

## **CHAPTER II**

### **THE BACKGROUND OF ASEAN – CHINA FREE TRADE AREA COOPERATION**

ACFTA is a regional agreement between ASEAN member states and China. There is a force for forming the ACFTA. ACFTA is an agreement to reduce and eliminate the trade barriers between states. ACFTA can open opportunities for countries that are ready to apply the policy so that they can benefit. Moreover, for countries that are not ready to face this agreement is a new challenge in facing the free trade regime.

#### **A. Free Trade Cooperation in the ASEAN Region**

International trade, in general, is developing towards more free and open trade. Countries bilaterally, regionally and globally, tend to establish cooperation in the form of reducing or eliminating barriers to trade, tariffs, and non-tariffs to create a more conducive, aggressive and progressive trading mechanism. With the development of the times, countries increasingly understand the meaning of free markets, including the benefits that can be obtained from the mechanism of trade.

International trade involves international countries and institutions both globally and regionally that refer to the provisions and principles of international law agreed upon in the GATT-WTO. Countries that tie themselves to become members of the WTO are subject to the principles set out in the GATT, even though this GATT also contains provisions to deviate from the principles in the GATT-WTO Agreement. Listed in article XXIV, namely permitting regional agreements between two or more countries to reduce or eliminate trade barriers among members of the regional agreement, to increase trade in the region (Kurniastutu, 2010).

The existence of free trade has many objectives, such as to increase prosperity for the countries involved, and have

hopes to create a stable and mutually beneficial economic order and to attract investors to invest in domestic investment and increase trade among world countries (Jamil, pp. 2, Vol 2)

Southeast Asia Regional Cooperation as a regional organization of ASEAN countries was declared on August 8, 1967, in Bangkok Thailand. Marked by the signing of the Bangkok Declaration of the founding countries of ASEAN. Yaitu, Indonesia, Malaysia, Philippines, Singapore and Thailand (Severino, 2008).

The ASEAN objectives in the economic field listed in the Bangkok Declaration are to accelerate economic growth in this region through joint efforts in the spirit of equality and friendship to strengthen the foundation of a community of nations, enhance active cooperation and help each other in common problems in the field economies, cooperate more effectively to improve their use of agriculture and industry, expand trade, study commodity problems. As stated above, ASEAN also participates in conducting international trade, especially within the Southeast Asia region, in order to create a more conducive trading climate for both trades carried out bilaterally and multilaterally. The Association of South East Asian Nations (ASEAN) was established with the Bangkok Declaration of 1967 and consisted of five countries, namely Indonesia, Malaysia, the Philippines, Singapore, and Thailand. ASEAN has grown and developed into a relatively sizeable regional organization with ten member countries, known as the Big Ten or "big ten" (Husin, 2009, p. 56)

ASEAN member countries impose AFTA (ASEAN Free Trade Area) to achieve those goals as mention above. The AFTA free trade zone aims to make the ASEAN region a competitive production place so that ASEAN products have strong competitiveness in the global market, attract more Foreign Direct Investment, and increase trade between ASEAN members (intra-ASEAN Trade) conducted by reducing various trade barriers such as reducing tariffs on various commodities.

The block of trade cooperation between ASEAN countries and China is motivated by a shift in the balance of economic power from Europe to Asia after the crisis that occurred in 2008. This can be seen from the country's economy which showed a very impressive increase, seen from the country's economic growth indicators.

The close relation between ASEAN and China start since China did the economic reform program, and it is more open to the outside world, then along with that, the relationship of economic cooperation between China and ASEAN is being conducted. International circumstances change the tendency for cooperation with other countries in order to increase the rate of the economy has encouraged both sides to enhance the intensity of cooperation further.

China conducted the reformation program, and be more open toward the other state, then along with that, the relationship of economic cooperation between China and ASEAN started implemented in many sectors, Change in International situation and the tendency to cooperate with other countries in order to enhance economic growth, have driven the two sides to enhance cooperation further.

## **B. The Meaning of ACFTA**

The ASEAN-China Free Trade Area (ACFTA) is an agreement between ASEAN member countries and China to create free trade areas by eliminating or reducing barriers to trade in goods both tariffs and non-tariffs, increasing market access services, investment regulations and provisions, as well as improving aspects of economic cooperation to encourage economic relations between the ACFTA parties in order to improve the welfare of the people of ASEAN and China.

ACFTA also can be interpreted as the liberalization of trade, because ACFTA wants to reduce the interference from the government, by eliminating the regulation that considered as the barriers for trading. By agreement of ACFTA, China and ASEAN member states could simplify their trading

activity, because ACFTA would eliminate the trade barriers, but it also could make the trading more difficult if there is unbalance condition between those state The trading activity becomes more comfortable because the entry fee will be reduced or even eliminated, thereby reducing the cost. However, it also could complicate the trading activity, since it can cause imbalance ability between countries.

The state which acquires better economic factor will have a stronger position in free trade because the state will be more competitive compared to another state with a weaker economic factor. The stronger state could support their industry by giving a good infrastructure, stimulus, or issued a policy that could support domestic industry. Meanwhile, the state with low economic factor will be difficult to compete in free trade because their industry is not supported by several factors, such as infrastructure, complicated bureaucracy, etc.

Informing the ACFTA, the Heads of ASEAN Member Countries and China have signed the ASEAN - China Comprehensive Economic Cooperation on 6 November 2001 in Bandar Sri Begawan, Brunei Darussalam. As the starting point of the ACFTA formation process, the Heads of State of both parties signed a Framework Agreement on Comprehensive Economic Cooperation between the ASEAN and People's Republic of China in Phnom Penh, Cambodia on November 4, 2002. The Framework Agreement change protocol was signed on October 6, 2003, in Bali, Indonesia. The second amendment protocol framework agreement was signed on December 8, 2006. The signing of the Framework Agreement on ASEAN-China Economic Cooperation in 2002 showed an effort to improve relations between member states of the Association of Southeast Asian Nations (ASEAN) and China. This agreement further developed into what is referred to as the ASEAN-China Bilateral Free Trade Agreement (ACFTA-ASEAN Free Trade Agreement). On paper, the decisions of ASEAN and China to form the agreement illustrate the expansion of economic and political relations between the two parties. The implementation of the 2010

ACFTA came into force on 1 January 2010. The ACFTA uses the principle of free trade (Chandra, Wibowo, & Hadi, pp. 231-232).

Free trade for ASEAN will be gradual. Free trade took effect in 2010 between China and ASEAN-6, namely for Indonesia, Singapore, Thailand, Malaysia, the Philippines, and Brunei. While 2015 applies to China with ASEAN-4 namely Cambodia, Vietnam, Laos, and Myanmar.

## **C. The framework of Agreement and Mechanism of ACFTA**

### **1. Framework Agreement of ACFTA**

- a. Building a free trade area within ten years in the form of elimination of tariffs and other obstacles.
- b. Agree on the framework of a comprehensive economic cooperation agreement, where for senior ASEAN, namely Indonesia, Malaysia, Philippines, Thailand and Singapore, the free market will take effect in 2010. Meanwhile, the other ASEAN member countries, namely Vietnam, Cambodia, Laos, and Myanmar began to apply in 2015.
- c. Negotiation of the ASEAN-China free trade area with the potential of 1.7 billion people and the value of gross domestic product between the US \$ 1.5 trillion and the US \$ 2 trillion; will begin on July 1, 2003, together with the implementation of free trade (AFTA).
- d. ASEAN and China will progressively reduce tariff and non-tariff barriers to free trade in perishable goods together to move towards free trade efforts for service products.
- e. ASEAN and China agreed to establish an open and comprehensive investment regime, which was supported by more natural immigration procedures. China will provide favorable tariff

treatment for three ASEAN developing countries, namely Cambodia, Laos and Myanmar.

- f. ASEAN and China agreed to strengthen cooperation in five priority sectors, namely agriculture, technology, communication, information, human resource development, investment and development along the Mekong river.
- g. Within ten years of the realization of ASEAN-China free trade, China offered earlier certain agricultural sectors. This package will be implemented in 2004.
- h. 8. Organizing the first Sub-regional Summit of countries around the Mekong (Great Mekhong Sub-regional) between Vietnam, Cambodia, Myanmar, Laos, Thailand, and Yunan province in South China intended to catch up with developments in this region.
- i. 9. ASEAN-China agreed to explore new fields and develop steps to increase cooperation to facilitate the integration of new ASEAN members, namely Vietnam, Cambodia, Myanmar, and Laos to catch up with the lagging countries.

The decision to form a free trade zone between ASEAN and China was a response to proposals that emerged from former Chinese Prime Minister Zhu Rongji during the sixth ASEAN Summit in November 2000. Later in November 2002, ASEAN and China signed the Framework for Comprehensive Economic Cooperation Agreement between ASEAN and China.

Framework for cooperation between ASEAN and China to strengthen economic cooperation. In the framework agreed upon the stages of establishing free trade for goods in 2004, the service sector in 2007, and investment in 2009. These three elements are generally seen in the economic cooperation agreement between ASEAN and China. Moreover, if explicitly seen, there are six essential elements in

the agreement on overall economic cooperation between ASEAN and China:

- a. Trade and steps of facilities (covering various issues such as the elimination of non-tariff barriers, agreement on standard and assessment of service sector procedures).
- b. Technical assistance and capacity building for new ASEAN member countries (or CLMV countries, including Cambodia, Laos, Myanmar, and Vietnam).
- c. There are trade promotion measures that are consistent with the regulations in the WTO.
- d. Expansion of cooperation in the fields of finance, tourism, agriculture, human resource development, and intellectual property rights and others.
- e. Establishment of the ASEAN-China Free Trade Area (ACFTA) within ten years, and giving unique and different treatment to CLMV countries (ASEAN 6, including Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand, expected to complete their tariff reduction process in 2010. Meanwhile, CLMV countries were given five additional years, or until 2015, to do the same).
- f. Establishment of appropriate institutions between ASEAN and China to implement a framework of cooperation between the two parties.

## **2. Mechanism of ACFTA**

ACFTA would be implemented by three steps (Tevini, 2018, p. 231).

- a. Early Harvest Programmers.
- b. Normal Track.
- c. Sensitive Track.

### **1. *Early Harvest Programmer***

On the 6 October 2003, at the ninth ASEAN – China summit in Bali, Indonesia was signed on the implementation of the *early harvest programmers*, some provisions in the framework agreement were amended. On that framework agreement, all of the party could enjoy the tariff concessions of all product, as long as it is covered in the early harvest programmers. The protocol showed that the EHP covered 600 agricultural product.

All the 600 products were divided into three categorize. The first categories are MFN tariff rates higher than 15 percent for China and ASEAN, 30 percent or higher for the new ASEAN member state, The second categories MFN tariff rates between 5 percent and 15 percent ( exclusive ) for China and ASEAN. Between 15 percent inclusive and 30 percent exclusive for newer ASEAN member state, the Third categories, MFN tariff rates lower than 5 percent for China and ASEAN, lower than 15 percent for the newer ASEAN member states.

The Third categories were agreed in 2003 after the signing of the framework agreement. The EHP is Intended to realize the concessions that have been made by the parties, especially by China and ASEAN to eliminate the tariffs on about 600 products over three years. Ten percent before 2004, 5 percent in 2005, and zero tariffs not later than 1 January 2006. The newer ASEAN should eliminate their tariff on the product not later than 2010.

EHP is a regulation to accelerate the implementation of ASEAN and China FTA



that would be implemented in January 2004. The agreement consists of chapter 1-8, namely: Living Animal, Meat and Consumable Meat Product, Fish, Milk, and Dairy Product, Plant, Vegetables, Fruits, and Beans (Gugler & Chaisse, 2010, p. 241). That consist of 530 post tariffs.

Bilateral agreements (Specific Products) include coffee, coconut oil / CPO, chocolate, rubber goods, and furniture (Minister of Finance Decree No. 356 / KMK.01 / 2004 dated 21 July 2004 concerning Stipulation of Import Duty Rates on the Import of Goods in the Bilateral EHP Framework Indonesia-China FTA.

## 2. ***Normal Track***

The arrangement of tariffs reduction or elimination on the good in standard track should be applied to start from 1 July 2005 as planned, but the actual starting date of the program in July 2005. Under the Normal Track provision of the trade in goods, the parties who placed tariff lines under this category shall have their respective applied Most Favored Nation ( MFN ) rates gradually reduced and eliminated in accordance to the modalities set by the government.

### a. Normal Track 1

Based on the provisions of the ASEAN – China Free Trade Area, The following are the dynamics of the Agreement:

1. a. All countries have to reduce tariffs to 0-5% for 40% of commodities that are on standard track before 1 July 2006.

2. b. All countries have had to reduce tariffs to 0-5% for 60% of commodities that were in standard tracks before January 1, 2007.
  3. c. All countries must reduce tariffs to 0-5% for 100% of commodities that are in the standard track before January 1, 2010.
  4. All parties shall eliminate all its tariffs for tariff lines placed in the Normal track not later than 1 January 2012.
3. ***Sensitive Track***

The member states from ASEAN 6 and China are allowed to place 400 and 10% from the original import of 2001 based on statistical trading in Sensitive Track. This Sensitive Track is further divided into two parts, namely the Sensitive List and the Highly Sensitive List,

- a. The Sensitive List is a tariff reduction program that will begin in 2012. The maximum import duty rate in 2012 is 20 percent. The imports duty rate will be 0-5 percent.

The products in the Sensitive List are 304 Tariff Posts (HS 6 digits), which among others consist of finished goods leather; bag, wallet; footwear: sports, casual, leather shoes; eyeglasses; musical instruments: blow, pick, swipe; toys: dolls / mannequins; sports equipment; stationary; iron and

steel; spare parts; conveyance; glokasida and vegetable alkaloids; organic compounds; antibiotics; glass; plastic goods.

- b. Highly Sensitive List is a decline in the tariff which began in 2015, with scheduling that in 2015 the maximum import duty rate is 50 percent. The products in the Highly Sensitive List are as big as 47 HS 6 digit Tariff Posts), which among others consist of agricultural products, such as rice, sugar, corn, and soybeans; textile and textile products; automotive products; tableware ceramic products.

To realize the ACFTA region, the parties involved must comply with the basic principles of this collaboration, namely:

- a. Reciprocity.  
According to the framework of the agreement, the ACFTA Agreement adheres to reciprocity. Moreover, in the framework of the agreement, it was agreed that the reduction in tariffs on agreed products must use reciprocity and mutual benefit.
- b. Rules about the Origin of Goods.  
(Purba, 2008, pp. 33-42) defines the rules about the Origin of Goods having three main elements, namely :
  - a. Criteria for origin.
  - b. Shipping requirements.
  - c. Document Proof.
- c. Basic principles or Most-Favorite-Nation (MFN) clauses.
  - a. Conditional MFN.
  - b. MFN is unconditional.

- c. National Treatment Principle.
- d. Principles of Transparency.
- e. Prohibition against quantitative restrictions.

## **D. Indonesia Ratification as ASEAN stating to Joining ACFTA and The Implementation**

### **1. Indonesia Ratification as ASEAN Member States to Joining ACFTA**

The ratification of Indonesia in the agreement of the ACFTA was signing of the Framework Agreement on Comprehensive Economic Cooperation between the Association of the Southeast Asian Nation and the Peoples Republic of China by the president of Indonesia in November 4, 2004, hereinafter referred to as the ACFTA Agreement in effect as of January 1, 2010. Indonesia as an ASEAN country with a population and the most significant market has close trade relations with China. The ASEAN-China Free Trade Area (ACFTA) is a follow-up of agreements between ASEAN countries and the People's Republic of China.

The relationship between Indonesia and China since 65 years ago which officially made into diplomatic relations is a real commitment of Indonesia's foreign policy that is freely active. Indonesia's relations with China took place from the era of President Soekarno to the era of President Jokowi. So Indonesia's participation in the ACFTA is a government effort in the economic field that seeks to prosper the people.

### **2. Indonesia Aims to Join the ACFTA**

Indonesia's participation in ACFTA has various objectives including:

- a. To encourage economic growth in Indonesia.

With the existence of free trade areas that are part of international trade, Indonesia participates in the free trade of the ACFTA. It hoped that Indonesia could open markets to other countries to ASEAN and China without barriers or non-tariff so that Indonesia can increase exports to other countries.

By entering the markets of ASEAN member countries and China, Indonesian businesses add to the market and increase profits that are expected to drive the economy in Indonesia

b. Increasing foreign exchange.

Investing or investing can increase Indonesia's foreign exchange. Because the ACFTA encourages economic growth by facilitating exports of products from Indonesia, ASEAN member countries and China due to the absence of tariffs and non-tariff barriers and the existence of investment agreements. Export activities of both goods and services, investment, tourism which are sources of foreign exchange are expected to be more comfortable because of the ACFTA because all are regulated in the framework of the ACFTA agreement.

c. Strengthening relations between countries.

Each party in the ACFTA has different specifications in natural resources and human resources. It is expected that with the ACFTA it can strengthen Indonesia's relations with ASEAN and China member countries so that it can impact cooperation relations not only in economic contexts but also in politics, culture, and defense.

d. Creating legal certainty.

In economic development, the law can play a role if the law can create "stability, predictability, fairness." As for those included instability, the due potential balances competing for interests. Can predict the consequences of a step taken especially crucial for a country where the majority of its people for the first time enter economic relations beyond the traditional environment is a function of law, and aspects of justice such as equal treatment of government behavior standards are needed to maintain market mechanisms and excessive bureaucracy.

Then the ACFTA is expected that Indonesian businessmen can predict what products from Indonesia can compete, estimate the amount to be paid, determine the origin of imported goods circulating in Indonesia and other activities from export-import activities. Products that have not been able to compete from each party in the agreement can be included

in the provisions excluded in the ACFTA agreement. Indonesia must also harmonize laws and statutory provisions by legalizing and ratifying the law regarding ACFTA to create legal certainty.

- e. I am creating a conducive business climate in order to increase competitiveness.

The ACFTA agreement will spur domestic industries to increase competitiveness. So far, the process of producing goods in Indonesia is still not efficient. Starting from the procurement of raw materials, production processes in factories, and inefficient distribution, the prices of goods are high, but the quality is low. The domestic industries must produce products that are not only quality but also cheap in order to compete with China's product.

- f. Enhancing capabilities in mastering information and communication technology including marketing promotions and lobbying.

Many opinions that ACFTA is a challenge for the domestic industry, of course, depends on which side we see the problem. When viewed from the side of the industry of finished goods such as textiles, crafts, household appliances, children's toys may indeed be a direct threat. However, when viewed from the side of distribution and retail, it certainly makes a promising business opportunity. With a large number of Chinese product items, of course, requires agents and suppliers, mainly if the product is classified as new.

### **3. Benefits of Applying the ACFTA for Indonesia**

The benefits of applying the ACFTA for Indonesia are as follows:

- a. Open market access for agricultural products (Chapter 01 to 08 to 0%) Indonesia to China in 2004.
- b. The opening of Indonesian export market access to China in 2005 which received an additional 40% of the Normal Track ( $\pm$  1880 postal tariffs), which reduced the tariff rate to 0-5%.

- c. The opening of Indonesian export market access to China in 2007 which received an additional 20% of the Normal Track ( $\pm$  940 postal tariffs), which reduced the tariff rate to 0-5%.
- d. In 2010, Indonesia will obtain additional export market access to China as a result of the elimination of all tariff posts in China's Normal Track.
- e. Until 2010 Indonesia will abolish 93.39% of tariff posts (6,683 tariff posts from a total of 7,156 Normal Track tariff posts) and 100% in 2012. Export commodities from Indonesia have an opportunity to increase 2.1% mainly from increased exports to China. Opportunities for market expansion to China are supported by the characteristics of Indonesia's export commodities and other ASEAN countries which have relatively low levels of competition. So that export goods from Indonesia and ASEAN, in general, are easier to expand.

With the enactment of the ACFTA, it does not require the possibility that national service providers will get their benefits, due to an increase in service market access in China, especially for Indonesian national service providers and foreign investment is increasingly not thinking about tariff issues and eventually more foreign investment comes from China to Indonesia.