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Insight into the Swiss-Sino Free Trade Agreement – a path to new business opportunities

Das Freihandelsabkommen zwischen der Schweiz und China tritt am 1. Juli 2014 in Kraft. Der Beitrag gibt konkrete Beispiele der Zollerleichterungen und zeigt chinesischen und Schweizer Exporteuren Möglichkeiten auf, vom Netzwerk bestehender Freihandelsabkommen zu profitieren. Dabei wird auch auf gewisse Besonderheiten und Schwierigkeiten des chinesischen Marktes hingewiesen, welche trotz des Freihandelsabkommens bestehen bleiben dürften.

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1 The Free Trade Agreement (FTA) between China and Switzerland

[Rz 1] The FTA between the People's Republic of China (PRC) and Switzerland (CH) will (eventually) lead to an abolishment or a substantial reduction of import customs duties for Swiss and Chinese products being imported into China or Switzerland respectively. In other words, goods originating from either country may be exported and sold in the other country without any import taxes (or at least only reduced taxes) being levied. Moreover, the FTA provides for some liberalization of exchange of services and, in principle, an easier market access for service providers. As regards the protection of intellectual property rights, the FTA mainly confirms the application of already existing agreements (such as the Agreement on Trade Related Aspects of Intellectual Property Rights of the WTO, TRIPS) with only some areas enjoying further protection (such as the area of copyrights to audio media under the World Intellectual Property Organisation (WIPO)). This article will focus on the customs tariff reductions.

[Rz 2] Experiences with other free trade agreements show that trade volumes rose by an average of 10.5% per annum and Swiss direct investments abroad increased by 18% yearly (i.e. 5–6% more than without a FTA). The FTA with China is thus also expected to boost direct investments between China and Switzerland and simultaneously facilitate market access for Swiss and Chinese products and service providers.

2 Scope of the FTA: Free trade in Goods and Services

[Rz 3] The FTA applies to the customs region of Switzerland (including Liechtenstein) and China (not including Hong Kong, Macao and Taiwan).

[Rz 4] The goods being exempted or benefitting from reduced import duties are specified in a comprehensive catalogue (i.e., Annex I to the FTA), which follows the nomenclature of the WTO Harmonized Commodity Description and Coding System of 2007 for description, classification and coding of all sorts of goods («**HS**», accessible under the following link: http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=en).

[Rz 5] While Switzerland will dismantle import duties on almost all (99.7%) products originating from China from day one of the entry into force of the FTA, with only very few reservations for agricultural products where tariffs will remain, Chinese import-taxes on most (96.5%) Swiss products will (merely) be reduced gradually within rather long transition periods ranging from 5 up to 15 years.

3 Few examples of tariff reductions

[Rz 6] In 2013, Swiss exports to China amounted to approx. CHF 8,8 billion (i.e., only 3.7% of all Swiss exports).[1] According to recent trade statistics, chemical and pharmaceuticals products are the main products being exported (roughly 40% of all exports), followed by the (high-tech) machinery and electronics industries (approx. 17% of all exports), clock and watch industry (approx. 10% of all exports), precision instruments (including medical instruments and appliances amounting to approx. 8%) and finally foodstuff (mainly typical Swiss products such as chocolate and cheese but also rather exotic product categories such as coffee and tobacco) and jewellery (other than watches, each with a share of approx. 5% of all exports).[2]

[Rz 7] Not surprisingly, the imports from China exceeded the Swiss exports by roughly CHF 3 billion, totalling CHF 11,4 billion[3] (equal to 5.5% of all Swiss imports) with machinery (and parts thereof), textiles, tools for watchmaking industries and products of the chemical and pharmaceutical sectors being the primary import product categories.[4]

[Rz 8] In view of the main product categories identified by these statistics, the charts below shall illustrate how the FTA may impact the trading of goods between China and Switzerland:[5]

1 Swiss exports to the EU reached approx. USD 143 billion in 2012 (source: EU Commission Trade report: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113450.pdf.

2 Source: Swiss Federal Customs Administration (http://www.news.admin.ch/NSBSubscriber/message/attachments/32356.pdf).

3 Swiss imports from the EU reached approx. USD 183 billion in 2013 (source: EU Commission Trade report: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113450.pdf).

4 Source: Swiss State Secretariat for Economic Affairs and message of the Federal council to the Federal Council to the Free Trade Agreement: http://www.seco.admin.ch/themen/00513/02655/02731/04118/index.html?lang=de.

5 China levies its customs duties on the basis of the value of the good imported. The valuation method is CIF (Cost, Insurance and Freight) meaning that the import duties are calculated on the basis of the complete shipping value (which includes the value of the imported goods, the cost of freight, and the cost of insurance).

Chinese Customs duties (applying to goods exported from Switzerland to China)			
		Import customs duty in PRC	
Tariff Line (HS)	**Product description**	**Before FTA**[5]	**After entry into force of FTA**
Chapter 2: Meat	Meat of bovine animals, salted, inbrine, dried or smoked	25%	Gradual tariff elimination within 5 years
	Cuts of unboned swine hams & shoulders, salted, in brine, dried or smoked	25%	No reduction
Chapter 4: Dairy products	Milk & cream with different fat rates, not concentrated or sweetened	15%	Gradual tariff elimination within 10 years
	Yogurt	10%	Gradual tariff elimination within 12 years
	Fresh, grated/powdered or processed cheese (except blue cheese)	12%	Gradual tariff elimination within 10 years
Chapter 9: Coffee	Coffee (not roasted)	8%	Gradual tariff elimination within 5 years
	Coffee (roasted)	15%	Gradual tariff elimination within 10 years
Chapter 19: Cocoa	Chocolate, etc., in blocks, slabs or bars, *not filled*	10 %	0% as from entry into force
	Chocolate, etc., in blocks, slabs or bars, *filled*	8%	Gradual tariff elimination within 5 years
Chapter 20: Preparations of fruits, etc.	Jams, fruit jellies, marmalades, etc.	30%	• *homogenized*: gradual tariff elimination within 5 years • *non-homogenized* of citrus fruits: 0% as from entry into force
Chapter 24: Tobacco	Cigars, cigarillos and cigarettes, of tobacco or of tobacco substitutes	25%	No reduction
Chapter 30: Pharmaceutical products	Various medicaments (including antibiotics)	6%	Gradual tariff elimination within 5 years
	Medicaments containing insulin (but not antibiotics)	5%	0% as from entry into force
Chapter 84: Machinery	Shaping Machinery	15%	Gradual tariff elimination within 10 years
	Other packing and/or wrapping machinery	10%	Gradual tariff elimination within 5 years
Chapter 90: medical instruments	Medical instruments, including mechano-therapy appliances, etc.	4%	Gradual tariff elimination within 10 years
Chapter 91: Clocks and watches	Wrist-watches (different types)	11–16%	Depending on type of watch, gradual tariff elimination or mere reduction within 10 years; some tariffs will only be reduced to 5–8% but not abolished altogether

[Rz 9] In contrast to this rather complex chart which confirms that for most Swiss products with export potential, Chinese custom duties will merely be reduced (or abolished) after a rather long transition period, the following chart listing the tariffs imposed on Chinese imports to Switzerland shows a more favourable picture of Chinese products:[6]

Swiss Customs duties (applying to goods exported from China to Switzerland)

Tariff Line (HS)	Product description	Import customs duty in CH: Before FTA	Import customs duty in CH: After entry into force of FTA
Chapter 2: Meat	Meat of swine, salted, in brine, dried or smoked, hams, shoulders and cuts thereof, with bone of wild boar	Approx. USD 59 / 100 kg	0 as from entry into force
	Meat of bovine animals, salted, in brine, dried or smoked (within the limits of the WTO tariff quota)	Approx. USD 422 / 100 kg	Approx. 250 / 100 kg
Chapter 4: Dairy products	Milk & cream with different fat rates, not concentrated or sweetened (within the limits of the WTO tariff quota)	Approx. USD 20–1450 / 100 kg	No or only a very limited tariff reduction
Chapter 24: Tobacco	Cigars, cigarillos and cigarettes, of tobacco or of tobacco substitutes	Approx. USD 800–1,500 / 100 kg	Approx. USD 650–1280 / 100 kg
Chapter 50/51: all silk/wool and other textiles	All sorts of textiles (silk, cotton and/or other woven fabrics) and clothing, footwear, etc.	Approx. USD 23–300 / 100kg	0 as from entry into force
Chapter 82: Tools	Watchmakers' tools	Approx. USD 60 / 100kg	0 as from entry into force
Chapter 84/85: mechanical and electrical machinery	All sorts of machinery and mechanical appliances, electrical equipment and parts thereof, including photovoltaic cells whether or not assembled in modules or made up into panels	Approx. USD 20–130 / 100kg	0 as from entry into force
Chapters 86–89: various vehicles	Vehicles, railways, aircrafts, vessels and associated transportation equipment	Approx. USD 8–80 / 100kg	0 as from entry into force

[Rz 10] In summary, Switzerland has only made very few reservations for selected dairy and tobacco products, where import duties remain. On the other hand, China made far-reaching re-

[6] Note that contrary to most other countries (including China), Switzerland levies its customs duties in proportion to the gross weight of the good (but not its value).

servations with only very few Swiss products enjoying a zero tax tariff from day one of the entry into force of the FTA. China argued that those (long) transition periods were justified because of the generally higher Chinese customs duty on average (medial of 8.7%, compared to 2.4% in Switzerland).[7] It goes without saying that China had a much higher leverage and bargaining power than Switzerland and the said differences in tariff reductions should not be seen as a failure of the Swiss negotiation team.

[Rz 11] As confirmed by the above charts, most Swiss producers and manufacturers will need to be (much) more patient than their Chinese counterparts before they may enjoy substantial tariff reductions. Indeed, given that the entry into force of the FTA is on 1 July 2015, Chinese exporters and producers should have their supply channels revisited now.

[Rz 12] Swiss exporters should consider that several classic Swiss products, which generally feature a high potential for export such as cheese and or dried beef meat, might not (yet) be in high demand among Chinese customers.

4 Reservations and exclusions under the FTA: Non abolishment of other national taxes

[Rz 13] Like other free trade agreements, the FTA provides for a general reservation as regards anti-dumping measures or countervailing duties applied in accordance with the GATT and WTO agreement. The FTA also provides for a general reservation to temporarily suspend the concessions if those prove to be detrimental to the domestic industry.

[Rz 14] It is further important to note that the FTA does not have an impact on the other (internal) taxes levied on imported goods, such as value added taxes (VAT) and, regarding China, the consumption tax (CT). Indeed, Switzerland and China both levy VAT on imports at the ordinary tax rate of 8% (respectively 2.5% for some products such as foodstuff) for imports into Switzerland and 17% (respectively 13% for certain products such as basic products, e.g. most agricultural products, water, heating, coal gas, natural gas, books, newspapers, magazines and many others) for imports into China. Exports from both countries are, as a rule, exempted from VAT in the country exporting. The basis for calculation of the VAT is – in rather simple terms – the value of the good, i.e. what was paid by the recipient (according to the Cost, Insurance and Freight Method (CIF-Method), cf. fn. 6). Exporters from both countries may, as a rule and under certain circumstances, get a refund on the VAT paid to their domestic suppliers of goods for export.

[Rz 15] The consumption tax is a particularity of China, which is levied on imports of various (luxury) consumer goods, amongst others and as far as relevant for Switzerland's exports: alcohol, tobacco and jewellery, including high-value watches. The tax rates vary greatly ranging between 1% and 45%, calculated as per the above mentioned CIF-Method. CT is levied at 20% on high-end watches, one of the Swiss products with high export potential. The tax rate even reaches 30% on cosmetics, including «high-end / luxury» skincare products. According to a recent announcement by the Chinese government, the CT is likely to be somewhat increased and expanded to other product categories rather than reduced or abandoned in the future[8].

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7 Source: WTO tax tariff profiles of China and Switzerland.

8 http://www.bloomberg.com/news/2013-08-28/china-to-place-consumption-tax-on-more-luxury-goods-xinhua-says.html

[Rz 16] Due to the high CT, most Chinese sales of luxury goods are conducted overseas. Indeed, a recent statistic confirmed that only 37% of all Chinese purchases of high-end watches are domestic whereas 59% are overseas. Imports of high-end watches from Switzerland to China have dropped by approx. 12% from 87,894 units in 2011 to 77,771 units in 2012 and were only at 10,428 units in the first quarter of 2013.[9] Of course, part of this reduction might also be the result of the Chinese fight against corruption and the government's recent call to its officials for frugality. The announced increase or expansion of the CT by the Chinese government could lead to a negative impact which may further outbalance the reduced or abandoned import taxes under the FTA.

5 The Rules of Origin: new business opportunities by way of mutual market access beyond the territory of Switzerland and China

[Rz 17] To benefit from the tariff reduction under the FTA, a product must qualify as originating from China or Switzerland.

[Rz 18] According to the FTA, this is not only applicable to products which are either:

i. wholly sourced in either China or Switzerland (such as for instance unprocessed agricultural products grown and harvested in either of these countries); or
ii. produced in China or Switzerland with materials/components originating exclusively from one or both countries (such as e.g. machinery and/or chemical products entirely manufactured and assembled in one country);
iii. but also to those produced with materials/components originating neither from Switzerland, nor from China, provided the goods have undergone a «substantial transformation» in either Switzerland or China.

[Rz 19] The circumstances resulting in a transformation/alteration being treated as «*substantial*» will vary depending on the product category; they are described in more detail in the appendixes to the FTA (accessible under the following link: http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=de&download=NHzLpZeg7t,lnp6I0NTU042l2Z6ln1acy4Zn4Z2qZpnO2Yuq2Z6gpJCGdX13hGym162epYbg2c_JjKbNoKSn6A--). As a rule, mere auxiliary processing such as (re-)packaging, bottling or filling, mixing or assembling does not suffice. The processing must either (i) lead to a change of the tariff code under the HS system; or (ii) create an added value (compared to the former work's price) ranging between 40–60 %, depending on the product, with 60% being the rule.

[Rz 20] A characterization as a «Swiss product» might be of particular interest to Chinese exporters, for reasons going beyond mere marketing concerns. Indeed, even though Switzerland is not part of the European Union (EU) and the FTA does thus not automatically grant customs free access for Chinese products to the EU market, it must be noted that Switzerland has established a broad network of bilateral agreements with the EU (and many other countries), providing for similar rules of origin as under the FTA. A product qualifying as a «Swiss product» from the FTA's point of view is thus also likely to be qualified as a «Swiss product» also under other free trade agreements which Switzerland has entered into with the EU and other countries.

[9] China Daily, 19 June 2013: http://www.chinadaily.com.cn/business/2013-06/19/content_16638320.htm(Source: Fortune Character Institute).

[Rz 21] By substantially processing their products in Switzerland, Chinese suppliers and exporters may thus, under certain circumstances, (i) get customs-free access to the EU market and other countries with which Switzerland has a free trade agreement; and/or (ii) find a way of «circumventing» anti-dumping measures as often imposed against Chinese products by the EU, such as the recent sanctions by the EU against Chinese solar panels (now abolished). Of course, it remains to be seen in each particular case whether such structure makes sense in view of the higher production and manufacturing costs in Switzerland.

[Rz 22] Likewise, China has a free trade agreement with the Association of Southeast Asian Nations (ASEAN)[10] that has been in force since 1 January 2010. By structuring their manufacturing and distribution chain through China and again subject to the product(s) being altered in a way that will qualify them as «Chinese products», Swiss exports and/or manufacturers may gain customs free access to the signatory countries of the ASEAN free trade agreement. This might be of particular interest for Swiss exporters since to date, Switzerland has only signed a free trade agreement with one ASEAN country, namely Singapore.[11]

[Rz 23] The ASEAN free trade agreement might proof beneficial for both Chinese and Swiss company also for the following reason: Production costs in China are increasing year by year, resulting in manufacturing operations being relocated from China to those ASEAN countries sufficiently developed but still offering cheaper manufacturing facilities, such as Vietnam, Indonesia, Malaysia, the Philippines and Thailand resulting in China turning from a production country into one of Asia's leading consumer markets.

[Rz 24] By relocating or setting-up new manufacturing operations in the ASEAN member countries, Chinese and foreign companies may manufacture their (semi-finished) products at low(er) costs. These (semi-)finished goods could then be imported to China at preferential import tariffs under the ASEAN free trade agreement. If substantially processed or altered in China, meeting the «rules of origin» requirements under the Sino-Swiss FTA, these (semi-)finished products could then be onward exported to Switzerland at again reduced tariffs. By substantially alter the same products in Switzerland, Chinese and any other company may even distribute them into the EU free trade zone at reduced customs duties. As mentioned above, this linking and accumulation of free trade agreements is subject to the products being substantially processed in each country and meeting the «rules of origin» requirements under each agreement.

6 Other trade facilitation measures: Cooperation in elimination of Technical Trade Barriers (TBS) as well as Sanitary and Phytosanitary Measures

[Rz 25] When doing business in China, factors other than the import tariffs might be more burdensome for foreign businessmen and investors, such as the need for government approvals and business licences for any kind of business activity. Indeed, the mere fact of setting up a company in China requires several gouvernmental approvals. The procedures for the set-up are often not very clear and may be unpredictable, resulting in a time-consuming and costly undertaking.

[10] ASEAN consist of the following 10 member states: Brunei Darussalam, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam.

[11] FTAs with Vietnam, Malaysia and Thailand are currently in negotiations.

[Rz 26] Also, exporters to China should be aware that China upholds broad national standards which products must meet (and accordingly tested) before they may be marketed, imported or used for any commercial purpose in China. Depending on the product category, there are different authorities in charge, with sometimes overlapping responsibilities. Moreover, the requirements to be met and the testing procedures are often not very clear. For instance, when joining the WTO in 2002/3, China introduced the China Compulsory Certification mark («**CCC-mark**»), a national safety and quality mark applying to many electronic and telecommunication products, medical devices and consumer appliances. If a product is listed in the CCC-mark catalogue, the said product must first be tested and approved before it may be marketed, imported or used on the Chinese market. However and as already mentioned, the requirements to be met and the testing procedures are often not very transparent. In any event, they consume time and resources, often with unpredictable results. One of the main concerns for most Swiss exporters of high-tech and/or medical appliances is the requirement to disclose sensitive technical know-how and trade secrets to the competent authorities. Such national approval procedures have even been tightened recently, especially after several free trade agreements were signed. For some products working on the basis of computer software, the Chinese authorities may also require full disclosure of the source code.

[Rz 27] Even though the FTA also foresees cooperation in these areas and even a mutual recognition of standards issued by international organisation, such as the International Standardization Organization (ISO), the International Electrotechnical Commission (IEC) and others, it remains to be seen how these general and abstract undertakings are implemented in practice. A promising sign is that China and Switzerland have recently agreed to set-up a joint committee with experts from either country in this regard.

[Rz 28] In view of the above and whilst the FTA should reciprocally facilitate market access for Swiss and Chinese products to the Swiss and Chinese market, Swiss exporters of high-tech and medical appliances should probably not be too optimistic yet, especially in view of the remaining approval mechanisms in China.

7 Conclusion

[Rz 29] The FTA is more favourable to Chinese exports with broader tariff concession applying to Chinese exports than to Swiss exports. Most Swiss products only benefit from reduced (or zero) customs duties after transition periods ranging between 5 and 15 years. Swiss exporters that consider entering the Chinese market should in any event be aware of some particularities of the Chinese markets, such as the internal Consumer Taxes on luxury goods, the need to obtain business licenses and permits for virtually all business activities in China, national product standards and certification requirements and the often not very transparent approval systems. It remains to be seen (not to say hoped for) whether the FTA between China and Switzerland will also lead to some simplification in these areas and will indeed boost trades between Switzerland and China.

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