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Customs and Trade Alert: What is the outlook of free trade in China?

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In PwC China's 2016 Customs and International Trade Best Practices Benchmark Survey, over 85% of companies indicated they have been utilizing Free Trade Agreements (FTAs) to legitimately achieve duty savings and improve market access and competitiveness. Indeed, successfully utilizing FTAs has become one of the most important and effective cost saving strategies, and should remain a top priority for many companies trading in this region.

Over the past few decades, trade agreements and economic partnerships in this region and around the world have been forged in tandem with the momentum of globalisation. However, recent geopolitical events now threaten the existing paradigm and question the stability of prior arrangements. As the United States, the world's largest economy, continues to hint at the adoption of protectionist policies, markets around the globe brace for uncertainty in the future.

How would the United States' withdrawal from the Trans-Pacific Partnership (TPP) affect Asia, particularly China? What is the status and outlook of the Regional Comprehensive Economic Partnership (RCEP) and its potential benefits to China? What are some of the ongoing practical challenges faced by companies and what should they be doing differently?

The rise of the RCEP

The RCEP, composed of the 10 member states of the Association of Southeast Asian Nations (ASEAN) and 6 states with which ASEAN has existing free trade agreements, including China, South Korea, Japan, India, Australia and New Zealand, represents around 30% of global GDP and nearly half of the world's population.

Supporters laud the RCEP and the TPP as pathways to the creation of a new trading bloc: the Free Trade Area of Asian Pacific. With the United States' formal withdrawal from the TPP on 30 January 2017, the TPP will unlikely come into effect as the agreement will not be successfully ratified in accordance with the terms. The role of torchbearer in promoting Asia Pacific trade liberalisation shifts to China and the spotlight shines brighter on the RCEP as the prevailing pathway to achieve greater regional economic integration. The RCEP recently concluded its 16th round of negotiations in December 2016 with a subsequent upcoming round slated for late February into March 2017.

While the details of scope and coverage of the RCEP remains unclear as of now, the centrality of ASEAN in the partnership may mean the RCEP could mirror certain aspects of the existing ASEAN framework. Actual benefits that companies could reap from partnership arrangement would still depend on the depth of goods, tariff coverage, and whether true "free trade" (an elimination of tariffs to 0% at the end of full implementation) can be achieved.

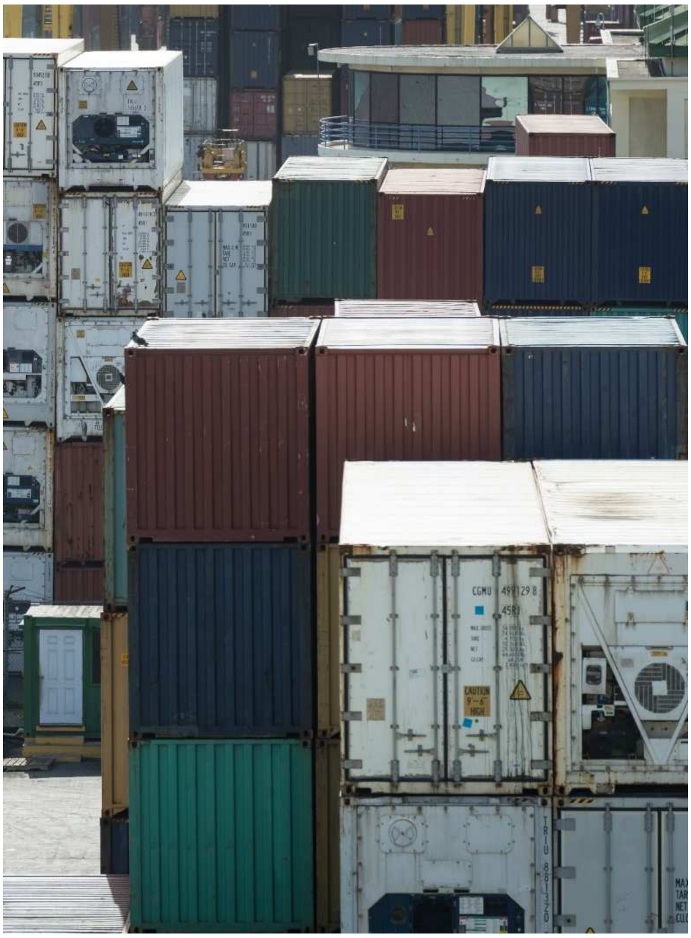
As a key member of the trade deal, China has mentioned that it will strive for an end to the negotiations as soon as possible with the hope that swift ratification will better promote expeditious economic integration of the Asia Pacific region. If the RCEP is signed and successfully ratified in the near future, even if the terms of the agreement were of a modest nature, its impact should not be underestimated because the trade deal bolsters the attractiveness of conducting business in the Asia-Pacific region at a time when western nations are blighted by a trend towards trade protectionism. The RCEP may signal a pendulum shift favouring China and Asia Pacific countries with far-reaching consequences.

What else to expect?

Other than the much anticipated RCEP, several other free trade agreements are under negotiation, including the following:

- China — GCC (Gulf Cooperation Council) FTA
- China — Sri Lanka FTA
- China — Pakistan FTA second phase
- China — Maldives FTA
- China — Georgia FTA
- China — Israel FTA
- China — Norway FTA

The ongoing negotiations and expansion of its free trade network shows that China is continuing to deepen reform and strengthening its role in the multi-lateral trading system.



Ongoing challenges that come with opportunity

Despite the active negotiations at the national level, at a local level, companies continue to face ongoing practical challenges in its daily operations of utilizing FTAs and strive to remain compliant with implementation requirements.

Common challenges and possible implications are summarized as follows:

Challenge	Implications
Different expectations in origin country vs. importing country	• Importation – acceptance at the border: The importer could be submitting all the relevant information and documents as required by the FTA, but actual acceptance still depends largely on the interpretation and expectations of importing country Customs reviewing the preferential claim at the border. In practice, there could be discrepancies in HS code, actual vs. theoretical quantities, availability of third party invoicing or other documentation support, etc. that could cause a rejection on preferential claim. • Exportation — getting the Certificate of Origin (CoO) that your importing country wants: Obtaining a CoO that can be accepted by the importing country is just as important. However, there can be instances where the local authority in charge of issuing the CoO cannot meet the requirements of what is needed by the importing country.
Shipment through a hub	• Purpose of the hub: In an MNC's supply chain, it is not uncommon for goods to be distributed and centralized in a regional hub. This could just mean temporary storage, and in some cases certain activities may also be carried out, such as repackaging, labelling, consolidation, bulk breaking, etc. While these activities should not on their own contribute to a change in origin of the goods, the bonded or non-bonded state of the warehouse, and in certain cases the country/location of the warehouse could mean disqualification of the preferential claim. • Certificate of Non-Manipulation: If the hub is located in a bonded area and in a country that is acceptable under the FTA terms, a Certificate of Manipulation shall be obtained from competent authorities in the country where the hub is situated. Acceptance of the Certificate of Manipulation may again depend on the local practices of the importing country.
Documentation accurateness and completeness	• Importation — acceptance at the border: Accurate and complete documentation and supporting information could help expedite the review and acceptance of preferential claim. • Post importation — managing origin audits: Even if a preferential claim was accepted at the time of import, Customs authorities still reserve the right to conduct post importation origin audits. Companies must ensure robust record keeping of documents and supporting information relating to preferential claims.

What should companies be doing?

As one of the most effective ways of achieving duty cost savings, companies should still try to maximize usage of FTAs. Some tips to ensure smooth implementation and minimize compliance risks are summarized below:

1. Plan ahead

The companies that are able to fully reap the benefits of FTAs are usually the ones who plan in advance. This goes beyond simple research and often means that utilization of FTAs is being prioritized in the company's pipeline of supply chain plans. For example, multinationals that look to establish regional headquarters or distribution hubs should also consider the possible impact of location on FTA implementation. Vendor responsibility and integrity could also represent a major obstacle in origin compliance, and this may need to be considered in the vendor selection process.

2. Establish SOPs and KPIs

It should be understood that successful FTA utilization and compliance often require cross function involvement, and should not only be the responsibility of the logistics, supply chain or trade compliance team. Putting in place relevant Standard Operating Procedures to outline the functions and responsibilities of different personnel would help to drive the process and avoid unnecessary misunderstandings.

Similarly, having appropriate Key Performance Indicators in place for both internal (employees) and external (vendors, suppliers, agents) resources would help the company to achieve its goals in a more efficient manner.

3. Conduct periodic compliance reviews

Periodic compliance reviews or integrating an origin compliance audit into the company's internal audit program is always helpful to effectively flush out any non-compliance practices or unidentified duty savings opportunities.

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PwC's Customs & International Trade Practice

Customs and international trade in China is complex, but with the right approach is manageable. A planned and structured approach results in cost savings, higher levels of compliance and fewer unwanted surprises during an audit. PricewaterhouseCoopers' specialists within our Greater China customs and international trade practice provide a wide range of advice and services related to creating value, ensuring compliance, and managing risk in relation to the movement of goods into and out of China. For more information, please also visit: www.pwccustoms.com