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United States And China Reach "Phase One" Trade Agreement

Deal Includes U.S. Tariff Concessions, Agreement To Purchase U.S.-Origin Goods By China, Sectoral Commitments, And Enforcement Mechanisms

The United States and China reached "a Phase One trade deal that requires structural reforms and other changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange," according to a press release issued by the United States Trade Representative ("USTR"). A fact sheet released by USTR also stated that China has committed to "make substantial additional purchases of U.S. goods and services in the coming years" and that "the agreement establishes a strong dispute resolution system that ensures prompt and effective implementation and enforcement."

As part of the Phase One Trade Agreement, the United States will maintain the additional 25% tariffs on Chinese-origin imports into the United States that are covered by List 1, List 2, and List 3. As part of the agreement, however, the 15% additional tariff on Chinese-origin products that are covered by List 4A will be reduced to 7.5%, and the additional tariffs on List 4B products that were scheduled to take effect on December 15 have been suspended. It is possible that the additional tariffs on List 1-4A products could be removed or reduced in the future as a part of any "Phase Two Agreement."

The text of the agreement has not been released, however, USTR Robert E. Lighthizer told reporters that a final legal review of the 86-page document is ongoing and that the signing should take place in early January. Mr. Lighthizer indicated that the U.S. tariff reductions will take effect 30 days after the agreement is signed. Mr. Lighthizer stated that the Phase One Agreement does not require China to reduce the retaliatory tariffs that it imposed on certain U.S.-origin products, but he

anticipates that purchases made by China pursuant to the agreement will be exempt from the Chinese import tariffs.

USTR's fact sheet provides additional details on several sector-specific aspects of the Phase One Agreement, including the following:

- **Intellectual property:** Addresses trade secrets, pharmaceuticals, geographical indications, trademarks, and enforcement.
- **Technology transfer:** States that China will "end its long-standing practice" of forced technology transfer and requires technology transfer and licensing "on market terms." Requires China "to refrain from directing or supporting outbound investments aimed at acquiring foreign technology pursuant to industrial plans that create distortion."
- **Agriculture:** Addresses "non-tariff barriers to U.S. agriculture and seafood products" including "meat, poultry, seafood, rice, dairy, infant formula, horticultural products, animal feed and feed additives, pet food, and products of agriculture biotechnology."
- **Financial services:** Addresses trade and investment barriers in "banking, insurance, securities, and credit rating services, among others."
- **Currency:** Addresses "unfair currency practices by requiring high-standard commitments to refrain from competitive devaluations and targeting of exchange rates" to "help ensure that China cannot use currency practices to unfairly compete against U.S. exporters."
- **Expanding trade:** Obligates China to "import various U.S. goods and services over the next two years in a total amount that exceeds China's" imports of the covered products in 2017 "by no less than $200 billion." China is "expected to continue" purchases "on this same trajectory for several years after 2021" in order to "contribute significantly to the rebalancing of the U.S.-China trade relationship."
- **Dispute resolution:** Creates a mechanism "to ensure the effective implementation of the agreement and to allow the parties to resolve disputes" fairly and expeditiously. Regular bilateral consultations "at both the principal level and the working level" will be combined with "procedures for addressing disputes" and providing for "proportionate responsive actions" to resolving trade disputes.

Announcement of the Phase One Trade Agreement is consistent with public statements made by U.S. and Chinese negotiators in recent weeks which indicated that the process could unfold through multiple "phases." Press reports indicated that the United States pushed for China to agree to $40-$50 billion in annual purchases of farm goods. In a December 6 interview with CNBC, White House Economic Advisor Larry Kudlow also cautioned that the Trump Administration would not agree to any deal absent sufficient tools to prevent intellectual property theft by Chinese interests and adequate enforcement mechanisms that are designed to ensure China's compliance. Although it is not possible to assess whether the enforcement tools agreed to in "Phase One" will be sufficient to address what the United States has long viewed as pervasive forced technology transfer and intellectual property violations in China, this area is likely to continue to be a flashpoint in the U.S.-China trade relationship as the process unfolds.

Recent actions on human rights legislation in the United States Congress also creates the potential to impact future developments the U.S.-China trade relationship. For example, President Trump signed the Hong Kong Human Rights and Democracy Act of 2019 (S. 1838) on November 27 and the House overwhelmingly passed the Uyghur Human Rights Policy Act of 2019 on December 3, which paves the way for the bill's consideration by the Senate. The legislation's original sponsor in the Senate, Sen. Marco Rubio (R-FL) stated that "The Chinese Government and Communist Party is working to systematically wipe out the ethnic and cultural identities of Uyghurs and other Muslim minorities in Xinjiang. Today, Congress took another important step to hold Chinese officials accountable for egregious

and ongoing human rights abuses committed against the Uyghurs." In response, China's Foreign Ministry stated that "as Xinjiang is part of China, its affairs are purely domestic affairs that allow no foreign interference…The Chinese government and people are determined in safeguarding national sovereignty, security and development interests." More fundamentally, the Foreign Ministry appeared to suggest that the outcome of the trade negotiations could be harmed if the United States enacts this legislation. The Foreign Ministry stated that if the United States "takes measures that harm China's interests, it must pay the price [and that] there is no way this won't affect bilateral relations and cooperation in important areas."

In sum, the Phase One Trade Agreement between the United States and China appears to pave the way for the United States to reduce or pause the additional tariffs on a portion of the Chinese-origin goods that were imposed as a result of USTR's investigation into China's acts, policies, and practices related to technology transfer, intellectual property, and innovation. In exchange, China has reportedly agreed to commitments in several areas (including implementation and enforcement requirements), including intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange. Several procedural steps must still take place before the agreement takes effect and the process also could be affected by ongoing geopolitical developments.