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U.S.-China Phase One Trade Deal

On January 15, 2020, then-President Donald J. Trump signed a trade agreement with Vice Premier Liu He of the People's Republic of China (PRC or China) that sought to resolve some long-standing U.S. government and business concerns about China's unfair trade, investment, and technology practices. The negotiations sought to address U.S. concerns and actions, including imposing tariffs, that the U.S. government took under Section 301 of the Trade Act of 1974 (19 U.S.C. §2411). The deal is called the *Phase One* agreement because it was to be the first of subsequent agreements to address key U.S. concerns. Many experts assess that PRC negotiators pushed most issues identified by the U.S. Trade Representative (USTR) to future talks, but the deal includes several PRC commitments that were difficult for the USTR to secure and could help shape U.S. trade policy toward China going forward.

Section 301 Context

In August 2017, the USTR, encouraged by many in Congress and some companies, invoked Section 301 in an effort to address China's industrial policies whose stated objective is to seek global commercial and technology leadership through discriminatory trade, investment, and technology practices. The USTR's efforts reflected a U.S. government and industry view, coalesced over 15 years of efforts in working directly with the PRC government, that it was unwilling to acknowledge and address U.S. concerns and priorities. Against this backdrop, of growing concern to U.S. officials and firms were China's perceived efforts to intensify these practices—including new *Made in China 2025* industrial policies—and an uptick in reports of corporate espionage, tightening of information and data controls (and pressure on U.S. firms to abide by these controls), and use of economic coercion and forced technology transfer. U.S. stakeholders assessed that China was deploying a web of mutually reinforcing government policies that offered preferences and support for PRC firms and some foreign firms willing to commit to certain terms, such as the transfer of technology, trade secrets, and core intellectual property (IP) to PRC entities in order to operate and expand in China. Also of concern was a sharp uptick in PRC firms' acquisition (often state-funded) of foreign firms in strategic sectors (e.g., aerospace and semiconductors).

While the USTR had prevailed in several dispute cases or elements of cases against China in the World Trade Organization (WTO), many experts assessed that most PRC practices at issue were systemic and pervasive and could not be resolved with the WTO's case-by-case dispute approach. Many U.S. concerns fell in gray areas of WTO rules or outside the WTO's purview. Prior experience with PRC industrial policies (e.g., steel, solar panels, and telecom equipment) led U.S. officials to seek countermeasures to address China's industrial policy in its early stages before an export existed, concerned that trade remedies such as antidumping were reactive and used too late in a product cycle to prevent China from securing a dominant global market position, particularly given the broad scope and potential effect of China's policies.

Section 301 Findings and Actions

In March 2018, the USTR released a report on the findings of its Section 301 investigation. The USTR concluded that China engages in forced technology transfer, cyber-enabled theft of U.S. IP and trade secrets, discriminatory and nonmarket licensing practices, and state-funded strategic acquisitions of U.S. assets. Section 301 allows for a range of counter-measures while requiring the USTR to negotiate with a country of concern. Some U.S. agencies, such as the Departments of Commerce and the Treasury, did not use other authorities under their purview, leaving the USTR to leverage tariffs. Since 2018, the USTR has imposed four rounds of tariffs at a rate of 7.5% to 25% on an estimated $370 billion worth of U.S. imports from China. China has countered with four rounds of tariffs on $110 billion worth of U.S. products. Both sides have granted some exceptions, but most tariffs remain in effect. Some trade may avert U.S. tariffs through *de minimis* trade—a practice that involves packaging products into low value shipments to avoid duties and one that some in Congress have sought to curtail.

Phase One Agreement: Select Provisions

The deal left the resolution of many concerns about IP, technology transfer, industrial policies, and state subsidies to future talks, but contains PRC commitments in these areas:

IP. Defines confidential business information as part of trade secrets subject to protection. Misappropriation to include electronic intrusions and unauthorized disclosure, including by government officials and third-parties. Burden of proof shifts to the accused party if a rights holder shows that the accused party had access or an opportunity to obtain a trade secret, the information used by the accused party is materially the same as that of the rights' holder, evidence that a trade secret has been or risks being disclosed, or other misappropriation evidence. Requires pharmaceutical patent extensions if there are unreasonable delays in granting patents.

Technology Transfer. Prohibits forced technology transfer, an activity the PRC government had denied. Requires that firms operate freely without pressure to transfer technology. Transfer or licensing of technology should be on market terms that are voluntary and reflect mutual agreement. May not require technology transfer in relation to acquisitions, joint ventures, or other transactions. May not require or pressure, formally or informally, technology transfer, or the use or favoring of a technology, including to show conformity with regulatory requirements or receive administrative approvals or licenses, to operate in the market, or to receive any advantages.

Foreign investment and acquisitions: Prohibits support of outbound investment to target foreign technology and capabilities in industries prioritized in China's industrial plans.

Currency: Similar to Chapter 33 of the U.S.-Mexico-Canada Agreement, requires market-determined exchange rates, and transparency and reporting requirements.

Negotiations: Creates a Trade Framework Group led by the USTR and a PRC Vice Premier to meet every six months. Talks to be held on unresolved IP and agricultural issues.

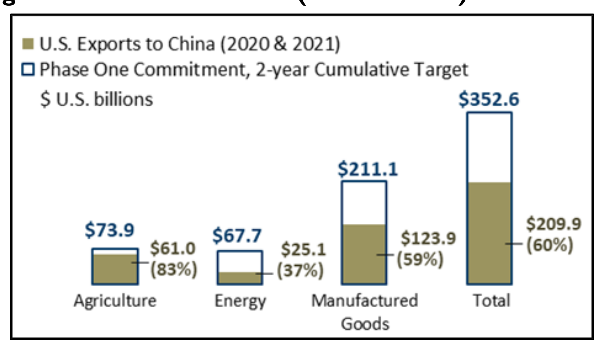
Dispute Resolution. Allows 90 days to resolve issues, after which either side could take proportionate unspecified action.

Other *Phase One* Commitments

China also made commitments in agriculture and financial services unrelated to Section 301 concerns, possibly to avoid commitments related to its industrial and technology practices. In agriculture, China committed to expand access in rice, beef, pork, and poultry, while leaving some technical issues to future talks. In financial services, China agreed to reduce some foreign equity limits, and licensed a few U.S. firms. China committed to review applications from Mastercard, Visa, and American Express, but did not commit to licensing, and still requires joint ventures in a market controlled by the state monopoly, China UnionPay.

The agreement also sought to address the U.S. trade deficit with China with a two-year purchasing deal. China agreed to purchase during 2020 and 2021 at least $200 billion above a 2017 baseline amount of U.S. agriculture (+$32 billion), energy (+$52.4 billion), manufactured goods (+$77.7 billion), and services (+$37.9 billion). China fell short of its commitment by 60% for goods (and about 57% for goods and services), due in part to its efforts to diversify agriculture and energy suppliers and the trade slowdown during the Coronavirus 2019 Disease (COVID-19) pandemic. At the same time, China hastened the return to China of empty shipping containers to boost its exports, likely impeding U.S. reloading and exports (**Figure 1)**.

Figure 1. *Phase One* Trade (2020 to 2021)



Source: CRS with data from the U.S. Census Bureau.

Notes: Excludes services commitments. Goods includes aircraft.

Issues for Congress

Congress might assess the U.S. experience with the *Phase One* process as it debates the merits of the deal and how to leverage it, the effects of the tariffs, and options to advance U.S. economic interests and counter China's persistent statist economic practices that the USTR raised in its 2018 report. Section 301 requires a review of tariffs at the four-year mark (2022), which the Biden Administration is now doing. China is reportedly using this juncture to pressure the USTR to lift tariffs while sustaining its practices of concern. Some U.S. firms, Members of Congress, and parts of the Biden Administration are also pressing for the elimination, reduction, or exclusion of certain tariffs, to provide relief for U.S. consumers and firms and address inflation. Others in Congress and the Administration argue that the tariffs provide a point of U.S. leverage and should be sustained, some noting that lifting tariffs could signal a lack of U.S. resolve and unwillingness to bear costs associated with actions that address U.S. priorities. China might not reciprocate and could make new demands. There has been little discussion about how to enforce the deal and address issues with China that remain unresolved. Some of the issues Congress might consider include

- In light of how difficult it was to secure China's acknowledgement of its practices of concern and limited commitments in these areas, to what extent may the United States reasonably expect talks with Beijing to achieve results that further U.S. policy objectives, when measured against the U.S. resources and efforts required? Does a focus on talks with China take U.S. attention away from efforts to deploy or develop U.S. trade tools and joint approaches with other countries to protect and advance U.S. economic interests?
- Are other approaches and measures needed in addition to or separate from tariffs, and if so, what are they? Should the USTR use Section 301 to address other concerns, such as subsidies? What approaches with allies and partners could be pursued, such as efforts with Europe and Japan to address non-market economic distortions and subsidies and develop new rules, inclusion of China-focused provisions in free trade agreements, stepped up efforts to reform WTO rules, or joining and leading new plurilateral trade agreements that address gaps in WTO disciplines?
- Should Congress require the USTR to enforce the *Phase One* provisions and actively use the *Phase One* dispute process? Should the USTR challenge China's industrial policies that appear to violate commitments not to require technology transfer, and its efforts to set global technology licensing and pricing terms, such as through its courts? (See CRS Report R46767, *China's New Semiconductor Policies: Issues for Congress* and CRS Report R46915, *China's Recent Trade Measures and Countermeasures: Issues for Congress*.)
- How might Congress weigh the tariffs' effects on U.S. firms and consumers against issues of economic competitiveness? To what extent are tariffs inflationary compared to drivers such as food, energy, housing, labor and supply chain shortages, and monetary policy?
- Could tariffs help diversify China-based supply chains and counter China's subsidies by raising costs vis-à-vis U.S. and third-market products? Could tariffs on goods tied to China's industrial policies (e.g., solar panels, electric vehicles, semiconductors, and batteries) help level the playing field, or would they violate U.S. trade commitments and encourage others to follow suit? The USTR proposed but never enacted tariffs on consumer electronics. Could these tariffs counter China's efforts to deepen technology supply chains in China?

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