

*ASEAN Free Trade Agreement, and the controversial case of Rolito Go v. Court of Appeals. The Journal is likewise pleased that, apart from the contributions of its past editors-in-chief like former Presidential Legal Counsel and Spokesman Adolfo S. Azcuna and law practitioner and lecturer Cesar L. Villanueva, it introduces a new breed of writers, majority of whom have come from the erstwhile Journal editorial boards.*

*But while the Ateneo Law Journal is encouraged by the quality of its second issue's content and contributors, it realizes that quality issues should be less an outcome of luck and more a result of school and editorial policy. Hence, the editors and staff of the 1992-93 Ateneo Law Journal exhort the Ateneo School of Law administration and faculty, as well as future members of the Journal, to more seriously perform a less noticeable aspect of their role in Philippine legal education, which is, to contribute to the development of legal scholarship primarily by encouraging legal writing – either through incentive or compulsion. After all, legal education isn't all about just passing the Bar.*

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Editor-in-Chief

## LEGAL PROBLEMS IN INTERNATIONAL TRADE SPAWNED BY THE ASEAN FREE TRADE AREA (AFTA)\*

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### INTRODUCTION

The dissolution of the Soviet Union and the dismantling of its awesome military apparatus have, from the point of view of many, eliminated the threat of a world-wide nuclear holocaust. With the exception of some regional conflicts, particularly in the Middle East, the prospect for long-term international peace is not seriously doubted. Russia and the United States have reduced their strategic nuclear weapons and have given credible assurance that the world need no longer worry about the "balance of terror" which preoccupied the consciousness of the last generation. Indeed, "Pax Americana" is here and now.

In place of military dominance, the leaders of the world are, more than ever, riveting their attention to economic pre-eminence. While the traditional rich like the United States, Great Britain, Japan, Germany, France, and other developed nations continue to produce the dominant world products and technologies, newly industrializing countries – especially those from the Pacific Rim, like Hong Kong, Singapore, South Korea, and Taiwan – have become the role models for many developing countries in their fervent effort to increase their share in the world market. In the fierce competition for economic

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dominance, countries that produce more and sell more take center stage. Hence, States have intensified competition for more trade and have lured business in many creative ways. From the simple and familiar flags-of-convenience, secret bank accounts, and tax havens provided by Liberia, Netherlands Antilles, the Cayman Islands, Liechtenstein, and the British Virgin Islands, many countries have devised more attractive "come-ons" for preferred industries and the creation of autonomous foreign trade zones and free ports.

### I. THE EMERGENCE OF TRADE BLOCS

The promotion of international trade has evolved from single country effort to regional trade blocs. International trade has become so sophisticated that fiscal incentives and tax-free schemes in a single country are no longer sufficient. It has become necessary to enlarge markets through the formation of trade blocs and to liberalize the movement of goods, services, capital, and labor across contiguous traditional state borders. Roberto R. Romulo, the Philippine Secretary of Foreign Affairs, proposes the following definition of a trade bloc:

A trade bloc refers to countries that have come together to establish a set of market conditions for themselves which differ from those applied to countries which are not members of the bloc. The preferential trading agreement, the free trade area, the customs union, and the common market are various forms of trading arrangements, but they all have this in common.<sup>1</sup>

#### A. The European Community

Perhaps the most oft-cited and probably the most advanced trade bloc in the world is the European Community (EC), which reached its "Europhoria" when it established the "Single European Market" (SEM) in December 1992. This makes the European Community truly a market without frontiers as it guarantees the movement of goods, people, money, and services among 380 million customers residing amongst its member nations. It must be added, however, that, of late, the EC's more ambitious goal of creating an Economic and Monetary Union (EMU) through the the famous Maastricht Treaty drafted in

<sup>1</sup> Speech delivered before the 18th Business Conference, 18-20 November 1992.

January 1993 has been set back by what is referred to as "the tumultuous ratification process of the same treaty" which, in turn, has been aggravated by the recent European monetary crisis, the ripple effects of German unification, persistent recession, and the strife amongst the newly-independent Balkan States.<sup>2</sup>

#### B. The North American Response to the European Community

A more recent international trade bloc was forged on 17 December 1992 when the United States, Canada, and Mexico signed the 2000-page North American Free Trade Agreement (NAFTA), which will become effective on 1 January 1994. With a combined annual output of over US \$ 6 trillion and a population of over 360 million people, NAFTA will be the world's largest single market. NAFTA seeks to eliminate barriers to agriculture, manufacturing investments and services; it likewise seeks to protect intellectual property rights. All tariffs within the free trade area will be eliminated within ten years for most products, with the remainder to be phased out within a maximum of fifteen years.<sup>3</sup>

#### C. The ASEAN Answer

Not to be outdone, our part of the world has recently launched its own the ASEAN Free Trade Area (AFTA). From 27-28 January 1993, the six Member States of the Association of South East Asian Nations met in Singapore for the 4th ASEAN Summit and adopted three documents:<sup>4</sup>

<sup>2</sup> Briefing paper distributed during a meeting of the AFTA Advisory Commission, 10 August 1993, Manila, Philippines.

<sup>3</sup> *Id.*

<sup>4</sup> The Singapore Declaration and the Framework Agreement, on the one hand, were signed on 28 January 1992 by the heads of state of six ASEAN nations, namely: Haji Hassanah Bolkiah, Sultan of Brunei Darussalam; Soeharto, President of the Republic of Indonesia; Mahathir Bin Mohamad, Prime Minister of Malaysia; Corazon C. Aquino, President of the Republic of the Philippines; Goh Chok Tong, Prime Minister of the Republic of Singapore; and Anand Panyarachun, Prime Minister of the Kingdom of Thailand. The CEPT Agreement, on the other hand, was signed on the same date by the trade ministers of the six member states, namely: Abdul Rahman Taib, Minister of Industry and Primary Resources of Brunei Darussalam; Arifin M. Siregar, Minister of Trade and Industry of the Republic of Indonesia; Rafidah Azia, Minister of International Trade and Industry of Malaysia; Peter D. Garrucho, Jr., Secretary of Trade and Industry of the Republic of the Philippines; Lee Hsien Loong, Deputy Prime Minister and Minister of Trade and Industry of the Republic of Singapore; and Anand Silaon, Minister of Commerce of the Kingdom of Thailand.

1. Singapore Declaration of 1992;
2. Framework for Enhancing ASEAN Economic Cooperation (Framework Agreement);
3. Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (CEPT Agreement).

## II. FEATURES OF THE AFTA

The Singapore Declaration, among others, sought "to safeguard ASEAN's collective interest in response to the formation of large and powerful economic groupings among the developed countries, in particular through the promotion of an open international economic regime and by stimulating economic cooperation in the region."<sup>5</sup> The Framework Agreement recognized that "tariff and non-tariff barriers are impediments to intra-ASEAN trade and investment flows, and that existing commitments to remove these trade barriers could be extensively improved upon."<sup>6</sup> In the three Agreements, the six ASEAN Member States agreed as follows:

1. AFTA was to be established within 15 years from 1 January 1993 or until the year 2008.<sup>7</sup>
2. The main mechanism for increasing trade amongst members is the so-called Common Effective Preferential Tariff (CEPT).<sup>8</sup>
3. Under the CEPT programme, the tariff for pre-identified manufactured products originating from a member State shall be progressively reduced, if not totally eliminated within said period of 15 years. Agricultural products are excluded from the CEPT scheme.<sup>9</sup>

<sup>5</sup> SINGAPORE DECLARATION, Item 2, par. 2, in MEETING OF THE ASEAN HEADS OF GOVERNMENT IN SINGAPORE, 53-57 (1992).

<sup>6</sup> FRAMEWORK AGREEMENT ON ENHANCING ASEAN ECONOMIC COOPERATION, PREAMBLE, par. 5 in MEETING OF THE ASEAN HEADS OF GOVERNMENT IN SINGAPORE, at 48-52 (1992). [hereinafter FRAMEWORK AGREEMENT]

<sup>7</sup> FRAMEWORK AGREEMENT, Article 2, par. A-1.

<sup>8</sup> FRAMEWORK AGREEMENT, Article 2, par. A-2.

<sup>9</sup> Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area, Article 3, in MEETING OF THE ASEAN HEADS OF GOVERNMENT IN SINGAPORE, at 48-52 (1992). [hereinafter CEPT AGREEMENT]

4. The CEPT tariff reduction<sup>10</sup> shall be accomplished in two ways or "tracks" or "streams," as follows:
  - a. Fifteen (15) products shall be covered by a "fast track" scheme which will lower tariffs to 0%-5% within seven to ten years. Hence:
    - \* Tariffs above 20% will be reduced to 0%-5% within ten years
    - \* Tariffs of 20% or below will be reduced to 0%-5% within seven years

The products under the "fast track" are vegetable oil, cement, chemicals, pharmaceuticals, fertilizers, plastics, rubber products, pulp, textiles, ceramic and glass products, gems and jewelry, copper cathodes, electronics, and wooden and rattan furniture.<sup>11</sup>

- b. Products under the "normal track" will have their tariffs reduced over a period of 10-15 years as follows:
  - \* Tariffs of above 20% will be reduced in two stages: a reduction to 20% within five to six years; a final reduction to 0%-5% after another seven years or a maximum total of 15 years
  - \* Tariffs of 20% and below will be reduced to 0%-5% in ten years
5. ASEAN Member States may exclude certain products temporarily from the coverage of the CEPT.<sup>12</sup> This is known as the *temporary* exclusion list. They shall be reviewed after eight years, whereupon a *permanent* exclusion list shall be drawn up of products which will not be subject to CEPT. Exclusion means that a country can continue to apply high tariffs on imports of that product, but exports of such products shall not be given lower tariffs by the importing ASEAN country.

<sup>10</sup> CEPT AGREEMENT, Article 4.

<sup>11</sup> SINGAPORE DECLARATION, Item 5, par. 2.

<sup>12</sup> CEPT AGREEMENT, Article 2, par. 3.

6. To be eligible for CEPT, at least 40% of product's value must originate from any member state.<sup>13</sup>
7. Once a product is listed under CEPT, all "quantitative restrictions" and foreign exchange limitations applicable to it shall be eliminated.<sup>14</sup>
8. Other non-tariff barriers affecting these CEPT products (like customs classification, subsidy scheme, and health safety regulations) shall be removed within five years after enjoyment of the concessions applicable to those products.<sup>15</sup>
9. Other areas of cooperation include the harmonization of standards, reciprocal recognition of tests and certifications of products, removal of barriers to foreign investments, macro-economic consultations, rules for fair competition, and the promotion of venture capital.<sup>16</sup>

### III. ADVERSE EFFECTS OF TRADE BLOCS

#### A. Impact on International Trade

As has been stated, AFTA is a response to the regional trade blocs established in Europe, North America, and elsewhere. To quote Mr. Goh Chok Tong, Prime Minister of Singapore:

... the Agreements commit ASEAN to open its markets sector by sector by reducing tariffs over the next fifteen years. This will attract more investments to ASEAN, and help ASEAN to maintain its position relative to SEM in Europe and NAFTA. By following through the Agreements swiftly to implement the CEPT scheme on a significant range of products, we will convince both domestic and foreign investors that ASEAN is a serious player in the new world order.<sup>17</sup>

<sup>13</sup> The Philippine government interprets this to mean "both single country and cumulative ASEAN context." See Department of Foreign Affairs, *Basic Notes on the Agreement for CEPT for the AFTA*, 5 April 1993 (Manila).

<sup>14</sup> CEPT AGREEMENT, Article 5, pars. A-1 and B.

<sup>15</sup> CEPT AGREEMENT, Article 5, par. A-2.

<sup>16</sup> CEPT AGREEMENT, Article 5, par. C.

<sup>17</sup> Address at the 4th ASEAN Summit in Singapore, 27-28 January 1992.

These international and regional trade groupings – SEM (Single European Market), NAFTA, or AFTA – have considerable impact on international trade basically through *trade diversion*, *investment diversion* and non-tariff barriers.

Trade diversion occurs when a producer within a free trade area gets a price advantage over a producer outside said area due to tariff differentials. Hence, Philippine exports to the United States would, in the normal course, be more expensive to US customers than similar products produced by Mexico as these enjoy tariff protection under NAFTA.

Similarly, foreign investments could be diverted from a non-member in favor of a member country, because the profits or climate in the latter would obviously be higher or better under a protected tariff scheme.

#### B. Legal Implications and Problems

These emerging phenomena of trade blocs have naturally spawned new legal concepts and problems – particularly in international law and conflicts of law. Due to limitations of time and space, this paper will deal only with these legal problems as they apply to AFTA, the regional trade bloc in our part of the world.

#### 1. SETTLEMENT OF DISPUTES

Although the Singapore Declaration of 1992 established a ministerial-level Council "to supervise, coordinate, and review the implementation of the Agreements on CEPT,"<sup>18</sup> it has not provided a judicial or even a quasi-judicial mechanism to settle actual disputes. Following the Asian tradition of solving problems amicably, the Agreement for CEPT stresses that disputes shall be resolved peacefully, as follows:

Any differences between the Member States concerning the interpretation or application of this Agreement, shall, as far as possible, be settled amicably between the parties. If such differences cannot be settled amicably, it shall be submitted to the Council referred in Article 7 of the Agreement, and, if necessary, to the AEM.<sup>19</sup>

<sup>18</sup> SINGAPORE DECLARATION, Item 8, last par.

<sup>19</sup> CEPT AGREEMENT, ARTICLE 8, par. 3.

Other than the above provision, the CEPT Agreement deems it unnecessary to provide a formal process or procedure for dispute settlement. Neither does it carry any statement on the binding authority of any decision by the Council or even the ASEAN Economic Ministers (AEM).

In fact, the Framework Agreement gives members the option of not following any resolution by the Council through the expedient of invoking Article 12, which provision grants any Member State the privilege of "taking action and adopting measures which it considers necessary for the protection of its national security, the protection of public morals, the protection of human, animal, or plant life and health, and the protection of articles of artistic and archeological value."

Furthermore, settlement of disputes by a political body like the Council is not the best way to resolve a legal question. Ideally, judicial or arbitral settlements should be objective and free from political influences.

Even more apparent is the lack of a mechanism for settling private disputes amongst private producers of CEPT products. Should a dispute occur between private parties, the legal system of the forum will probably be called upon to interpret the Agreements. This interpretation could possibly differ from a resolution given by a Court in another Member State, because the diversity in legal systems and preceptions.

## 2. IMPLEMENTING AUTHORITY

ASEAN has not created an institutional implementing authority or mechanism with sufficient resources and power to be able to define and enforce the terms of the AFTA. As pointed out by Sree Kumar, a fellow in the Institute of Asian Studies in Singapore,<sup>20</sup> the task that needs to be undertaken [by such institutional authority] now include the following: (1) defining the responsibilities of the institutional mechanism (2) drawing up its charter; (3) identifying these members of the mechanism; (4) defining the monitoring and dispute resolution

<sup>20</sup> Kumar, AFTA - Investments and Implementation, unpublished, 15 July 1993. This was a paper submitted by Mr. Sree Kumar, a Fellow of the Institute of Southeast Asian Studies, Singapore, to the meeting of the ASEAN Chamber of Commerce and Industry.

tracks; (5) setting up an agenda for immediate action; (6) identifying tariff lines; (7) harmonizing codes, classification, valuation; (8) evaluating the tariff reduction strategies by the country; (9) taking stock of non-tariff barriers (NTB) in ASEAN; and (10) designing an NTB removal strategy.

## 3. DOUBLE TAXATION

The advantages that the CEPT scheme envisions may be offset by possible double taxation problems. As pointed out by Lawan Thanadsillapakul:<sup>21</sup>

Most capital exporting countries impose a tax liability on the worldwide income of their residents; thus, for instance, when a resident of one state, the home country, invests in another state, the host country, he would, under normal circumstances, be liable to pay taxes in both countries. This is the so-called judicial double taxation situation. It means that the same income on the hands of the same person is taxed by more than one state. Another situation "where two different persons are taxable in respect of the same income or capital" is the so-called economic double taxation. For example, X who is a resident in country A holds total shares in company Y which is a resident in country B. The corporate income of company Y will be taxed on corporate income tax, then company Y remits the total profit to X in the form of dividends, such dividends will be taxed again by country A.

To prevent double taxation, it is necessary to study the tax consequences of the investment scheme and harmonize the tax burden through bilateral or even multilateral tax treaties amongst member states of the ASEAN.

## 4. DUMPING AND OTHER MALPRACTICES

Some ASEAN members like Singapore or the Philippines, via Subic Bay, have free ports. It is thus possible that non-AFTA countries will

<sup>21</sup> Thanadsillapakul, *The Legal Implications of AFTA with Special Emphasis on Harmonization of ASEAN Tax Law*, unpublished. This paper was submitted by Mr. Lawan Thanadsillapakul during the 6th General Assembly Conference of the ASEAN Law Association, 30 November to 4 December 1992, Manila, Philippines.

take advantage of the tariff reduction by unloading dumped goods or bulk cargo in these free ports and later on recycle or repackage them to other ASEAN countries.

To prevent this, it may be necessary to police more carefully the goods from free ports and/or to persuade free ports to list down the various CEPT industries operating in their territories. Only these products shall be entitled to free movement within ASEAN.

#### 5. NON-TARIFF BARRIERS

Non-tariff barriers under Article 1 of the CEPT Agreement refer "to measures other than tariffs which effectively prohibit or restrict the import and export of products within Member States." Under the CEPT Agreement, NTB's are to be eased out within five years. To be more fair, it is proposed that NTB should be phased out during the same period as the CEPT.

#### 6. THE LIMITED SCOPE OF THE CEPT

CEPT is designed to provide a larger market base for manufacturers in the favored countries and to give them economies of scale. The ultimate goal is to enable these manufacturers to compete globally with existing multinationals and with those companies being nurtured in other trade blocs. The present CEPT scheme is still limited and subject to exclusions at a member's absolute discretion. While the EC and even NAFTA are opening their borders to a member's *goods, services, capital, and people*, AFTA's CEPT merely reduces the tariff on pre-identified manufactured *goods*, excluding agricultural products.<sup>22</sup> There is no provision for services, capital, and people. And even in these limited manufactures, Member States may even exclude their own protected products. In the end, the protectionist clauses of the Agreements may create not only legal and documentation problems but may even diminish the chances of success that AFTA's organizers

<sup>22</sup> In an undated Briefing Paper, the Philippine Department of Trade and Industry argues that there are really "four stages of regional integration, namely (by degree of integration), Free Trade Area, Customs Union, Common Market, and Economic Union. CEPT-AFTA aims to attain the first degree of integration. Compared to the economic union of the EC (the third stage), CEPT-AFTA is still a tariff and non-tariff barrier-cutting exercise. It does not include services, agriculture, and environment which is widely covered in NAFTA."

envisioned.

#### 7. NEED FOR RATIFICATION OF THE THREE AFTA DOCUMENTS

The three AFTA Documents – Singapore Declaration, Framework Agreement, and CEPT Agreement – are obviously agreements that create both rights and obligations. Hence, there is an overriding necessity to find out whether, on the basis of the internal or national law of each ASEAN Member, there is need for further process to make the Agreements binding and effective in that particular State.

For instance, under the current Philippine Constitution,<sup>23</sup> "(n)o treaty or international agreement shall be valid unless concurred in by at least two-thirds of all the members of the Senate." A Filipino lawyer, Joseph Sedfrey S. Santiago,<sup>24</sup> in a paper submitted to the ASEAN Law Association, opined that there is no necessity for Senate concurrence, because "the AFTA Agreement does not lay down a new policy in so far as ASEAN trade liberalization is concerned." The Philippine government seems to agree with the non-necessity of ratifying the AFTA, because it is already implementing the documents even without Senate concurrence.

In the face, however, of the specific and express language of the Philippine Constitution stating that Senate concurrence is essential not only for treaties but also for "international agreements," there is need to take a second look at this situation. An arguable case can be made out on why it is advisable to first secure Senate ratification. After all, the AFTA documents involve not only the lowering of tariffs (which admittedly are within the powers of the President to do on his own authority)<sup>25</sup> but also other obligations. In the case of NAFTA, the three signatory governments are making sure that their respective constitutional requirements on ratifications are complied with. In the United States, such ratification process has not been without its share of public attention.

<sup>23</sup> PHIL. CONST., Article VII, Sec. 21.

<sup>24</sup> Santiago, *ASEAN Free Trade Area (AFTA): Preliminary Legal Implications for the Philippines*, unpublished. This paper was submitted by Mr. Joseph Sedfrey S. Santiago to the 6th General Assembly of the ASEAN Law Association, 30 November to 4 December 1992, Manila, Philippines.

<sup>25</sup> R.A. 1937, *TARIFF AND CUSTOMS CODE OF THE PHILIPPINES*, Sec. 402. (19 \_\_\_).