U.S. Signs Phase One Trade Deal with China

Karen M. Sutter
Specialist in Asian Trade and Finance

Updated January 17, 2020

President Trump on January 15, 2020, signed a phase one trade agreement with the Chinese government that is intended to resolve some of the trade and investment issues the Administration raised in March 2018, pursuant to Section 301 of the U.S. Trade Act of 1974. Including appendices, the agreement is 96 pages and covers some aspects of intellectual property (IP) (Chapter 1), technology transfer (Chapter 2), agriculture (Chapter 3), financial services (Chapter 4), macroeconomic policies and exchange rates (Chapter 5), trade purchases (Chapter 6), and dispute resolution (Chapter 7). Approximately one-fourth of the agreement addresses IP commitments. Discussion of technology transfer is confined to two pages.

Some Members assess the deal to be a first step in a longer effort to address U.S. trade concerns with China. Many observers call it a short-term truce, noting it falls short of the Administration's goal of a comprehensive settlement. The most significant potential gains for the United States appear to be in agricultural market access—an area that is important to the U.S. economy but falls outside the scope of the 301 investigation—suggesting to some that China may have directed talks away from sensitive IP and technology transfer issues by offering other commitments of interest to the United States. Chinese tariffs on U.S. agricultural products, however, remain largely in place, potentially mitigating the effects. China's potential use of selective exemptions—rather than across the board tariff reductions—may give it leverage in future potential talks.

Section 301 action emerged from a building of frustration in the U.S. government and business community over Beijing's perceived unwillingness to acknowledge and address key commercial concerns. In its March 2018 Report on the findings of its Section 301 investigation, the Administration identified four concerns: (1) forced technology transfer, (2) cyber-enabled theft of U.S. IP and trade secrets, (3) discriminatory and nonmarket licensing practices, and (4) state-funded strategic acquisition of U.S. assets. As a result, the United States imposed four rounds of tariffs on Chinese goods. China responded with four rounds of counter tariffs. Negotiations also sought to address President Trump's concerns about the trade balance and incorporate Chinese offers in unrelated areas, such as financial services.

Congressional Research Service
7-....
www.crs.gov
IN11208

Overview of Key Issues

Tariffs. The United States agreed to delay tariffs scheduled to take effect December 15, 2019, that would have affected approximately $160 billion worth of imports from China, particularly consumer electronics. For U.S. tariffs enacted on September 1, 2019, the United States, as of February 14, 2020, will cut the tariff rate from 15% to 7.5%. The remaining U.S. tariffs enacted since March 2018 will remain in effect. According to a December 15 announcement by China's State Council Tariff Commission, China has agreed not to proceed with its own scheduled December tariff increases (Appendix II) and will extend exemptions for autos, auto parts, and some pork and soybean imports it announced in September; earlier tariffs, including tariffs China implemented on September 1 (Appendix I), remain in effect. China may use a case-by-case tariff exemption process to meet its purchase obligations rather than reducing tariffs (See CRS Report R45949, *U.S.-China Tariff Actions by the Numbers*.)

IP. China's commitments on counterfeiting, patent and trademark, and pharmaceutical protections reflect domestic actions China already took and similar language from earlier commitments, according to former U.S. government negotiators. The agreement focuses more on enforcement—penalties and legal recourse in the event of IP theft—rather than prevention of theft. China's new Foreign Investment Law imposes legal penalties for officials who disclose trade secrets, but the agreement is silent on China's policies and practices that encourage theft and the ways in which the government directs, encourages, and facilitates technology transfer.

Technology Transfer. China committed not to force technology transfer but this provision may be difficult to enforce. The new Foreign Investment Law forbids forced technology transfer, but Chinese officials frequently state that foreign firms willingly give their technology. Chinese industrial policies, such as *Made in China 2025* and the national semiconductor policy, remain in force, and the Chinese government can leverage informal powers. The U.S. business community has voiced concerns that China is doubling down on industrial policies, including recapitalization of government funds and the launch of a new plan and $21-billion government fund to support advanced manufacturing. In 2020, Chinese officials will be adjudicating the country's next Five-Year Plan (2021-25) and new industrial policies.

Resolution of core U.S. concerns on IP, technology transfer, industrial policies, and state subsidies remain, for the most part, left to potential future phase two talks. These U.S. concerns center on what is perceived by U.S. stakeholders to be a web of reinforcing Chinese government plans and industrial policies that offer preferences and support for Chinese firms, both domestically and overseas. Often, non-Chinese firms are required to partner with and transfer technology, proprietary knowhow, and core IP to Chinese entities. The Chinese government may seek to further delay action on these contentious issues by prolonging phase two talks. The Preamble of the January agreement does not define "mutually agreed trade and investment concerns," potentially allowing China to debate the scope of phase two. Failure to resolve technology transfer issues could intensify congressional debate on the U.S. approach and harden the U.S. posture vis-à-vis China. (See CRS In Focus IF11284, *U.S.-China Trade and Economic Relations: Overview*.)

Other Issues to Watch

Authoritative Versions. The agreement states that the English and Chinese versions are equally authentic and that both official Chinese and U.S. trade data will be used to determine whether Chapter 6 trade purchases have been implemented. These provisions could open areas of potential disagreement on commitment terms, particularly if terms do not precisely correspond in both languages. The deal is silent on how trade purchases will be valued and whether they could include China's retaliatory tariff rates, many of which remain high.

Purchases. China committed to purchase at least $200 billion above a 2017 baseline amount of U.S. agriculture ($32 billion), energy ($52.4 billion), manufacturing goods ($77.7 billion), and services ($37.9 billion) between January 1, 2020, and December 31, 2021. China caveated that purchases will be market-based, allowing flexibility to fall below targets. China's purchases may not generate new demand and could displace other trading partners, prompting the European Union to consider a World Trade Organization challenge.

Currency. The Administration negotiated a currency commitment, similar to Chapter 33 of the approved U.S.-Mexico-Canada Agreement, for market-determined exchange rates, as well as transparency and reporting requirements.

Financial Services. China committed to selectively reduce some foreign equity limits and restrictions, but arguably could curtail implementation through licensing and operating requirements. China committed to accept and review the license applications of Mastercard, Visa, and American Express but did not commit to approving these companies' applications.

Dialogue. The agreement creates a Trade Framework Group led by the USTR and a Chinese Vice Premier that will meet every six months, resumes regular bilateral macroeconomic meetings led by the U.S. Treasury Secretary and a Chinese Vice Premier, and mentions technical discussions on unresolved IP and agricultural issues.

Implementation. Some commitments in agriculture and financial services have specific phase-ins. IP commitments appear to be more open-ended and are not linked to corresponding changes required in existing Chinese laws, regulations, rules, practices, and industrial policies.

Enforcement. An enforcement mechanism will allow 90 days to resolve issues, after which either side can take proportionate action. Snapback tariffs may be difficult to justify without specific benchmarks and timelines. The agreement is silent on what other retaliatory measures could be adopted.