10, 2002).

<sup>13</sup> [http://europa.eu.int/comm/internal\\_market/studies/stud12.htm](http://europa.eu.int/comm/internal_market/studies/stud12.htm) (viewed May 10, 2002.).

<sup>14</sup> [http://www.europarl.eu.int/enlargement/briefings/37a2\\_en.htm#3](http://www.europarl.eu.int/enlargement/briefings/37a2_en.htm#3) (viewed April 23, 2002).

2005, meaning the Mainland may well lose a significant share of the relevant market<sup>15</sup>.

#### *North American Free Trade Area*

Regarding trade diversion resulting from NAFTA, trade volume to the third countries to third countries varies a lot. Its neighbours, Central America and the Caribbean, with a large amount of trade potentially directed at the United States, have experienced significant economic downturns recently because of their inability to compete with Mexico<sup>16</sup>. In this regard, the World Bank has estimated that up to 36 percent of the Caribbean Basin Economic Recovery Act (CBERA) country exports to the United States could be displaced with countries such as St. Lucia facing displacement of 79 percent.

As has been indicated, from 1995 to 1999 Japan, Korea and Mainland China exports to the US declined 2.2 percent while Taiwanese export to the US declined 0.46 percent within this period.<sup>17</sup> Moreover, Mexico has now displaced Mainland China, the former largest suppliers of textiles to the US.

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<sup>15</sup> Jianming Xu, *Intonation Trade Issues (Chinese Version)* 1, 2002.

<sup>16</sup> David A. Gantz, *The United States and the Expansion of Western Hemisphere Free Trade: Participant or Observer?*, 14 *Ariz. J. Int'l & Comp. L.* 381, 382, 409 (1997).

<sup>17</sup> <http://www.cetra.org.tw/mars/mkrpt/891206.htm> (April 20, 2002).



### 3 The proliferating free trade areas under the regime of World Trade Organisation

Envyng the welfare created and fearing the distortions of the consequent trade diversion, free trade areas have been gradually proliferating since the 1950's. However, as can be seen from Figure III, the amount of free trade areas increased so rapidly after the creation of EU that this formed the so-called surge of free trade areas.

According to the World Trade Organisation's statistics in 2000, the "number of RTAs in which at least one World Trade Organisation member participates has roughly doubled in less than ten years",<sup>18</sup> and up to January 2002, there have been 162 notified RTAs<sup>19</sup>.

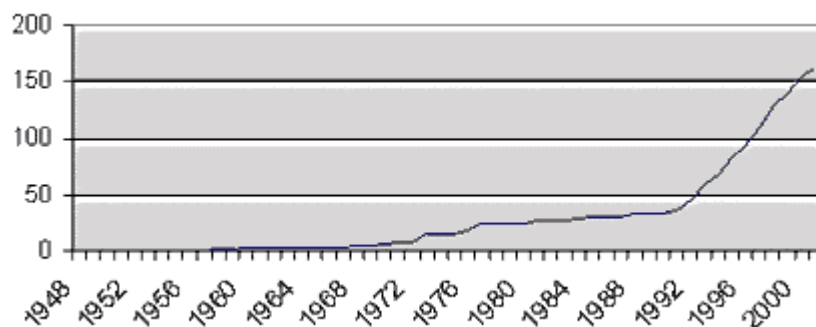


Figure III: RTAs notified to World Trade Organisation<sup>20</sup>

Currently, more and more people regard the very surge as indicating a lack of overall legal discipline and worry that it will undermine the Multilateral Trading System. Their fears concern not only the effectiveness of the concrete provisions which legitimate free trade areas, but also on the credibility of the World Trade Organisation regime as a whole.

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<sup>18</sup> *Synopsis of "Systemic" Issues Related to Regional Trade Agreements*, WT/REG/W/37, 2 March 2000, (00-0789).

<sup>19</sup> [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm) (April 20, 2002).

<sup>20</sup> *Id.*

### **3.1 Relevant Provisions Legitimizing free trade areas under the World Trade Organisation regime**

From GATT 1947 to the World Trade Organisation, free trade agreements have always constituted a lawful exception to the General Most-Favoured-Nation Treatment. This positive attitude is formulated in different legislation as following: Article XXIV of GATT 1947, 1974 Decision on Differential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Enabling Clause), Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994 (hereinafter, the Understanding) and Article V of General Agreement on Trade in Services (GATS).

In 1996, the World Trade Organisation Membership further confirmed its stance on Regional Trade Agreements in Singapore Ministerial Declaration as follows:

“We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number, scope and coverage. Such initiatives can promote further liberalisation and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and extent of regional trade agreements make it important to analyse whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules. In this regard, we welcome the establishment and endorse the work of the new Committee on Regional Trade Agreements. We shall continue to work through progressive liberalisation in the WTO as we are committed in the WTO Agreement and Decisions adopted at Marrakesh, and in so doing facilitate mutually supportive processes of global and regional trade liberalisation.”

Further, in 1996, the Committee on Regional Trade Agreements (CRTA) was established. The CRTA is in charge of examining the applications regarding free trade areas proposed by contracting parties and, by referring to its standard model, making an assessment of the likely impact on the multilateral trade system.

#### **3.1.1 GATT 1947**

##### *Definition*

Under Article XXIV (8) of the GATT, a customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that duties and other restrictive regulations of commerce are virtually eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union; A free-trade area means a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

#### *Purposes establishing the customs union and free trade area*

Article XXIV (4) of the GATT states that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

#### *Coverage on trade.*

GATT requires that the regional trade organisation must cover “substantially all the trade”, i.e., SAT. GATT XXIV (a) says that either in a customs territory or a free-trade area, the duties and other restrictive regulations of commerce should be eliminated with respect to substantially all the trade between the constituent territories of the union. The goal here is to avoid the formation of the regional blocs where the real point of the union is to arrange preferential treatment on certain products rather than to practice free trade, solely with a view to preventing products of third countries access its market.

#### *Interim period*

Concerning the situation that the regional trade area needs to be established gradually, GATT XXIV (5) (c) states that, any interim agreement leading to a formation of customs union or free trade area, shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

#### *Consequences of the agreements*

GATT XXIV (5) requires that, with respect to a free-trade area or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement, shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area.

#### *Procedure of examination*

GATT XXIV (7) stipulates that a contracting party deciding to enter into a customs union or free-trade or an interim agreement leading to the formation of such a union or area, shall promptly notify the Contracting Parties and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

### *Compensation*

GATT 1994 states that, in fulfilling the requirements of sub-paragraph 5 (a), a contracting party proposing to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.

## **3.1.2 The Enabling Clause**

Under the Enabling Clause, i.e., the 1974 Decision on Differential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, regional trade agreements concluded by developing countries shall be notified to the Committee on Trade and Development who, after examining it for consistency, forwards it to the Committee on Regional Trade Agreements for its examination. After that, the latter sends its report to Committee on Trade and Development for its confirmation.

## **3.1.3 The Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994**

The Article XXIV Understanding basically purports to strengthen legal discipline in the proliferation of RTAs. In pursuing this goal, the Article XXIV Understanding addresses the situation from two angles of approach.

### *Substantial aspect*

First of all, the Understanding is consistent with the building block perspective in acknowledging the increasing importance of RTAs and their contribution to the expansion of world trade.

In the main text, the Article XXIV Understanding reemphasizes the importance of meeting the requirements of paragraphs 5, 6, 7, and 8. Regarding paragraph 5, it clarifies that the calculation to assess whether the post-RTA level of tariffs outweighs pre-RTA ones shall be based upon an overall assessment of weighted average tariff rates as well as applied (as opposed to bound) tariffs. Also, it

defines the reasonable length of time as ten years and allows extra time only in exceptional cases and with a full explanation.

The Article XXIV Understanding also elaborates the rebalancing mechanism for tariff concessions through the negotiation of mutually satisfactory compensatory adjustment and modification or withdrawal of pre-existing concessions.

#### *Procedure aspect*

In the preamble, the Article XXIV Understanding emphasizes the need for review of agreements notified under Article XXIV as well as for the transparency of all Article XXIV agreements. Further, it stipulates a set of mechanisms concerning monitoring and surveillance. In particular, paragraph 7 requires that a working party shall recommend a plan and schedule for an interim agreement if these are not included in the interim agreement itself. This provision is regarded as a strong check against the endless delays encountered during the final stages of integration of some interim agreements.

Finally, paragraph 12 clarifies that the WTO dispute settlement procedure can be invoked with respect to any issue concerning Article XXIV.

### **3.1.4 Article V of General Agreement on Trade in Services (GATS)**

#### *Purpose*

GATS stipulates that the purpose of regional liberalising trade in services shall be designed to facilitate trade between the parties to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services. If, a Member herewith intends to withdraw or modify a specific commitment inconsistently with the terms and conditions set out in its Schedule, it shall provide at least 90 days advance notice of such modification or withdrawal and the procedure set forth in paragraphs 2, 3 and 4 of Article XXI shall apply.

#### *Coverage*

The “substantial sectoral coverage” laid down in GATS as a condition refers to the number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply. Under the coverage, the Members shall remove substantially all discrimination through elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time-frame.

#### *Procedure of examination*

GATS stipulates that Members of the regional trade area shall promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services. They shall also make available to the Council such relevant information as may be requested by it. The Council

may establish a working party to examine such an agreement or enlargement or modification of that agreement and to report to the Council on its consistency with this Article.

## **3.2 Lenient practices under the above umbrella**

From the aforementioned provisions we can see that the authors of the World Trade Organisation clearly intended to balance the end of promoting free trade areas and the need to prevent the misuse or even the abuse of the exception. However, it would be rather difficult to say that the growing surge of the RTAs is a positive outcome in line with their intentions. What is worse, it is reported that only one (the Czech Republic-Slovak Republic Customs Union) out of more than one hundred and sixty RTAs has been “confirmed fully compatible” with the relevant GATT rules<sup>21</sup>. Discussing the reasons for this, the failure of the Committee on Regional Trade Agreements in prudently verifying the RTAs could be one cause while the political motivations behind the formation of RTAs often overwhelm the “economic tests” embedded in Article XXIV. Reviewing the operation of those provisions, there indeed seem to be deficiencies.

### **3.2.1 Questionable examples regarding the applications of GATT XXIV**

According to the working party reports dealing with Article XXIV, we can see the following problems.

*Purpose-“not to raise barriers to the trade of other contracting parties”* Paragraph 4 is regarded as the most critical legal text in Article XXIV in defining the objective of trade regionalism in light of the multilateral trading system. However, some contract parties, especially giants like the EC and the United States, used to misinterpret or understate this paragraph in order to justify the imposition of new trade barriers as a result of the formation or expansion of RTAs<sup>22</sup>. For instance, in the context of the accession to the EC, where Spain and Portugal introduced new quantitative restrictions which were suspected of being inconsistent with Articles XI, XIII, and XXIV, the EC delegations claimed that paragraph 4 of Article XXIV was only an overall objective which did not impose

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<sup>21</sup> See *supra* note 18.

<sup>22</sup> *Working Party on the Free-Trade Agreement between Canada and the United States: Report of the Working Party adopted on 12 November 1991, L/6927, Nov. 12, 1991, GATT B.I.S.D. (38th Supp.).*

an obligation on the contract parties<sup>23</sup>. They further claimed that members of a RTA could introduce new trade barriers or extend existing barriers to new members if the net impact of all barriers is less than what had prevailed before the creation of the RTA. Relying on this ground, the EU even required candidates for EU membership “to increase tariffs as a condition” for the membership: U.S. Senator Phil Gramm stated that this condition is a violation of Article XXIV.<sup>24</sup>

### *Compensation*

The provision of compensation is stipulated in paragraph 5(a) of Article XXIV; this is understood by EU as stating that the inevitable increase of discriminatory trade barriers in certain areas, such as agriculture and textiles, could be compensated for by more generous trade liberalisation in other sectors, such as manufacturing. This view has been challenged on the ground that the alleged compensation will not provide for balance. This is because trade diversion resulting from the expansion of pre-existing trade barriers in such areas as agriculture and textiles would exact its heaviest toll on the less developed countries that enjoy a comparative advantage in those sectors.

### *Coverage of trade-“Substantially all the trade”*

We have seen that Article XXIV (8) (b) requires clearly that duties and other restrictive regulations of commerce must be eliminated on substantially all the trade in products between the constituent territories of the union if it is to be considered a free trade area. When the Treaty of Paris established the ECSC which restricted trade liberalisation only to two industries, no one in theory regarded these two industries as representing “all the trade” and thus being consistent with Article XXIV. However, “U.S. support for European integration and the key position of the ECSC Member states in GATT made it unlikely that the Agreement would be an obstacle to the implementation of the Treaty of Paris”, so, instead, a compromise was concluded stating “the ECSC members were encouraged to adhere to the GATT principles as much as possible and to remove all obstacles to trade in respect of the products covered”<sup>25</sup>. It would be arguable whether other such RTAs not having the ECSC’s special status would have the same opportunity.

On the present standard of SAT, according to the Report of the Sub-group of the Committee on the European Economic Community, the EEC-member countries proposed that “a free trade area be considered as having been achieved for substantially all the trade when the volume of liberalised trade reached eighty

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<sup>23</sup> *Accession of Portugal and Spain to the European Communities: Report of the Working Party adopted on 19-20 October 1988, L/6405, Oct. 19-20, 1988, GATT B.I.S.D. (35th Supp.) 19, 22 (1989).*

<sup>24</sup> Daniel S. Potts, *Dubious Partnership: the Legal, Political, and Economic Implications of Adding the United Kingdom to the North American Free Trade Agreement*, Minnesota Journal of Global Trade, Winter 2002.

<sup>25</sup> D. Lasok, *The Customs Law of the European Economic Community*, Second Edition.

percent of total trade.” However, the report also reveals that many other members of the sub-group argued that it would be inappropriate and unrealistic to fix a general percentage of trade that might be applicable to each different case.

To fix a given figure as a criterion for qualification as a RTA is deemed problematic for many reasons. First of all, the measurement of “liberalised ” trade volume would hardly be accurate in reality because such measurement is generally based on prediction of unrealised transactions, such as increased imports resulting from the formation of a RTA.

Moreover, even if a certain figure, such as eighty percent, were accepted as a legitimate criterion for endorsing the formation of an RTA, no one could ensure that “trade restrictive” effects resulting from the non-liberalised or even newly restricted portion (twenty percent) would be fully offset by the “trade creating” effect resulting from the portion of liberalised trade (eighty percent). In this regard, the working party reviewing the European Free Trade Association (EFTA) Stockholm Convention noted differing opinions on whether a specific sector, such as agriculture, might be excluded in assessing substantiality. Some members of the working party argued that even if ninety percent of trade was covered due to the creation of a RTA, that fact alone should not allow the exclusion of any specific sector. Nevertheless, EFTA members argued that some latitude should be granted for different products.<sup>26</sup>

Ultimately, the substantiality test must be conducted on a case-by-case basis. Considering the inherent textual ambiguity of this test, only jurisprudential development through accumulation of a sufficient body of case law is likely to clarify what is substantial in each case.

### **3.2.2 Case: Turkey-Restrictions on Imports of Textile and Clothing Products<sup>27</sup>**

#### *Background*

Turkish Quantitative Restrictions (Turkish QRs) was the first case in GATT/World Trade Organisation history that directly involved Article XXIV. As a step toward integration into the EC, Turkey followed the EC's lead by introducing quantitative restrictions on imports of textile and clothing products from India. India complained that these measures were inconsistent with Articles XI and XIII. Turkey tried to justify its measures on the grounds that without these new quantitative restrictions, the EC would have excluded these products

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<sup>26</sup> *European Free Trade Association: Examination of Stockholm Convention: Report adopted on 4 June 1960, L/1235, June 4, 1960, GATT B.I.S.D. (9th Supp.) 47-58 (1961).*

<sup>27</sup> *Turkey-Restrictions on Imports of Textile and Clothing Products, Appellate Body Report adopted November 19, 1999, WT/DS34/AB/R, [http://www.wto.org/english/tratop\\_e/dispu\\_e/34abr\\_e.pdf](http://www.wto.org/english/tratop_e/dispu_e/34abr_e.pdf) (viewed April, 22, 2002).*



from free trade within the Turkey-EC CU, which would have prevented Turkey from meeting the requirement of “substantially all trade”.

### *Decisions*<sup>28</sup>

Examining the Turkish defence, the panel stated that Article XXIV (5) does not allow parties in a newly formed CU to escape the prohibitions laid down in Articles XI (General Elimination of Quantitative Restrictions) and XIII (Non-Discriminatory Administration of Quantitative Restrictions). Similarly, regarding the requirements of paragraph 8, the panel said that the provision does not oblige Turkey to erect barriers on imports of textiles and clothing that violate other provisions of the World Trade Organisation Agreement. Thus the Turkish defence was rejected. However, the panel based its consideration on the so-called “flexibility” test, saying that the EC and Turkey could have introduced relevant “administrative means”(system of certificates of origin).

This position was confirmed by the Appellate Body, stating that Turkey could have adopted a “reasonable alternative” like the “system of certificates of origin”. Further, the Appellate Body held that, under Article XXIV, it is permitted to allow the World Trade Organisation system to be harmonised with the proliferation of RTAs. This position is regarded as opening the way for a new perspective on trade regionalism.

### **3.2.3 Other problems**

#### *GATS*

Like the GATT XXIV, Article V of the General Agreement on Trade in Services (GATS) provides for “economic integration.” But also, GATS Article V contains vague terms such as “substantial sectoral coverage.” What is worse, the problem is compounded by the fact that GATS Article V has little recourse to a body of jurisprudence providing interpretative guidelines since the area of trade in services is still marked by “vast stretches of uncharted territory”, both under the GATT/World Trade Organisation system and the RTAs.

As for the possibility of adopting GATT/World Trade Organisation jurisprudence in interpreting Article V, it is regarded as very difficult because, for example, GATT Article XXIV presupposes legal concepts such as tariffs and RTAs that have no parallel under GATS. Moreover, the very difference between goods and services disallows such legal conflation, leading to a more complicated situation.

#### *Surveillance after the formation of RTAs*

Although GATT Article XXIV is designed carefully in so far as concerns the formation of free trade areas, it apparently ignores the situation regarding the post-formative “operation” of RTAs vis-à-vis other trading units including the

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<sup>28</sup> [http:// www.ejil.org/journal/curdevs/sr6.html](http://www.ejil.org/journal/curdevs/sr6.html) (viewed April 26, 2002).

World Trade Organisation. This limited scope of Article XXIV is quite obvious either on its own terms or in the context of other World Trade Organisation legal documents.

All in all two main elements lead to unhealthy regulation of the extension of the RTAs, i.e., the lack of legal discipline and its inability to address the sophisticated legal issues pertaining to the operation of RTAs which go beyond its coverage.

### **3.3 Credibility crisis of the World Trade Organisation**

Indeed those abovementioned problems allow for considerable growth of free trade areas, which is one of the main reasons for the formation of the surge. However, if the defective rules could have been applied equally, the surge should have not been so huge. But, the lack of equity and the weak enforcement regime within the World Trade Organisation remind us of the need to re-examine the structure of the World Trade Organisation before analysing any deficiencies.

#### **3.3.1 The Institutional Structure of the World Trade Organisation**

##### *Legitimacy*

The legitimacy of the World Trade Organisation is derived from its universal membership (equal representation) and equal rights and obligations for all members. The World Trade Organisation embodies a rules-based multilateral trading system.

At the heart of the multilateral trading system are the World Trade Organisation agreements, which were developed through a series of negotiation rounds over the past five decades. These agreements are essentially binding contracts that govern the general conducts and norms of international business. The goal is to enable producers, consumers, exporters, importers, and service providers alike to perform their business functions in a transparent and predictable business environment.

One of the World Trade Organisation's most important functions is to serve as a forum for trade negotiations. The member economies can avoid complicated and tortuous bilateral negotiations by using the single forum of the World Trade Organisation to negotiate with all or most of their trading partners. This can help reduce transaction costs and increase the efficiency of the negotiation procedure.

In principle, all the World Trade Organisation members have equal rights and obligations. A single set of trade rules applies to all members. The World Trade Organisation's rule-making process is all-inclusive. Decisions are made by the

entire membership, typically by consensus. The World Trade Organisation agreements are agreed upon by the entire membership and ratified by members' parliaments. Through this process, a commitment cannot be changed or reversed without going through the formal negotiation process again. In theory, the World Trade Organisation rules ensure non-discrimination and fair competition for all. Both the developed and developing countries have an equal right to challenge others in the World Trade Organisation's dispute settlement procedure. The members are also obliged not to act unilaterally, should disputes arise.

### *Enforceability*

To enable the World Trade Organisation to be effective, the WTO has established an institutional mechanism to enforce the international trade rules at two levels: the multilateral trade level and the national trade policy level.

#### 1) Multilateral Trade Level

The World Trade Organisation agreements are legally binding and enforceable. Each agreement contains specific measures on market access, transparency, non-discrimination, and MFN. For instance, GATT obliges the individual members to make commitments to "bind" their tariff rates.

#### 2) National Trade Policy Level.

The World Trade Organisation reviews national trade policies through an institutionalised peer review system, namely the Trade Policy Review Mechanism (TPRM). The TPRM ensures the transparency and full compliance of national trade policies. Under the TPRM, the largest four members namely the EU, the US, Japan, and Canada, are subject to reviews each two years, while the rest are reviewed each six years.

### *Dispute settlement*

For its ability to resolve disputes justly and deliver the results promptly, the World Trade Organisation has set up its Dispute Settlement Mechanism (DSM) consisted of a set of clearly defined rules and procedures under which the members have an equal right to challenge others in the World Trade Organisation, should trade friction arise. Also, DSM contains a judiciary body named the Dispute Settlement Body (DSB), which has the sole responsibility to establish tribunal panels, to monitor and implement rulings, and to authorise trade sanctions. A settlement procedure typically lasts between twelve to fifteen months, depending whether there is appeal.

At the completion of the panel procedure, the DSB would draft a final report, which becomes the ruling. Both litigants can appeal the ruling. By rules, appeals may not be made after 90 days. Under the DSM, any final ruling is automatically adopted unless the entire membership reaches a consensus to reject it. Since January 1, 1995, countries have brought more than 230 dispute cases before the World Trade Organisation DSB.

### 3.3.2 The Crisis in the World Trade Organisation

#### *The inequity in the World Trade Organisation*

Despite the principle of equal rights and obligations of the World Trade Organisation, some unequal practices have appeared which are complained about by developing countries.

1) The unfair decision-making process under the principle of equity.

In this aspect, the main problem could be the conventional practice, namely the Quad (namely the EU, the US, Japan, and Canada). Quad is usually formed through an informal consultative process, in which only those four advanced industrialised parties possessing sufficient human and institutional resources to deal with the complex trade and legal agenda, are invited to participate. As the decision-making process is not subject to consensus like that of the final agreement, once in the Quad consensus is reached through interests swap between those powerful industrial parties, and the Quad will possess absolute influence in the process of decision making. As critics point out, during the past rounds of World Trade Organisation talks, almost all major issues relating to rule-making or procedural amendments had been dominated by the Quad. Virtually, developing countries are excluded from the rule-making process. In this context, it is not surprising that the content of the produced rules tend to favor their makers, the advanced industrial powers. For instance, during the Uruguay Round negotiations, less than three percent of written proposals were submitted by the sub-Saharan countries; however, all of the African members of the GATT must accept the new obligations of the World Trade Organisation. Unfortunately, even until the Seattle Conference, such practices were kept on by way of secret meetings named the “greenroom process”.

However, within the framework of the World Trade Organisation, the developing countries do not have adequate strength to counter the above unfair practice. Because of the relatively small size of the Quad, it can circumvent the collective-action problem more effectively than the developing countries. In contrast, the developing countries suffer serious resource constraints, “most small delegations do not have the appropriate resources in Geneva...to service the negotiating process and thereby participate meaningfully in what could be meetings of primary importance for their national interests”.

2) The unequal opportunity of attendance

According to the World Trade Organisation International Trade Statistics 2000, in 1999, the developing countries enjoy 74 percent of World Trade Organisation membership. However, the G7<sup>29</sup> powers account for 47.9 percent of world

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<sup>29</sup> Canada, Japan, France, Mexico, United Kingdom, Germany, Italy and United States. See <http://www.g8.utoronto.ca/g7> (viewed March 3, 2002)

merchandise trade, and 49.8 percent of world trade in commercial services, and they have more financial, technical, and human resources to support their Missions in Geneva. As a result, in the late 1990s, only around 66 percent of developing country members actually had a Mission in Geneva, while almost all the developed counterparts enjoyed one. The average size of Mission for developed countries was 6.8 persons, compared with 3.5 persons for developing countries, not to mention the least developed countries' average size, 1.2 persons. Of the key institutions, representatives from the developed countries occupy about 54.8 percent of all chief executive offices including chairmen and vice chairmen in the General Council, Working Parties and Committees, Dispute Settlement Body, and Trade Policy Review Body. By contrast, the developing members have weaker negotiating power vis-à-vis the developed countries. Further, their relatively large size creates serious collective-action and free-rider problems for the developing camp as a whole, which renders it hard for them to take a common position on major issues in the World Trade Organisation.

### *Penal system to effect legal sanctions*

Although the Understanding successfully clarified that the World Trade Organisation dispute settlement procedure can be invoked with respect to any issue concerning Article XXIV, the DSB itself proves questionable.

#### 1) Problematic efficiency

Between early 1995 and mid-2000, a total of 234 dispute cases had been brought before the World Trade Organisation's DSB but only 39 cases had been successfully settled or withdrawn. Besides this poor record in settling disputes, the World Trade Organisation DSM does not have the ability, as does the Commission in the European Union, to pass a sentence on the violator of international trade laws. Although in theory the DSB has the authority to issue trade sanctions against any member failing to comply with the ruling, in reality this has rarely been done.

#### 2) The question of prejudice

Critics from the developing world point out that the DSM is prejudiced against the developing countries. Among the 173 cases received between April 1994 and March 1999, the Quad filed 110. Further, small members cannot rely on retaliation against the large ones because raising import barriers will have little impact on the latter. The banana trade dispute between Ecuador and the EU exposed the very weakness of the World Trade Organisation dispute settlement system. Ecuador had to rely on the US to file the case against the EU. The relatively small size and the weakness of the Ecuadorian economy make it impossible to bring retaliatory pressure on the EU.<sup>30</sup>

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<sup>30</sup> *European Communities-Regime for the Importation, Sale and Distribution of Bananas*, Appellate Body Report adopted on November 17 1997, WT/DS27/AB/R.

# 4 East Asia: strong willingness followed by frequent activities

## 4.1 Interaction of exogenous and endogenous elements provides strong motives

The World Trade Organisation's deficiencies and the possibility of inviting trade creation instead of continuing to suffer trade diversion constitute general reasons for the East Asian countries to conclude free trade agreements. These motives are noticeably strengthened when they interact with the concrete situation in this territory.

### *Painful lessons learned from the financial crisis*

After suffering the financial crisis, at least three things about these countries were recognised.

First, their economic system, especially their monetary system, proved severely unhealthy and problematic. Second, none of them could successfully deal with the crisis individually. Finally, further disappointment arose from the level of international assistance. In this regard, it was clear that the Asian members expected more than what they actually got. Now they feel they cannot rely on the US to resolve a regional crisis because, in the aftermath of the Asian Financial Crisis, the US left it to the IMF to deal with the crisis. But the latter vetoed Japan's proposal to establish an Asian Monetary Fund. At the same time, the IMF imposed a stringent conditional loan package on the recipients. And in the proposed emergency loan program for Thailand worth \$17 billion, IMF provided less than 25 percent with the rest promised by other countries in East Asia including Japan. European and North American nations stood outside the programme.

From then on, the Japanese Ministry of Finance realised that future currency crises in any country in East Asia, which would be highly transmissible to others, had to be treated much more by countries in this territory than by the IMF- who are not a benevolent fund. Sharing this view, as a tentative step, ASEAN, Japan, South Korea, and Mainland China decided, in July 2000, to establish a Currency Swap Agreement (CSA) as a pre-emptive safeguard against another regional financial crisis.

### *Accession of Mainland China and Taiwan to the World Trade Organisation*

Both Mainland China and Taiwan were approved simultaneously last November. This issue has led to at least two outcomes. First, Taiwan's accession as an individual customs territory renders it capable of participating in free trade areas

covered by GATT XXIV, meaning it will have fairly extensive room to act. Second, the accession of Mainland China results in both challenges and opportunities in the area. Regarding the challenges, ASEAN alleged that its share of total global FDI inflows declined from 7.9 percent in 1994 to 1.8 percent in 1999 because of investment flowing to China. And this percentage is likely to grow further now China is in the World Trade Organisation.<sup>31</sup> As for the opportunities, the vast market of 1.7 billion people in Mainland China is promising.

*Views on the free trade area from Mainland China: from a negative attitude to an active one*

At an earlier stage, Mainland China was sceptical regarding both globalization and regionalization. This attitude arose from its concern that globalization is Americanisation or the promotion of American hegemony (economic, social and political). As a result, national autonomy would be undermined. Of the regional co-operation in this area, Mainland China kept on worrying about Japan's leading role and America's intervention. In addition, the domestic economy of China still needed a high degree of protection with regard to imports and inward flow of investment. The export markets were primarily United States and Europe and there was therefore no urgent need to further open up the markets in the Asian region through economic integration. Gradually, being aware of the inevitability of globalization and the promising mutual benefits arising therefrom, Mainland China started to work on entering the World Trade Organisation more than ten years before. After the Asian Financial Crisis, domestically, China's stance toward East Asian economic co-operation and integration also underwent significant changes. Sharing the view of Japan that individual economies are very vulnerable to external shocks, and acknowledging that the foreseeable capital inflow is so important an issue of economic security, Mainland China is now a very active advocate in fostering an East Asia free trade area.<sup>32</sup>

*Main actors' fights for the hub rather than the spoke*

As well as the impulse to counter the EU and NAFTA, themselves based on alliance, the main actors namely ASEAN, Japan, Mainland China, Korea, Taiwan, Singapore etc., also have individual interests. For one thing, they seek to join more free trade areas in order to obtain more trade creation while avoiding trade diversion. For another thing, within a free trade area, they each pursue a dominant position.

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<sup>31</sup> Ms. Jeannie Ng, AFTA and "East Asian Economic Zone" East Asia: Regional Development and Outlook Taipei, Taiwan 21 September 2001.

<sup>32</sup> Edward K.Y. Chen, *East Asia: Regional Development and Outlook*, Taipei, Taiwan 21 September 2001.

## 4.2 Many activities

In the context of above motives, many things are happening in East Asia. ASEAN, Japan, Mainland China, South Korea, Taiwan etc. are in the process of establishing free trade areas or extending the existing FTAs.

### 4.2.1 Activities surrounding Asian Pacific Economic Co-operation

Before the Asian Pacific Economic Co-operation, there was a proposal for an economic community due to the initiative of Premier Mahathir of Malaysia. He proposed that the Association of Southeast Asian Nations countries and East Asian nations such as Korea, Japan, Taiwan, should create an economic community with more or less strong economic ties. But, it seemed that the United States does not like any Asian integration that excludes it. By U.S. initiative, after Japan's suggestion (perhaps made because of its heavy dependence on the US), the Asian Pacific Economic Co-operation (APEC) was created in 1989 as an economic co-operation all over the Pacific Economic Basin. The parties of Asian Pacific Economic Co-operation come from United States, Canada, Mexico, New Zealand, Australia and all the Asian countries including Mainland China and Taiwan.<sup>33</sup>

According to the United States, the Asian Pacific Economic Co-operation can still become a free trade area with binding norms, but for fear of the strength of the US, this has been doubted by some of the Asian members. Furthermore, as Mainland China felt angered by Taiwan's accession to the Asian Pacific Economic Co-operation, it did not support the US. Instead, it insisted that Asian Pacific Economic Co-operation should just be a "forum" and confined to economic issues. So the enforcement of consensus reached within the Asian Pacific Economic Co-operation is dependent on peer pressure.

However, such peer pressure proved very weak. For instance, in early June 2001, Japan and China were engaged in a bilateral trade dispute over some low-value Chinese agricultural imports. In April, Tokyo announced a decision to impose import duties of 266 percent on shitake mushrooms and 106 percent on rushes used to make tatami mats. Shortly after that, Mainland China threatened to retaliate with 100 percent tariffs on imports of Japanese cars, mobile phones, and air conditioners. Since Mainland China was not yet a World Trade Organisation member, Japanese Prime Minister Koizumi and Chinese President Jiang Zemin have agreed to discuss the issue at the Asian Pacific Economic Co-operation

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<sup>33</sup> See *supra* note 6.



summit meeting held in Shanghai in October 2001. But no one could see any peer pressure at the time and ultimately, it was resolved depending on the *political* will to settle<sup>34</sup>.

Considering the above situation, the main actors in this area seem to prefer to set up or enter other free trade areas for closer co-operation and meanwhile, compete the central position by concluding more free trade agreements than others.

## **4.2.2 Activities surrounding the Association of Southeast Asian Nations (ASEAN)**

### **4.2.2.1 Background of the Association of Southeast Asian Nations (ASEAN)**

Due to the increasing tensions among the states and overall uncertainty in the Southeast Asia in 1960's, there was a need to develop a regional forum to alleviate pressures within the region and to promote economic growth between countries.<sup>35</sup> On August 8, 1967 in Bangkok, Thailand, the Association of Southeast Asian Nations was established by five original member countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. From 1984 to 1999, Brunei, Vietnam, Laos, Myanmar and Cambodia joined in. Now ASEAN has become home to all ten Southeast Asian countries<sup>36</sup>.

ASEAN had three basic objectives: “to alleviate intra-ASEAN tensions, to reduce the regional influence of external actors, and to promote the socioeconomic development of its member states as a further hedge against Communist insurgency.”<sup>37</sup> These ends have involved the support of the ASEAN establishment, strengthening regional solidarity and self-reliance by emphasising “economic, social, and cultural co-operation and development.”<sup>38</sup> Gradually, there develops what is known as the “ASEAN way” based on Malay cultural

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<sup>34</sup> <http://finance.sina.com.cn/g/20011221/157641.html> (Chinese)(viewed March 3, 2002).

<sup>35</sup> Shaun Narine, *Institutional Theory and Southeast Asia: The Case of ASEAN*, 161 World Affairs 33 (1998).

<sup>36</sup> *Association of Southeast Asian Nations: An Overview*, <http://www.asean.or.id/history/overview.htm> (viewed April 20, 2002).

<sup>37</sup> *See supra* note 34.

<sup>38</sup> Bureau of Public Affairs, U.S. Dep't of State, *Background Notes: Association of Southeast Asian Nations*, March 1992. [http://www.state.gov/www/background\\_notes/asean\\_0392\\_bgn.html](http://www.state.gov/www/background_notes/asean_0392_bgn.html) (viewed April 20, 2002).

practices.<sup>39</sup> Following the “way”, all decisions “are made within ASEAN on the basis of consensus,”<sup>40</sup> which in return led to the strong cohesion that now exists between the ASEAN member states.

#### 4.2.2.2 ASEAN Free Trade Area (ASEAN)

Seeing that the European Union and the North American Free Trade Agreement in the 1990s had powerful effects on world trade patterns<sup>41</sup>, and concerned about the rapid proliferation of free trade areas among important trading partners, the leaders of ASEAN decided to make a similar move towards regional economic integration.<sup>42</sup>

Having previously experienced failure in setting up a free trade area called Preferential Trading Agreements (PTA) signed on February 24, 1977<sup>43</sup>, at the Fourth ASEAN Summit in Singapore in 1992, the Asian Free Trade Area (AFTA) was launched. Because of the failure of the PTA, the ASEAN member states introduced a more rigid instrument in the AFTA. There was a strategic objective to increase the ASEAN region’s competitive advantage as a collective trading bloc. Under this came the proposal to eliminate tariff and non-tariff barriers among the member countries which was expected to promote greater economic efficiency, productivity, and competitiveness. After that, the Agenda for Greater Economic Integration was adopted at the Fifth ASEAN Summit held in Bangkok, Thailand, in 1995. This Agenda accelerated the timetable for the AFTA from a fifteen year time frame to ten years-the projected conclusion date was set for 2003.<sup>44</sup> Furthermore, at the Sixth ASEAN Summit in 1998, the process was further accelerated by setting a target date for the original ASEAN members of 2002.

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<sup>39</sup> Shaun Narine, *Institutional Theory and Southeast Asia: The Case of ASEAN*, 161 *World Affairs* 33 (1998).

<sup>40</sup> *See supra* note 38.

<sup>41</sup> Ross Garnaut, *ASEAN and the Regionalization and Globalization of World Trade*, 14 *ASEAN Econ. Bull.* 215, 321 (Mar. 1998).

<sup>42</sup> Carolina Alberto Lopez & Jacint Soler Matutes, *Open Regionalism Versus Discriminatory Trading Agreements: Institutional and Empirical Analysis*, 14 *ASEAN Econ. Bull.* 253, 254 (Mar. 1998).

<sup>43</sup> Peter Kenevan & Andrew Winden, *Recent Development: Flexible Free Trade: The ASEAN Free Trade Area*, 34 *Harv. Int’l L.J.* 224, 225 (1993) (stating that the “PTA’s flexible provisions resulted in widespread abuse of exclusion lists that ultimately limited the PTA to a rather comical free trade in snow plows and other Southeast Asian nonessentials”).

<sup>44</sup> *Association of Southeast Asian Nations: An Overview*.

<http://www.asean.or.id/history/overview.htm> (viewed March 30, 2002)

This “projected” date is only for the original six ASEAN members. Vietnam, Laos, Myanmar, and Cambodia will be phased in at later intervals.

#### **4.2.2.3 ASEAN Plus Three**

While the ASEAN was in the process of having a free trade area between its members, the idea of setting further free trade area involving both ASEAN and other East Asian countries has also been pursued.

In December 1990, the Malaysian Prime Minister Mahathir proposed the formation of an East Asian Economic Group (EAEG) which excluded the US in order to reduce the region's heavy dependence on US markets. Mahathir's proposal a received warm welcome from ASEAN and South Korea. However, Mainland China, supported it conditionally, stating it was opposed to Taiwan and Hong Kong joining initially. What was worse, the US did not wish to see a "dividing line down the Pacific,"<sup>45</sup> therefore was strongly opposed to the idea of the all-Asian club. Partially in consideration of the stance of US, Japan refused to endorse the EAEG.

So the EAEG was downgraded to the East Asian Economic Caucus (EAEC) in 1995. The EAEC, known as ASEAN Plus Three, which is composed of ASEAN, Mainland China, Japan, and South Korea was subsumed under Asian Pacific Economic Co-operation. Not satisfied with this result, and like Mainland China, Malaysia's Minister for International Trade and Industry Rafidah Aziz declared that "anything that happens in Asian Pacific Economic Co-operation is non binding, period." The Philippines Under-Secretary for Trade and Industry Edsel Custodio also responded: "Asian Pacific Economic Co-operation...should be a loose consultative machinery, it should be non-binding, it should not be a negotiating forum and it should not be institutionalised."

#### **4.2.2.4 Mainland China's unilateral activity towards ASEAN**

Although Mainland China has not yet entered into any formal free trade agreements, it is contemplating establishing a strategic free trade area with ASEAN. At the ASEAN Plus Three Summit Meeting held in Singapore in September 2000, Chinese Premier Zhu Rongji called for the formation of an "ASEAN-China free trade area" as a political and economic counterweight against the European Union and North American Free Trade Agreement. In November 6, Zhu and ASEAN reached an agreement to set up the "ASEAN-China FTA".

Up to March 28, 2001, there have been held three joint committees between the two sides.<sup>46</sup> These committees centered on the issues of establishing an ASEAN-

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<sup>45</sup> *US Assistant Secretary for East Asian and Pacific Affairs Winston Lord* (Atkinson 1995: 39).

<sup>46</sup> <http://www.aseansec.org/archive.html> (viewed March 30, 2002).

China Expert Group on Economic Co-operation to look into the implications of China's accession to the World Trade Organisation and recommend measures on how to further enhance ASEAN-China economic co-operation and integration, including the possibility of establishing a free trade area between ASEAN and China.

### **4.2.3 Other activities**

#### **4.2.3.1 Japan and Korea**

Among the “three” countries of the ASEAN Plus Three, Mainland China was the first one to propose concluding a free trade area with ASEAN. Surprisingly, Japan then reasonably accelerated its activities. On January 13, 2002, the Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership, (JSEPA) was signed. This approach was regarded as a Japan's “touch stone”<sup>47</sup> prior to deepening relations among the ASEAN Plus Three.

In addition, Japan is also discussing with Korea regarding the establishment of a free trade area.<sup>48</sup>

#### **4.2.3.2 Singapore**

Singapore is making vigorous effort to secure a strategic hub position in Southeast Asia. Before the agreement mentioned above, Singapore had signed a free trade area with New Zealand (ANZSCEP) on November 14, 2000. Now, Singapore is negotiating free trade areas with Australia, Canada, Japan, Mexico, and the US.

#### **4.2.3.3 Taiwan**

Considering the alleged intervention of Mainland China, Taiwan has issued its counter policy. It stated that “friendly countries are first to be considered” concerning the establishment of free trade area. On 11 April, 2002, its leader Chen Shuibian proposed to set up a free trade area with the United States and Japan.

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<sup>47</sup> <http://www.tier.org.tw/> (viewed April 11, 2002).

<sup>48</sup> <http://www.npf.org.tw/PUBLICATION/NS/091/NS-C-091-090.htm>(viewed April 07, 2002).



## 5 Strong willingness v. reality

It is well known that a healthily operated free trade area, would, like EU and NAFTA, foster the development of regional free trade leading to freer global trade. However, mere strong willingness is far from adequate. Examining the factors behind the success of the European Common Market, and comparing them with the present situation in East Asia may be helpful to the East Asia countries in allowing them to assess the perspective of their planned regional alliance in a more reasonable way.

### 5.1 The experiences of a successful EU

There are many reasons leading to the success of European Union. These reasons should be strongly considered in planning an East Asia free trade area.

#### *Political background*

In the context of the post-Second World War period, Western Europe has looked outward not inward for their future. Simultaneously, most nations begin to share similar political systems: that is an essential basis allowing them to abandon divergence and reach a compromise position. In addition, the need to counter their Communist common enemy led to the formation of NATO which in turn granted them necessary experience concerning the building of a union.<sup>49</sup>

#### *Similarity and proximity*

First, although the present member states and the candidates each possess their own culture, many cultural similarities are to be found, deriving Christian, Roman and Greek origins. The nations in this territory are characterised by their western outlook, have a common religious base and, in particular, enjoy a strong legal tradition with a long history.

Second, being located together on a relatively small territory allows them to have a natural and intense trade relationship.

Third, nations here are almost all well developed and industrialized and even the less developed countries like Spain and Portugal still have a GNP/per capita higher than most other states in the world.

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<sup>49</sup> Ken Day and Paul Herbig, *Outgrowth of ASEAN, a Common Market of the Pacific: lessons to be learned from the European experience*, European Business Review Volume 95 · Number 2 · 1995 · 12–23.

These similarities are regarded as a basis for ease of establishing and maintaining a union. The fact that the EFTA countries have joined EU one after another is a further convincing support for this view.

### *Boldly to remove trade barriers*

It is admirable that the member states can almost always keep a very reasonable attitude towards the relationship between the national good and the EU's competitive international position. Whenever conflict happens, the member states, even if reluctant at first, will accept the Community interests by way of eliminating any disputed tariff or similar measure.

## **5.2 Diversity in East Asia**

Compared with the situation in the European Union, many countries in this area have considerable diversity of ethnicity, religion, history, political system, and economic mechanism.

### *Religion*

The diversities can be well illustrated by focussing on religion. Protestant Christianity is fairly influential in Korea. Catholicism is dominant in the Philippines. Islam is the main religion of Malaysia, and Indonesia has the largest Moslem population in the world. In the other part of this region, Buddhism is influential. Further, the ethic of Confucianism lies in the background in Mainland China as well as in Taiwan.

### *Political system*

In this area, it is noted that two polar types of political system still exist. Human rights issues in one of them are subjects of criticism by developed nations. This fact seriously prevents from building up mutual trust. Although some of them are the Transitional Economies of Asia, it still seems difficult to establish cooperation between the Transitional Economies and the market economies. The struggle between Mainland China and Taiwan surrounding this central problem is an obvious example.

### *History*

Observing the history of East Asia, several of the countries or areas have experienced colonialism. The Philippines have a history of Spanish and American colonial influence; the South Asia Countries, Singapore, and Hong Kong were under British colonial influence; and Korea and Taiwan were under Japanese influence. In this context, it would be a rather complicated issue to reach consensus among these countries to the extent that what is involved relates to the interaction between local systems and relics of the colonial system.

### *Economy*

It is remarkable that some countries are in transition from the socialist economy to the market economy. Generally speaking, these transitional economies have been doing well in average, and extremely well in some cases. However, the degree of openness of these countries varies. In external trade, Singapore and Hong Kong are free ports, pursuing free trade system and have benefited from it. In contrast, other economies still have some protectionistic elements.

## **5.3 Basis for cooperation**

### **5.3.1 General Tendency among the countries of ASEAN Plus Three**

According to ASEAN statistics, trade volume between ASEAN and China, Japan and Korea grew by 27.5 percent from US \$ 158.2 billion in 1999 to US \$ 201.7 billion in 2000. However, despite the positive economic growth and optimism of the year 2000, there is a growing consensus that the trend would not continue in view of the slow down in the US, EU and Japan. In this regard, the economic ministers and the ministers of Mainland China, Japan and Korea underlined their commitment to maintain outward looking policies to attract trade and investment and bolster economic growth. Further, they stressed the importance of continuing regional economic integration as a means of promoting trade and investment flows.<sup>50</sup>

### **5.3.2 Mainland China and ASEAN**

#### **5.3.2.1 Present situation**

##### *Value of Trade*

There has been a steady rise in the relative share of ASEAN in China's merchandise trade—from 5.8 per cent in 1991 to 8.3 per cent in 2000. ASEAN has thus become the fifth largest trade partner of China (after Japan, the United States, the European Union, and Hong Kong). And this is an important trend: the absolute value of China's trade, for example, went up very significantly—from US\$ 135.8 billion in 1991 to as much as US\$ 473.4 billion in 2000.

At the same time, China has also become an important trade partner of ASEAN, occupying the sixth position in 2000. The share of China in ASEAN's trade expanded from 2.3 per cent in 1991 to 5.0 per cent in 2000. In absolute terms,

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<sup>50</sup> <http://www.aseansec.org/archive.html> (viewed March 20, 2002.)



the total value of ASEAN's export trade was US\$ 343.8 billion in 1991 rising to US\$ 795.0 billion in 2000.

### *Structure of Trade*

The composition of ASEAN-China trade has evolved considerably. Resource-based commodities – especially hydrocarbon, wood, and fat and oil products – accounted for two-thirds of the total export value of ASEAN to China in the early 1990s, but only 22 per cent in 1999. The relative share of manufactured goods – electrical machinery and computer equipment especially – went up from 12 to 38 per cent in the same periods.

Meanwhile, ASEAN imports from China have been comparatively more diversified. The top five imports <sup>51</sup> accounted for almost two-fifths of the total import value in the early 1990s, and 57 per cent in 1999.

### *Trade in Services*

Two-way services flows between ASEAN and China have also been on the increase. Tourism is a good case in point. ASEAN tourists visiting China totalled almost 1.1 million in 1995; the number reached an estimated 1.8 million in 2000. Meanwhile, ASEAN received about 0.8 million tourists from China in 1995. More remarkably, however, the number of Chinese tourists to ASEAN almost tripled to 2.3 million persons in 2000.

The potential for two-way tourism is really inviting. At present, ASEAN tourists were less than 8 per cent of the total tourist arrivals (19.8 million) in China during 1999 while Chinese tourists in ASEAN made up just 10 per cent of the 22.6 million persons visiting ASEAN in 2000.

### *Investment Flows*

Both ASEAN and China have invested considerable resources overseas. Foreign direct investment made by China in other countries averaged US\$ 2.1 billion per year during 1989-1994; it rose to US\$ 2.2 billion a year over 1995-2000. Outward FDI from the old ASEAN-5 members (except Brunei Darussalam) averaged US\$ 3.7 billion a year during 1989-1994; it reached US\$ 7.0 billion in 2000.

China has been a destination for FDI from some ASEAN member countries-directly or via Hong Kong. Likewise, several ASEAN member countries have also been the host to important FDI flows from China, both directly and via third party ventures.

It is likely that the old ASEAN-5 (excluding Brunei Darussalam) collectively have been a net investor in China. In general, a large proportion of FDI is channelled to resource-based and trade related activities. Manufacturing for the domestic market is also another important sector for such investment. In addition, there is considerable FDI “in kind” – that is the investors supply manufacturing equipment

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<sup>51</sup> electrical machinery, computer equipment, hydrocarbon products, cotton and tobacco.

and machinery as equity in the joint ventures with their local partners, who usually provide land and infrastructure.

### **5.3.2.2 Future Cooperation**

It is estimated that the industrialized countries in America and Europe will continue to be the most important trade markets, sources of investment finance, and origins of cutting-edge technologies for both ASEAN and China in the foreseeable future. But within this region, there are potential and opportunities – both substantial and exciting – for greater and closer ASEAN-China complementarities along their routes to further development.

#### *Economic perspective*

The Chinese economy is a huge one. Gross domestic product (GDP) reached US\$ 1,080 billion in 2000. In comparison, the combined GDPs of ASEAN amounted to US\$ 573.8 in the same year. What is more, China has been the fastest growing economy in the world for over a decade. Even during the economic crisis and slowdown of the late 1990s, GDP in China continued to expand by between 7 to 9 per cent a year during 1997-2001. On the other hand, the GDPs of several ASEAN member countries contracted, some quite severely, in 1997 and again slowed down significantly during this year.

#### *World Trade Organization membership*

China's World Trade Organisation membership is widely expected to have several positive spill-over effects on ASEAN-China trade and investment relationships in a wide range of areas and services.

Firstly, China has agreed to a very comprehensive package of market liberalization measures, with five years to carry out its full commitments. The liberalization process is expected to enhance greatly China's economic efficiency, industrial modernization, and integration with the global economy.

In particular, various research studies indicate (a) higher levels of China's share in global exports and imports, by 2 percentage points by 2005; (b) higher levels of export earnings (by 24 per cent) and import spending (by 18 per cent), and (c) higher GDP growth by at least one percentage point (equivalent thus to over US\$ 10 billion on the basis of GDP in 2000).

Secondly, there will be greater market access for ASEAN producers in China. Trade barriers on ASEAN exports, for example, will be reduced faster than the average reduction – with tariffs on ASEAN products to be cut by 34 per cent (to 47 per cent) within five years. It is estimated that, with its accession to the World Trade Organisation, China's demand for ASEAN imports will expand by 10 per cent a year. Thus, the value of such imports will reach US\$ 35.5 billion in 2005, compared to 22.2 billion in 2000. However, the actual increase may even be

larger, given the faster rate of increase of China's imports of ASEAN products relative to China's imports from all sources.

Thirdly, there will also be greater market access to China among ASEAN member countries. The sectors facing greater competition from China include textiles and clothing plus other labour-intensive manufactures. In addition, China is expected to enjoy a competitive advantage in a wide range of other manufactures. Generally, it appears that both ASEAN and China will have to manage-effectively, and in a forward-looking manner, the many challenges brought by trade liberalization as well as from their own competition in third-country markets. The promotion and facilitation of cross-border co-operation, inter-firm networking, and mutual dialogue are among the key requirements for the effective management and mitigation of such challenges. It is also essential to ensure smoother integration over time.

### *Tariffs*

Another important factor was the decision by the leaders of ASEAN and China to look at ways and means to enhance economic co-operation and integration specifically between ASEAN and China. Among the possible options is the possibility of setting up a free trade area between the two sides. Their marketing and purchasing power would be very much enlarged in a free trade area – to over 1.7 billion consumers with a combined GDP of almost US\$ 1,665 billion and a combined external trade value of US\$ 1,269 billion as of 2000.

The removal of trade and investment barriers will certainly lower transaction costs, raise economic efficiency, upgrade product quality, increase economies of scale and scope etc. All these will help improve external competitiveness in third-market trade. The (net) trade creation effects could be substantial, and so would likely be the even bigger flows of trade-related investment.

It has been estimated that the ASEAN-China free trade area would raise ASEAN's exports to China by 48 per cent and China's export to ASEAN, by 51 per cent. At the same time, the combined GDP of ASEAN would expand by at least US\$ 5.4 billion while that of China, by some US\$ 2.2 billion.

### *ASEAN's experiences in free trade area*

ASEAN members have gained much practical experience through the accelerated implementation of the ASEAN Free Trade Area, and through such operational schemes as ASEAN Industrial Co-operation (AICO) and ASEAN Investment Area (AIA). Further, AFTA is scheduled to be in force from 2010, instead of 2015 – with some extension for the newer ASEAN member countries.<sup>52</sup>

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<sup>52</sup> *ASEAN and China – Partners in Competition*,  
[http://www.aseansec.org/news/asean\\_china\\_partner.htm](http://www.aseansec.org/news/asean_china_partner.htm) (viewed March 16, 2002).

### 5.3.2.3 Challenges

#### *Negative elements between ASEAN and Mainland*

Big challenges to liberalizing trade and investment relationships between ASEAN and China exist. First, ASEAN countries may not be able to compete with China's vast pool of cheap, skilled and semi-skilled labour force. Second, the countries of the ASEAN extensively fear concerning the potential for dumping from Mainland China. Third, in the context of the other "two" countries, i.e. Japan and Korea, there will surely be a fight for the "leadership" in ASEAN Plus Three.

#### *The challenges to the regime of ASEAN*

First, the present problems

Like most other regional associations in the world, ASEAN is a voluntary association of sovereign states that do not yield their sovereignty to a central authority. Although ASEAN has its secretariat, it has never had supranational authority or responsibility. Compared with the regime of the European Union, it has no parliament, no court of justice, and no court of auditors. Nor has it a common currency and central monetary authority. Moreover, it has no common set of external tariffs or trade policies and regulations.

Second, the context of enlargement

It is well known that the issue of enlargement of the European Union encounters many challenges, even though the EU enjoys admirable efficiency and almost fifty years of experience. In addition, all the applicants are much weaker than the EU as an entity or than may of the Member States.

In the context of enlargement, the ASEAN regime will be challenged much more seriously. Because, for one thing, as mentioned above, its present regime itself proves problematic and, for another, each of the Three countries has, individually, the power to counter ASEAN, not to mention its single members. This situation will pose a major problem to the regime of ASEAN.

## 6 “China Free Trade Area”

### 6.1 Initiation of the free trade area<sup>53</sup>

Right after China’s application for World Trade Organisation membership was accepted on 10 November 2001<sup>54</sup>, Mr Tung Chee Hwa, Chief Executive of the Hong Kong Special Administrative Region(HKSAR), suggested setting up a free trade area within the territory of Mainland China and Hong Kong. Later, Mainland China confirmed that this proposal was welcome and was being positively studied. Following that, Mr. Fulin Chi, the Dean of the China (Hainan) Institute for Reform and Development Research proposed establishing the China Free Trade Area where Mainland China, Hong Kong, Taiwan and Macao will be included.

### 6.2 Analysis on the Triangle Relationship of Mainland China Taiwan and Hong Kong<sup>55</sup>

#### *General approach*

In the context of regional co-operation in this area, it was until now basically driven by private initiative and market forces. Despite the absence of formal intergovernmental agreements, each Government still provided independent measures to facilitate such an integration. On external trade within the triangle economies, Hong Kong has been used as a main enterpot for Mainland China’s booming export-oriented industries, and Taiwan has been increasingly depending on Mainland China’s economy in so far as concerns its trade balance in recent years. Regarding foreign direct investment, about 60 percent of FDI utilised by Mainland China was from Hong Kong and Taiwan, and Mainland China has become Hong Kong’s second most important source of FDI in recent years. Mainland China did have some FDI in Taiwan mainly through Mainland China’s

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<sup>53</sup> *A regional free trade agreement between Hong Kong and China*, Concept Paper Hong Kong General Chamber of Commerce, [http://www.chamber.org.hk/business\\_world.asp](http://www.chamber.org.hk/business_world.asp) (viewed March 23, 2002).

<sup>54</sup> China’s application for World Trade Organisation membership was adopted at the World Trade Organisation Ministerial Conference in Doha on 10 November 2001, and it formally became a World Trade Organisation member on 11 December, 2001.

<sup>55</sup> Wu-Long Lin, *Integrating the Triangle Economies of Taiwan, Hong Kong and Mainland China -- Co-operation versus Competition*. (October 21, 1999). <http://depts.washington.edu/gttl/htdocs/bachman/linpaper.pdf>.(viewed march 9, 2002).

state owned enterprises registered in Hong Kong. Finally, both Taiwan and Hong Kong have been gradually losing their international competitiveness as against Mainland China and have seen a decrease in their imports' market shares in the United States and Japan. Taiwan is obliged to adopt a conservative and precautionary approach to cross-strait economic relations with the aim of ensuring that Taiwan's economic security can be protected. Such policy measures can perhaps be revised once cross-strait relations can be conducted on the basis of mutual respect and without hostility.

### *Taiwan Strait Relations*

In order to solve technical problems arising from "indirect" trade and investments as well as from the desirable cross-strait tourism, the two sides across the Strait have independently adopted separate measures. Taiwan has set up an official organisation, called Straits Exchange Foundation, while Mainland China has also set up an official organisation, Association for Relations Across the Taiwan Straits. Within the terms of references empowered by their respective governments, officials from these two organisations meet periodically to exchange their views and to tackle technical problems.

However, until now, there seems no sign that the two sides can go any further politically. It can be hoped that increased economic interrelations will also have a positive effect on the situation.

## 7 Conclusion

Reviewing the facts above, we can say that the proliferation of the free trade areas in East Asia is natural. Examining the reasons behind it, the economic dynamics and the shortcomings of the World Trade Organisation could be one while the complicated political elements within this area could be another. In this regard, it seems there is a need to strengthen the governing of the regional trade agreement within the framework of WTO. It would also help developing countries to see a more reliable WTO regime.

As for Mainland China's approach, i.e. the "ASEAN-China free trade area" and the "China Free Trade Area", it is difficult to foresee its future. The key problem, of course, is the different political system. This very fact continuously prevents deeper co-operation. However, the fact of China's entry into the World Trade Organisation means the political factor is weakening.

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