

# China Customs & Trade News

## China's Free Trade Agreements

May 2007



### Introduction

China has been establishing new Free Trade Agreements (FTAs) over the past several years. China's FTAs cover trade in goods, services and investment. For trade in goods, China's major FTAs provide for the elimination of tariffs and other trade barriers over a period of time.

China's FTAs retain the principles that are set forth by the World Trade Organization (WTO). For example, China's FTAs cover substantially all trade, include standard rules of origin, retain pre-existing tariffs in trade with third countries and contain a reciprocity requirement.

A comparison between China's leading trade partners and FTAs is summarised as follows:

Figure 1: China's Top 10 Trading Partners (Imports and Exports):

Country/Area	FTA Status	Remarks
EU	None	Not likely
US	None	Not likely
Japan	Feasibility study	Several years away
Hong Kong	CEPA implemented	In 2004
ASEAN	Implemented	In 2005
South Korea	Under negotiation	1-2 years away
Taiwan	None	Not likely
Russia	None	Not likely
Australia	Under negotiation	1-2 years away
Canada	None	Not likely

As can be seen from above, China is neither establishing nor likely to establish FTAs in the near term with key trading partners such as the United States, the EU and Japan.

China is a member of the Asia Pacific Free Trade Agreement (APTA), which has been implemented and includes South Korea, Laos, India, Sri-Lanka and Bangladesh. However, product coverage under this regional FTA is very limited, as are therefore the potential customs duty savings. China implemented a bi-lateral FTA with Chile in 2006. China has also implemented a bilateral FTA with Pakistan.

### China – ASEAN FTA

The most prominent FTA that China has implemented is that with the Association of South East Asian Nations (ASEAN). The Trade in Goods Agreement took effect on 20 July 2005 and significant tariff reductions can now be taken advantage of. The pace of tariff reduction depends on:

- the type of product (Normal Track, Sensitive Track, Highly Sensitive Track)
- the country (more time for the newer members of ASEAN)
- the applied MFN rate as at 1 July 2003 (MFN stands for Most Favored Nations, essentially any WTO member)

For the Sensitive Track only 400/500 tariff lines at HS 6-digit level are allowed. For the Highly Sensitive Track only 100/150 tariff lines at HS 6-digit level are allowed. In other words, most products should fall under the Normal Track and therefore benefit from lower tariff rates. A phased tariff reduction plan has been negotiated. For the more developed ASEAN 6 countries (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand) 0% tariffs will be granted by 2010. For the developing ASEAN 4 (Cambodia, Laos, Myanmar, Vietnam) 0% tariffs will be granted by 2015.

Since implementation, both the Chinese and ASEAN governments have reported low utilization of the FTA by the private sector. Too few Certificates of Origin (Form E) are being obtained by companies when they ship products between China and ASEAN. This is attributed to a lack of knowledge amongst the private sector players.

### China’s Future FTA Plans

China is busy negotiating FTAs with a number of other countries, the most notable of which are summarised as follows:

Figure 2: China’s Key FTA Negotiations:

Country	Remarks
Gulf Co-operation Countries (GCC)	Negotiations were launched in July 2004 and four rounds have been completed. Negotiations have included trade in services, goods and market access. Rules of origin, technical barriers to trade, sanitary and phytosanitary measures have also been discussed. An FTA may be implemented in 2008.
South Korea	Afeasibility study was completed last year. South Korea is reluctant to proceed due to fears that low-priced Chinese agricultural products could flood the domestic market. This has not stopped negotiations continuing. A comprehensive FTA – but with limits in the agricultural sector – may be implemented in 2009.
Australia	In 2007, Australia recognised China’s market economy status and six rounds of negotiations have now been completed. The focus is on deepening cooperation in energy and mineral resources, expanding mutual investment, and improving the cooperation environment. An FTA may be implemented in 2008/2009.
New Zealand	This was the first FTA negotiated between China and a developed country. Negotiations commenced in 2004, covering trade in goods, services, non-tariff measures, investment, rules of origin, sanitary and phytosanitary measures, and safeguards. An FTA may be implemented in 2008.

China is also at various stages of feasibility study and/or negotiation with smaller trading partners or trading blocs such as Iceland, MERCOSUR and SACU.

### FTA Negotiation

Negotiations are led by the Ministry of Commerce (MOFCOM), which is strongly involved in trade policy-making. Given the complexity of trade agreements and negotiations and the institutional capacity in government, MOFCOM has a complicated agenda to manage. To ensure sound implementation other agencies, such as the Customs Authority, are also involved in the negotiations.

### Rules of Origin

#### Value-Added Criterion

As mentioned above, China's FTAs retain the principles that are set forth by the WTO including the use of standard rules of origin. China's FTAs therefore provide for the following:

- Wholly obtained or produced products
- Substantial transformation (change in tariff classification; specified process of manufacturing; or value-added)
- Cumulation (i.e. adding value from partner countries as originating)
- Non-qualifying operations

For most trade, the wholly obtained or produced rule is not applicable. Most companies will find that they fall under the "substantial transformation" rule. Within this, the "value added" rule is the most common. A 40% value-added criterion typically applies. If manufacturing in China, domestically sourced materials, local labor, overheads and profit can all contribute to the "value added". There is no official cap on the amount of profit that can be treated as part of the "value added". In practice, most companies manufacturing in China find that they easily achieve the 40% value added criterion.

The manufacturing supply-chains of most multi-national companies in China enable qualification for originating status to be achieved without relying on cumulation. Non-qualifying operations typically include: (i) preservation of goods in good condition for the purposes of transport or storage (ii) facilitating shipment or transportation (iii) packaging or presenting goods for sale.

#### Direct Shipment

China's FTAs typically require products to be transported directly from one party of an FTA to another party (e.g. direct shipment from China to Thailand). Transport through non-parties – such as Hong Kong in the case of the ASEAN-China FTA – with or without trans-shipment or temporary storage, may be allowed provided that (i) the products have not entered into trade or consumption there; and (ii) the products have not undergone any operation there other than unloading and reloading or any operation required to keep them in good condition. A "Certificate of No Further Processing" may be applicable if goods are transported via Hong Kong. The Certificate is issued by the China Inspection Company Limited.

#### Third Party Invoicing

The manufacturing supply-chains of most multi-national companies include sale of products via an affiliate (e.g. regional headquarter office) that is located in a non-party country (e.g. Hong Kong). The ASEAN Free Trade Agreement (AFTA) has formally created provisions to allow for this type of arrangement. However, China's FTAs, particularly the ASEAN-China FTA, is silent on this topic. In practice and as of now, most ASEAN countries will reject preferential tariff treatment if products are invoiced through a party not resident in either China or an ASEAN country. However and somewhat interestingly, China seems to be accepting such arrangement. Within the next 1 – 2 years a provision to support this arrangement may be created and written into the existing Operational Certification Procedures.

### Regional Distribution Centers

Under China's FTAs it is difficult to set up a regional distribution hub in a non-party and obtain FTA benefits for all products. For example, under the ASEAN – China FTA goods may be made in China and then sent to a regional distribution hub in Hong Kong. Some products will be distributed to ASEAN and, provided that they have a "Certificate of No Further Processing", qualification for the preferential tariff in ASEAN countries may be possible.

However, some products will be distributed in China. China Customs have verbally confirmed that goods of Chinese origin remain subject to a MFN duty rate if they are re-imported from Hong Kong or an ASEAN country (e.g. Singapore). This means that such goods are precluded from the coverage of China-ASEAN FTA. This is due to the fact that: (i) the China-ASEAN FTA does not explicitly include such goods into the coverage of preference; (ii) A <Notice Regarding Supervision of Re-importation Goods Originated in China by Way of General Trade> issued by the Ministry of Commerce and General Administration of Customs dated May 30, 2006 which states that the goods made in China should be re-imported by way of General Trade (unless Processing Trade rules apply).

### Documentary Requirements

#### Exportation

If manufacturing and exporting from China, a two-step process is required, and both steps are completed with the Commodity, Inspection and Quarantine (CIQ) authority:

- **Step 1 - Factory Registration:** This is a one-off requirement, with annual renewal. If the manufacturer is already registered for other purposes (e.g. General System of Preference), it may be possible to seek a waiver of factory registration. Otherwise, the manufacturer should prepare the application form, supporting documents, and complete the factory examination.

- **Step 2 - Certificate of Origin:** A Certificate of Origin should be obtained on a shipment-by-shipment basis. In the case of the ASEAN-China FTA, this is known as a Form E. Again, standard application requirements and procedural steps apply. There is no electronic Certificate of Origin as of now (still paper based and issued with triplicate copies).

#### Importation

Along with the normal shipping documents, the below documents are also required:

1. A through bill of lading issued by the exporting country
2. A copy of the original commercial invoice of the goods
3. The Certificate of Origin issued by the Authority in the exporting country

If the FOB price of imported goods of the origin of an ASEAN country is less than USD 200 then the Certificate of Origin (Form E) can be exempted.

### Verification and Dispute Settlement

Verification of Certificates of Origin in China is performed by the CIQ. This may take place on the initiative of CIQ itself, or in response to a request by an overseas country. The Rules of Origin and Operation Certification Procedures provide for dispute settlement procedures. These procedures include private hearing between the respective countries concerned, prescribed time limits etc. However, as China's FTAs are relatively new these dispute settlement procedures have not been thoroughly tested in practice.

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