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Improving market access under the China-Korea and China-Australia Free Trade Agreements

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China Customs and Trade Alert

pwc

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The much anticipated China-Korea Free Trade Agreement ("CKFTA") and the China-Australia Free Trade Agreement ("ChAFTA") took effect on 20 December 2015. Producers of goods in South Korea and Australia can now improve their access to the ever growing Chinese middle-class.

For Trade in Goods the "1st tier tariff elimination" took effect on 20 December and the "2nd tier tariff elimination" will take effect 1 January 2016. Companies can enjoy lower tariffs assuming that they comply with the Rules of Origin.

The purpose of this Trade Alert is to update the key benefits in tariff elimination that companies may enjoy. South Korean and Australian producers may "level the playing field" with competitors from countries such as ASEAN, New Zealand, Chile, and Switzerland with whom China has already established FTA.

Overview of CKFTA and ChAFTA

China-Korea FTA

Korea agrees to remove tariffs up to 92% of tariff headings, accounting for 91 % of China-Korea export value. China promises an overall tariff concession with 91% of tariff headings, covering 85% of Korea-China export value. The tariff reduction timeline shall be last no more than 20 years.

Goods from
China to Korea
92%

Goods from
Korea to China
91%

China-Australia FTA

The Australian parliament passed the bill of tariff exemption covering 100% of China-Australia exports. Most tariffs will be reduced to 0% within 3 years. For more "sensitive sectors" the tariff should fall to 0% within 5 years.

China promised a preferential treatment on tariffs exemption with 96.8% tariff headings. Approximately 95% of the tariffs will be eliminated within 5 years. The remaining "sensitive sectors" will be reduced over 15 years.

Goods from
China to Australia
100%

Goods from
Australia to China
96.8%

Key tariff reductions

China-Korea FTA

Manufacturing sector

China shall reduce the tariff within 10 years and this should account for 66% of Korean exports. Korea will cover 80% for China exports during the same period.

Korea shall eliminate the most of the tariffs on Chinese exports covering:

- 100% of electronic equipment products
- 99% of metal products;
- 98% of chemical products;
- 96% of industrial machinery equipment products;
- 96% of transportation equipment products.

However, China gives **no** preferential tariff to Korean-made auto and parts.

Agriculture/Fishery sector

China shall eliminate the tariffs to 56% of Korean exports, while Korea promises to conduct the elimination to 40% of Chinese exports.

Chinese customer could enjoy zero tariff on Korean-origin sea sedge, with 15% tariff elimination within 10~20 years.

Chinese customer could enjoy zero tariff on Korean-origin pickle, with 20% tariff elimination within 20 years.

China provided **no** tariff reduction to Korean rice, garlic, grape wine, spicy sauce and related aquatic products.

Household appliances

The current 15% tariff on Korean-made fridges, microwave ovens, electronic cookers, etc., will be gradually eliminated within 10 years.

Other consumer products

The 10% tariff on Korean-made toothpaste will be eliminated within 10 years. The 20~35% tariff on shampoo will be decreased to 0% within 5 years.

Lipstick, perfume, and eye cream are excluded. Korean producers may prefer to use cross-border e-commerce as a business model to access the Chinese consumer.

Textile sector

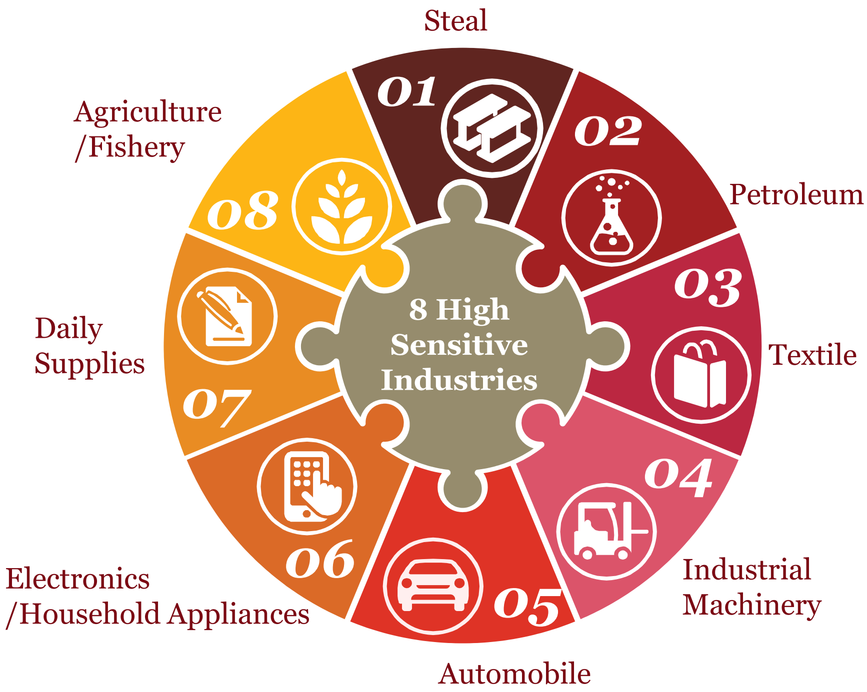
Garments shall enjoy a 0% tariff within 10~20 years; the current rate is approximately 15%.

Key tariff reductions

China-Korea FTA

Sensitive industries still protected

China and Korea both listed “highly sensitive products” in key industries, which are still protected or viewed as a matter of national interest/security. Both parties reach a consensus to maintain a balance of mutual benefit. Considering the tariff reduction arrangement, China focuses the high-end products in auto, steel and the electronics industries, whilst Korea focuses on textile, auto and the agricultural industries.



Key tariff reductions

China-Australia FTA

Industrial products sector

Australian will reduce the existing tariff on 92.9% of Chinese exports once ChAFTA takes effect. After the completion of the tariff reduction, an average tariff reduction will be achieved from 8.8% to 0.2%.

China will eliminate the existing tariff benefiting 81% of Australian exports once ChAFTA takes effect.

Agriculture/Fishery

China shall lower the average tariff level from 12.94% to 0.51% in agricultural industry, where 93.7% tariff headings of agricultural products would be cut down to zero.

Australia will curtail all tariff of 99.4% tariff headings, covering 99% of imports from China.

- Elimination of tariffs of 12 ~25% on beef within 9 years
- Elimination of tariffs of 12~23% on sheep meat within 8 years
- Elimination of tariffs of 20% on pork within 4 years
- Elimination of 7.5~30% tariffs on orange juice within 7 years
- Elimination of 14~20% tariffs on wine within 4 years
- Elimination of 15% tariff on rock lobster within 4 years
- Elimination of 10% tariff on malt and wheat gluten within 4 years

Mining/Energy sector

Post 4 years of the FTA taking effect China will reduce the tariff for most resource and energy products that are imported from Australia.

- Elimination of Australian-produced coking coal tariff from 3% to zero.
- Elimination of Australian-produced steam coal tariff from 6% to zero.

Dairy products

China will conduct elimination of the existing 15% tariff on liquid milk within 9 years, 15% tariff on infant formula powder within 4 years and 10~15% on cheese, butter and yogurt within 9 years.

Key tariff reductions

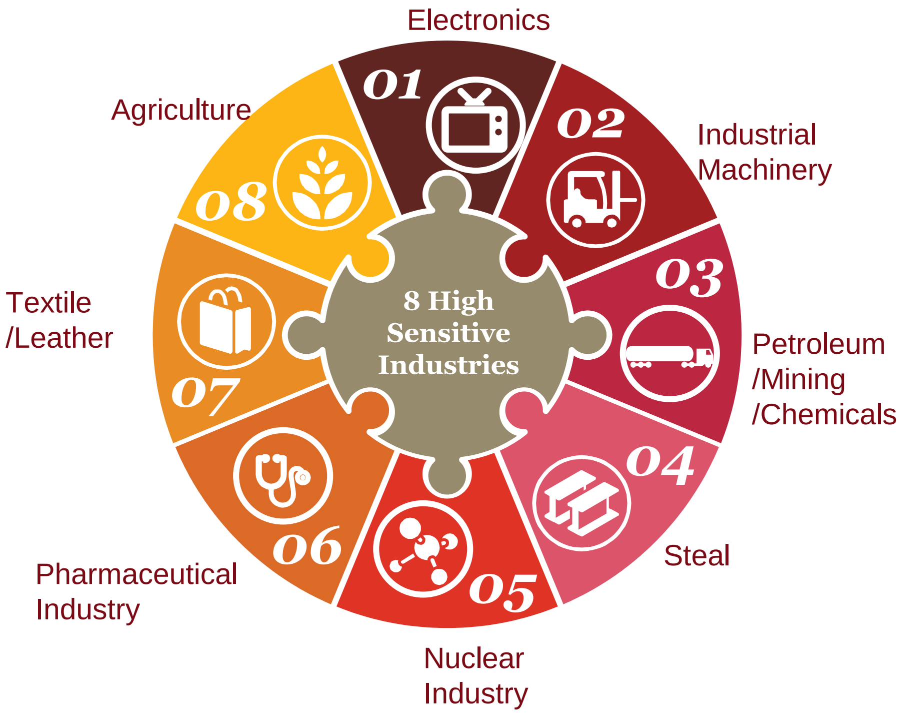
China-Australia FTA

Sensitive industries still protected

Considering the strong competitiveness on agriculture industry, Australia agricultural products would bring considerable pressure to China market. In this regard, China imposes a relative long timeline on tariff elimination, special safeguard and country quota measures, which aims to render some protection to domestic market under the appropriate open policy.

As respect to the competitiveness of China industrial products, Australia government imposes 3 or 5 years tariff elimination timeline, which provides a buffer to Australia-made industrial products and marketplace.

In addition to the above mentioned industries, both governments focus on the some key products in relevant sensitive industries as follow illustration.



Rules of Origin (RoO)

Key Rules of Origin under CKFTA & ChAFTA

In each FTA, the Rules of Origin is a critical issue determining a product whether could enjoy the FTA preferential tariff, be entitled to corresponding trade facilitations or not.

Both CKFTA and ChAFTA maintain the preferential rules of origin, we summarize the key rules of them for your easy understanding.

Wholly obtained / produced

- The products should be fully manufactured and processed with the materials grew, extracted , harvested or supplied by natural resources within one country.

Substantial transformation

<u>Regional Value Criterion (RVC)</u>

- Both FTAs state that the RVC should be abided by the follow formula:

  *Regional Value = (Goods Value – Non-originating Material Value)/Goods Value * 100%*

<u>Change in tariff classification (chapter, heading & subheading)</u>

- For specific products, the tariff classification of the non-originating material should be changed after the manufacturing and processing within the export country/region (e.g. cast iron of 7201 changed to alloy iron 7202).Thus, the products could be entitled to origin of export country.

<u>Specified Process of Manufacturing</u>

- Under specific tariff classification, the specified process of manufacturing should be conducted and met accordingly, otherwise, underlying products could not obtain the export country origin (e.g. roasted coffee are limited to the process of roasting , whist the raw material is limited to coffee bean only).

Direct Shipment and Operational Procedure for Certificate Origin

Direct Shipment

Under special circumstances, the goods may be transported to the import country via 3rd country due to commercial logistics arrangement. In this regard, if the follow specific requirements could be met, the captioned circumstance could deemed as the "direct shipment" :

CKFTA	ChAFTA
• 3rd country transportation is only for geographical reasons or transport purposes. • The goods is not subject to enter these countries for trade or consumption. • No further action is conducted, other than unloading, packing and other necessary treatments to maintain a good status of goods.	• No further action is conducted, other than unloading, packing and other necessary treatments to maintain a good status of goods. • The goods is for temporary storage purpose and the period will not be exceed 12 months. • The goods should be under supervision of the in-charge customs of 3rd countries.

Operational Procedure for Certificate of Origin

Exporter should apply for the Certificate of Origin before the goods export.

The Certificate of Origin should be issued by the authorized authorities of export country.

During import declaration, the Certificate of Origin should be submitted to import country customs in connection with other shipping documents (including commercial invoice and entire transport shipping documents).

Importer should obtain the document issued by the 3rd country customs (e.g. Movement Certificate) if goods transported via 3rd country.

PwC Observations

As summarized above, both the FTAs map out the overview of tariff deduction arrangement. As of the 13^{th} and 14^{th} signed FTA, China has gained tremendous benefits from the past agreed FTA. Below are our observations on those key FTAs:

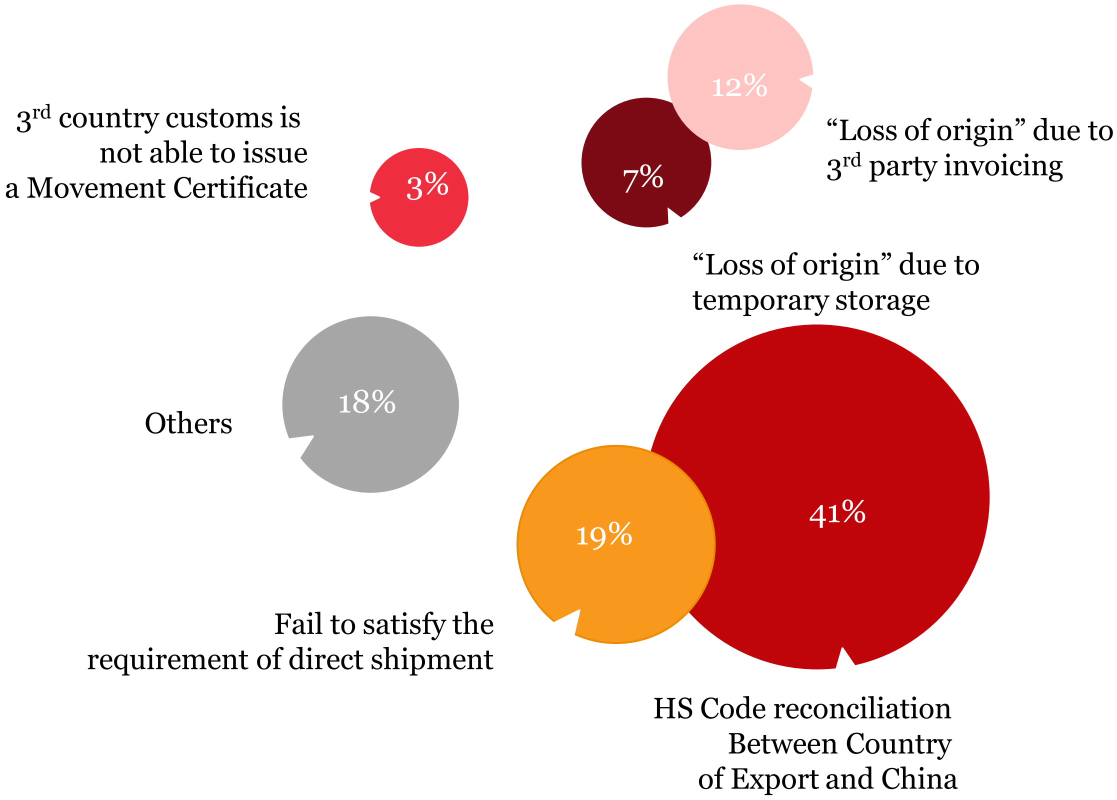
Key Outcomes	PwC Comments
Benefits of Tariff Reduction and Exemption	Tariff is one of critical factors of import/export operation. Undoubtedly, tariff reduction and exemption of underlying FTAs could help companies to save considerable import tax cost and mitigate the financial pressure, especially, when the companies in China are facing more and more fierce competition in domestic marketplace. Moreover, the FTA would help foreign company to achieve the localization to be closer to the China market.
Incentives to both signed governments	FTAs encourage trade between signed countries, which could help governments to achieve more customs revenue due to the increase of trade, as well as creating more job and investment opportunities.
Positive impacts to various industries of FTA engaged parties	• Korean-produced household appliance could enjoy zero tariff within 10 years. This leads a positive impacts to China importers and final customers. In this regard, a lower and lower price trend will last. • Korea produced daily chemical supplies could enjoy zero tariff, such as toothpaste, shampoo, sun block lotion with tariff reduction of 10~35%.This could lead a price reduction up to 20%. • The tariff reduction on wool imported from Australia could benefit the textile/garment industry companies in China and cut down the import tax cost, upgrade the comprehensive competitiveness. • The tariff reduction provides more available choices to customers on beef, dairy, wine, seafood, which could improve the structure of China domestic foods market.
Shorter tariff reduction timeline	Australia promised to call off the entire tariff covered 100% of its tariff heading within 5 years. In terms of the captioned timeline, 99% of agriculture products and 81% of industrial products would be subject to zero tariff less than 5 years. For China company, it renders a good opportunity for export operation.

PwC Benchmarking Best Practices Survey

PwC Benchmarking Best-practices in 2015

Although we observed abundant of benefits obtained from the FTA implementation, hurdles are identified during our client's daily trade operations. To map out the difficulties, PwC conducted a benchmark survey to our MNC clients in various industries in 2015. We summarized feedbacks obtained and may find that some clients are facing the practical difficulties on goods origin, tariff classification, direct shipment and movement certificates, etc.

Which of the following practical challenges has your company experienced when utilizing FTA(s)?



Customs reserve the right to challenge the legitimacy of an FTA claim as lodged by the importer. Checks typically take place upon arrival and declaration of the imported goods and they are made by the in-charge port customs.

Based on PwC experience the Rules of Origin and facts and circumstances of the specific importation have to be evaluated in order to work towards a sustainable FTA solution with customs.

PwC's Value

PwC can help you from the following aspects:

Assistance in communication with GAC for timely update of the new rules and implementation measures for CKFTA and ChAFTA, and support on applying for trade facilitation treatments

Assistance in the establishment of the Standard Operation Procedure (SOP) for daily import/export operation under new FTA schemes to secure trade compliance

Assessment on the current logistics arrangements of companies subject to enjoy the preferential tariff treatments , and advice on clearance model optimisation

Insights sharing and training on customs management modes and new requirements after the implementation of the CKFTA and ChAFTA

Assessment and structuring the current business model based on the interpretations of underlying FTAs upon you provided industry background information, products and corresponding tariff headings.

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PwC Customs & International Trade Practice

Customs and international trade in China is complex. However, a planned and structured approach with the right resources assigned results in cost savings, higher levels of compliance and fewer unwanted surprises during an audit. PwC 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.