

# China and Australia Conclude Landmark Free Trade Agreement Negotiations

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## Summary

On November 17, 2014, **China and Australia completed their negotiations for a China-Australia Free Trade Agreement (“ChAFTA”)** by signing a Declaration of Intent which contained the **essential elements of the free trade deal** and commits both countries to draft the legal text of the agreement for signature at a later date. This agreement ends almost a decade of free trade negotiations between China and Australia. The ChAFTA is significant because it will initially lower and ultimately eliminate tariffs on a wide range of exports between the two countries boosting bilateral trade between the world’s second largest economy and a significant U.S. free trade partner in Asia.

## “Best Ever” Trade Deal with China

Australian Prime Minister, Tony Abbott, described ChAFTA as the best ever between China and a Western country. ChAFTA builds on Australia’s trade deals with Korea and Japan which account for Australia’s three largest export markets. In the short term, ChAFTA will consolidate Australia’s competitive position in the resources and energy market by phasing-in zero tariffs on products including iron ore, coal, gold, and crude petroleum oils which comprise 4 of the top 5 leading exports (by value) from Australia to China.

ChAFTA will also reduce and eliminate tariffs on a wide range of Australia-produced agricultural products, foodstuffs and wine as Australia attempts to transition in the longer term to what commentators have described as a “mining to dining” export economy.

China has also offered Australia its best ever services commitments in an FTA (other than China’s agreements with Hong Kong and Macau) which includes new or significantly increased market access for Australian banks, insurers, securities and futures companies, law firms and professional service suppliers, education service exporters, as well as health, aged care, construction, manufacturing and telecommunication services businesses in China.

Importantly, ChAFTA will contain an Investor Dispute Settlement Mechanism (IDSM) which generally contain administrative, judicial and/or arbitral protections that enable companies to invest in China

with greater confidence because an IDSM permits compensation claims against alleged government regulation that negatively impacts investments.

## Promoting Chinese Exports and Investment in Australia

ChAFTA will promote further Chinese investment in Australia by, for example, raising the Foreign Investment Review Board (FIRB) screening threshold for private companies from China in non-sensitive areas from AS\$248 million to AS\$1,078 million. However, FIRB will continue to screen proposed investments by Chinese State Owned Enterprises regardless of value.

ChAFTA will also increase China's exports to Australia, in particular, of telecom equipment and parts, computers, clothing, domestic furniture and children's goods which comprise China's top 5 exported products to Australia.

## Potential Effect on U.S. Trade

The potential impact of ChAFTA on U.S. trade cannot be determined at this stage. In general, recent economic studies suggest that the effect of "hub-and-spoke" free trade agreements where one country, in this case, Australia, acts as a "hub" by establishing two different bilateral FTAs with countries that retain their trade barriers on each other's goods, i.e. U.S. and China, is of positive and significant effect on bilateral trade among all three countries. However, these economic studies do not incorporate the rules of origin ("ROO") which are an essential part of FTAs because they define the conditions under which the importing country will view a product as originating in an FTA partner.

Without the full text of the ROO for ChAFTA, it is not possible to indicate the potential for more Australian manufacturing using U.S.-origin components that would otherwise attract high duty if exported directly to China but may not if incorporated into goods in Australia. However, based on the proposed tariff-reduction on imported Chinese telecom equipment and parts, and computers, ChAFTA does suggest the potential for increased manufacturing in Australia for the U.S. market using Chinese components that could not otherwise be imported directly into the U.S. without paying significant duty.

Under the ROO of the U.S.-Australia FTA, Chinese-origin components would need to satisfy any applicable tariff-shift and/or meet any applicable regional value content. Alternatively, those Chinese-origin components that did not satisfy an applicable tariff-shift could not comprise more than the *de minimis* level of 10% of the adjusted value of the good.

Finally, ChAFTA offers the potential for U.S. investors to structure their investments in China using an Australian entity by taking into account the final text of ChAFTA's IDSM because there is currently no investor protection offered by a bilateral investment treaty between the U.S. and China.

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National Law Review, Volume IV, Number 329

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