U.S.-China Trade Deal: What it Does and What it Doesn't

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The "Phase One" deal signed by the U.S. and China on January 15, 2020, calls a truce to the trade war for now, halting the imposition of additional tariffs and promising increased market access for U.S. products, services and industries. Less clear is exactly how the deal will be enforced and whether it can be sustained if one side believes the other is not abiding by its commitments. Though there is hope supply chains between the two countries can be restored, secular trends point to a technological decoupling pulling the countries apart, due to underlying national security concerns.

What the Deal Does

The 96-page Economic and Trade Agreement Between the United States of America and the People's Republic of China (the "Agreement") represents the culmination of sustained effort by the Trump Administration to get China to change its trade practices. Highlights include:

Tariffs: The U.S. pledges not to implement new tariffs on Chinese goods and to reduce tariffs from 15% to 7.5% on $120 billion worth of goods, and expects China to exempt U.S. goods from its tariffs. The 25% tariffs on $250 billion worth of Chinese goods will remain.

Exports: Between 2020 and 2021, China commits to purchase $200 billion in U.S. goods and services above 2017 levels, including $32 billion in agricultural goods, $77.7 billion in manufactured goods, $52.4 billion in energy products and $37.9 billion in services.

Market Access: China undertakes to open up its market to previously prohibited U.S. industries, such as financial services and insurance companies, and introduce intellectual property protections.

What it Doesn't

Notwithstanding this achievement, questions remain about whether the trade deal actually addresses certain underlying issues that were the root cause of the tariffs, or that, unlike in the past, both sides will actually honor their obligations and work through their differences.

Forced Technology Transfer: Chapter 2 includes provisions that neither party, e.g., will "require or pressure" companies to transfer technology nor "support or direct" the outbound foreign investment activities of its companies in acquiring certain technology. This seems aimed squarely at U.S. concerns that China requires U.S. companies to transfer technology in exchange for market access, while sponsoring efforts to acquire U.S. technology companies.

However, the Agreement's pledge that technology transfer be "based on market terms that are voluntary and reflect mutual agreement" doesn't appear to account for the reality that companies may practically believe they have no choice but to agree. Unlike other chapters of the Agreement, Chapter 2 has less detail and doesn't provide for a particular enforcement mechanism or penalties if there is a violation.

Enforcement: Chapter 7 establishes a process to resolve disputes over a fixed period, centering around escalating consultations between increasingly senior trade officials of both countries. If the parties cannot agree on a resolution, the complaining party can adopt a "proportionate" remedial measure "in a way that it considers appropriate."

The other party can only respond if it views the complaining party as acting in "bad faith," with the only recourse to "withdraw" from the Agreement. This sets up a situation where, if the U.S. were to re-impose tariffs being unilaterally unsatisfied with China's progress under the Agreement, China could only accept them or exit the Agreement, triggering its collapse.

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What Lies Ahead

Attention should not be diverted from the more profound strategic competition underway between the two countries, specifically over advanced technologies, that promises to be an omnipresent tension in the bilateral relationship over the longer term. The Agreement does not resolve key bilateral tensions — U.S. regulatory storm clouds are already on the horizon.

Huawei and the Entity List: The trade deal does not remove Huawei from the Entity List, a concerted effort by the U.S. government to cut the company off from U.S. technology, creating collateral impacts for U.S. companies. The Administration has issued some licenses to export to Huawei while placing other companies on the Entity List, indicating it may increasingly use this lever.

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Safeguarding U.S. Information and Communications Technology and Services Supply Chains: The U.S. Department of Commerce published a Proposed Rule to establish a transaction review process similar to CFIUS for information and communications technology and services transactions that "pose an undue risk to critical infrastructure or the digital economy of the United States." The final rule will likely target China and Chinese companies.

Export Controls on Emerging Technologies: There is a broader effort underway by Commerce to restrict China's access to "emerging technologies," including in artificial intelligence, robotics and quantum computing. Though not limited to China, the clear impetus is responding to China's "Made in China 2025" program.

Key Takeaways

- For now, it appears U.S. companies importing from China may be able to rely on existing tariffs not increasing, fortifying supply chains disrupted by the trade war.
- In the longer term, however, if the Administration views China as reneging on its commitments, tariffs could “snap back.”
- Looming technology restrictions seem to be gradually driving a wedge between the U.S. and China, potentially creating a technologically bipolar world.
- Non-U.S. companies in particular may eventually face a choice between the U.S. or China as each seeks to make its standards dominant.
- Though the Administration indicated remaining issues with China will be addressed in “Phase Two,” given the forthcoming U.S. election, no one should count on that in 2020.

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