HD **ChAFTA 2014: The winners, the thresholds and the opportunities**

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WC 2,157 words

PD 20 November 2014

SN Mondaq Business Briefing

SC BBPUB

LA English

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The much anticipated **China** Australia Free Trade Agreement (ChAFTA) was announced earlier today. ChAFTA secures Australia's competitive position with our largest trading partner and lays the foundation for a deeper and stronger long-term strategic partnership.

It's a major step forward, sending a strong and unmistakable message that Australia is committed to developing a deeper engagement - economically, politically and socially - with **China**, and vice versa.

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This is the first agreement that **China** has concluded with a developed economy and the most comprehensive compared to any other nation. While some industries and products may have missed out, it is important to look at the big picture and remember that today's announcement is not an end-point, but rather a base from which to build on. Australian businesses have been granted unprecedented access to the fastest growing markets in the world, unlocking **billions** of dollars of exports.

Process going forward

While the Governments should be congratulated on reaching this significant milestone, the hard work is not over. Signing ChAFTA is just the first step. Now ChAFTA's benefits need to be **sold** to the community. The **Chinese** and Australian Governments have adopted a letter of intent to reach an agreement. It is expected to be finalized in two months after which the agreement will be subject to ratification by parliament. There's also a process to be followed on the **Chinese** side.

This process cannot be left purely on the shoulders of Government. **Business** must actively support the case for ChAFTA and proactively engage with businesses in **China** to explore opportunities for integrated partnership models that encompasses the entire value chain from research and development all the way through to marketing and sales, moving away from the purely transactional model that thus far been the hallmark of our commercial relationship with **China**.

Australia won't enjoy this competitive position for long before other nations receive similar if not better trade concessions. The sooner ChAFTA gets ratified, the sooner the benefits will flow. Once ratified the key changes we can look forward to include:

removal and reduction of tariff barriers;

relaxation of Australian regulatory barriers to **Chinese** investment; and

facilitation of Australian investment into **China**.

While it will still be some time before the benefits of this agreement materialize the significant opportunities which will open up for key sectors of the economy are not to be underestimated.

1 Removal and reduction of tariff barriers

The Australian agriculture and **mining**, **energy** and resources industries have been confirmed as two big winners with the elimination of a host of tariffs and the planned phase down of many more.

Agriculture

ChAFTA will deliver significant tariff cuts for various agriculture exports particularly dairy, beef, sheep meat, live animal exports, wine, seafood and horticulture, providing Australian farmers with a huge advantage. Most of these tariff cuts are to be implemented within 4 to 9 years, with tariff cuts for barley and some grains becoming effective immediately on day one of ChAFTA. China will review the position on rice, wheat, cotton and sugar 3 years after ChAFTA comes into force.

ChAFTA is expected to boost Australia's already substantial $9 billion agriculture and fishery exports into China. This new playing field is also expected to attract additional Chinese and other foreign investment into the Australian agriculture sector.

Mining/ energy and resources

Once ChAFTA is in force 92.9% of China's imports of resources, energy and manufactured products from Australia will enter duty free. Within four years this should increase to 99.9%.

Of key interest to coal producers is that the 3% tariff on coking coal, introduced in October, will be removed on day one of ChAFTA. This will be a welcome reprieve for local coal producers under pressure if it can be implemented quickly. The thermal coal industry will be disappointed to learn that it will be up to 2 years after ChAFTA before the 6% tariff also introduced in October will be removed.

Outside of coal, transformed resources and energy products such as refined copper and alloys as well as major exports iron ore, gold and liquefied natural gas will also see the removal of tariffs.

2 Relaxation of Australian regulatory Barriers

FIRB

Australia has matched the same threshold as the US, Japan and Korea for private Chinese investors. This means investment proposals below the $1.078 billion threshold will not require FIRB approval. Investments by SOEs and SWFs will require approval regardless of size.

Consistent with the approach in the current FTAs, ChAFTA does not impact the sensitive sectors which include defence related materials and activities, communications, transport, media, most land as well as uranium and plutonium extraction. Likewise, for the threshold to apply the investment must come directly from China.

Foreign Government Investment

China hoped to see its SOEs and SWFs treated as private enterprises for investment purposes. Although we have seen relaxations allowing for less than 10% passive investments by foreign government related investors, the Government has resisted introducing a blanket exemption for foreign government investment activities under ChAFTA. This is consistent with all of the FTAs. The Australian Government has signaled a review of the position after 3 years.

Rural Land and Agribusiness

The Australian Government went to the previous election on a platform that included a substantial lowering of the rural thresholds under the foreign investment regime.

The ChAFTA includes the Australian Government's proposed new rural thresholds of A$15 million for rural land and A$53 million for agribusiness interests. This is also consistent with the Japanese and Korean FTAs.

Investor-state dispute mechanism

ChAFTA will contain an Investor-State Dispute Settlement (ISDS) mechanism. This protects investors against States changing investment rules and is aimed at promoting investor confidence. The ISDS will contain carve outs for legitimate regulation objectives. This balancing approach is consistent with other modern investment protection treaties (such as the Canada-China bilateral investment treaty). It is particularly encouraging for Chinese investment in Australia because it marks a change from the previous Australian Government's avoidance of ISDS mechanisms.

Labour

ChAFTA will introduce measures to reduce some of the barriers to labour mobility between Australia and China through changes to each country's existing immigration and employment structures. These changes are expected to provide improved access for a range of Australian and Chinese skilled service providers, investors and business visitors.

Specifically, certain Chinese owned companies registered in Australia undertaking certain infrastructure projects above $150 million will also be able to negotiate increased labour flexibilities in some cases (called Investment Facilitation Arrangements). These arrangements will operate within Australia's existing immigration system and will still need to meet minimum Australian employment laws and standards.

3 Facilitation of Australian investment into China

In addition to the relaxations for all investors announced by the NDRC earlier in November in the form of a draft Catalogue for the Guidance of Foreign Investment Industries to be implemented across China, ChAFTA has given the Australian services industry a big leg up in the form of market access in China. This is especially the case for Australian financial and professional service suppliers, education, health and aged care suppliers.

Health and aged care suppliers

Soon wholly Australian-owned hospitals and aged care institutions can establish in China. We expect Australian service providers to seize these opportunities. Early movers are already set to benefit from these changes with Ramsay Health Care announcing on Friday a 50/50 joint venture with Chinese hospital operator Jinxin. Ramsay hopes to finalise its partnership with Jinxin early next year. No doubt Australian corporates will continue to partner with experienced locals as they launch into unfamiliar markets - at least now there is regulatory flexibility on the terms of the venture.

SFTZ

A number of opportunities have been presented in the Shanghai Free Trade Zone (SFTZ), which we expect to become a focal point of Australian investment as a result. For example in the SFTZ Australian law firms can tie up with Chinese law firms, there will be new access for investment in value-added telecommunications services with improved foreign equity limits, and maritime transport service suppliers can establish wholly owned ship management enterprises.

Financial Services

The outcomes achieved for financial services are much more positive than many commentators had expected. Australian banks and financial services companies have gained enhanced access to the China's growing domestic market. The streamlined licensing requirements and approval process will allow Australian banks and financial institutions to operate on a more level playing field.

This is an important step towards opening up China's services market more deeply and broadly. While we do not think this will result in Australian financial service providers going head to head with domestic Chinese businesses in their own markets, we do expect Australian banks, insurers and financial service providers to take advantage of the concessions to access China's emerging service industries before they are offered to competitor nations.

There are also encouraging commitments on transparency, regulatory decision-making and streamlining of licencing in China. A financial services committee will be established facilitating cooperation between Chinese and Australian financial regulators. ASIC and the China Securities Regulatory Commission have agreed to strengthen cooperation and improve mutual understanding of Australia's and China's respective regulatory frameworks. Both countries have identified a range of areas for further cooperation.

Along with the simultaneous announcement that an official renminbi clearing bank will be established in Sydney, this will underpin ever greater flows of trade and investment between Australia and the fast growing economies of China and Asia.

The SFTZ is an important testing ground for further liberalisation of financial services, including a greater role for foreign banks and financial service providers. With two of the four major Australian banks established in the SFTZ (ANZ and Westpac), Australia is placed to take early advantage of opportunities provided by China's opening up. Reforms within the SFTZ are, however, moving slowly with Chinese authorities continuing to release further details.

Private Equity

One of the less expected announcements today is the cooperation between Australia and China in relation to the export of Australia's leading PE fund services. Australian PE funds have outperformed the S&P/ASX 300 Index on a public market equivalent basis over the last ten years by a significant margin demonstrating that the asset class is a long-term driver of returns. Australian PE funds also play an important role in the innovation system. These same Australian PE funds being able to capitalise on future investment opportunities in China directly and through their portfolio investments will deliver long term benefits to China and Australia

Education

China is already the Australian education sector's largest export market (worth $4 billion in 2013). The sector has received a real boost from ChAFTA.

Australian institutions will have more opportunity to set up an establishment in China to build their brand and network. Specifically, all CRICOS-registered Australian higher education providers will be listed on the Chinese Ministry of Education's website within one year of ChAFTA entering into force. This increases the number of Australian institutions on the website from 105 to 182, with the potential for further additions. This website provides Chinese students and employers with quality and fraud assurance, and listed institutions were favoured by 88% of Chinese higher education students in 2013.

Additionally, improved mutual higher education qualification recognition and enhanced mobility of students, researchers and academics at school, tertiary and research levels are expected to be agreed in the form of memoranda of understanding.

Legal services

Close to our heart is the announcement that Australian law firms will be able to tie up with Chinese law firms in the SFTZ. There will also be various legal services cooperation initiatives, a number of which flow from our input and submissions. We are delighted with the outcome and welcome the competition which vindicates our strategy. We'll continue to use our first mover advantage to facilitate a stronger long-term relationship between Australia and its largest trading partner.

As China moves from manufacturing, to services, to integrated business models, people mobility will be a key issue. Integrated businesses (such as our own) must have more flexibility. The opportunities presented by ChAFTA will only be available in the short term. As of today, all Australian businesses will be a better position than any of our global competitors. However the concessions given will soon become the norm for other countries. It's for Australian businesses to use their first mover advantage.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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