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Report on Supply Chain Compliance Volume 3, Number 3. February 06, 2020
Phase one trade deal offers little certainty

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The United States and China settled on a phase one agreement[1] on trade that could cool down the trade war that has caused so much disruption to international business over the last 18 months. The agreement was hailed by both sides as a solid step forward and a "win-win" solution for some of the issues plaguing bilateral trade. The English text of the agreement, signed on Jan. 15, is available on the official website of the United States Trade Representative.

The centerpiece of the agreement is China's commitment to purchase USD 200 billion worth of U.S. goods. The exact wording of the agreement is found under Chapter 6 of the agreement:

"During the two-year period from January 1, 2020 through December 31, 2021, China shall ensure that purchases and imports into China from the United States of the manufactured goods, agricultural goods, energy products, and services identified in Annex 6.1 exceed the corresponding 2017 baseline amount by no less than $200 billion."[2]

Annex 6.1 includes services, manufactured goods, agricultural goods and energy products. The agreement also states that "[t]he Parties acknowledge that purchases will be made at market prices based on commercial considerations and that market conditions, particularly in the case of agricultural goods, may dictate the timing of purchases within any given year," addressing concerns that the agreement mandates managed trade between the two countries.

Zhang Xiaoqiang, a former vice-chairman at the National Development and Reform Commission, who is now executive vice-chairman at the China Center for International Economic Exchanges, told the *South China Morning Post*,[3] "The agreement is just a kind of framework. You cannot take the chance to raise prices arbitrarily or sell inferior quality products to China—that would certainly not be acceptable for local companies and consumers. The framework is based on the principles of the market economy."

Still no certainty, despite some progress

The agreement requires China to implement a series of measures in order to avoid the re-application of tariffs and offers merely a reduction of existing tariffs and a temporary stay in additional tariffs in return. Instead of an ironclad agreement and peace treaty, the phase one agreement resembles a temporary cease-fire.

In fact, the disruption to international business continuity caused by increased costs due to tariffs, uprooted and reshored supply chains, and shifting changes to an already complicated set of customs paperwork could resume at any time.

Even if China were to implement all the changes listed in the agreement and finally achieve the type of transparency the international business community has been calling for, the disruption of the last two years will be difficult to undo. The increase in purchases and further opening up of financial, pharmaceutical and agricultural markets demand a regulatory sea change in China coupled with transparency and implementation down to the customs border level that would be difficult to achieve along the timeline proposed in the agreement.

Until a trade deal is signed and backed up by clear enforcement measures, there can be no regulatory certainty regarding bilateral trade. Organizations should continue as if the trade war is still simmering, at least until the details of phase two of the trade negotiations become clearer.

One-sided deal?

The agreement places substantial requirements on the Chinese side. Chapters 1-5 are almost exclusively China agreeing to implement reforms to how it governs intellectual property, technology transfer, agricultural imports and financial services. The section on intellectual property contains articles on pharmaceuticals, counterfeit medicines, e-commerce platforms, patents and protecting trade secrets, with most of the articles containing the clause, "The United States affirms that existing U.S. measures afford treatment equivalent to that provided for in this Article."

The *South China Morning Post* reports that "[t]he … document has 105 mentions of 'China shall', or in other words, 'the 105 China must-do items', while there are only five mentions of 'the United States shall …'"[4]

Many of the articles require action within a very short time frame, as early as 10 days in some instances and no later than six months in others. One example is Article 1.35, which states, "Within 30 working days after the date of entry into force of this Agreement, China will promulgate an Action Plan to strengthen intellectual property protection aimed at promoting its high-quality growth. This Action Plan shall include, but not be limited to, measures that China will take to implement its obligations under this Chapter and the date by which each measure will go into effect."

The requirements placed on China seem to reflect the long list of reforms that countries have been calling for since China joined the World Trade Organization in 2001. Some of the requirements are actions that China has already agreed to or is in the process of implementing. This phase one agreement could be an attempt to spur on what has been, to some analysts, a process of opening up that China has intentionally kept slow and protracted in order to glean as much benefit from the international system of trade as possible.

Enforcement and implementation

Chapter 7 of the agreement established a Trade Framework Group as a Bilateral Evaluation and Dispute Resolution Arrangement in order to "to effectively implement this Agreement, to resolve issues in the economic and trade relationship of the Parties in a fair, expeditious, and respectful manner, and to avoid the escalation of economic and trade disputes and their impact on other areas of the Parties' relationship."

The arrangement does not provide for a third-party dispute forum nor penalties for noncompliance with any article in the agreement. In fact, if either party is dissatisfied with the conduct of the other, and consultation up the chains of command do not resolve any disputes, either party can withdraw from the agreement at any time without penalty.

The agreement is held together by the stick of tariffs and whether they are removed or reapplied. As such, the agreement does not provide the certainty many in the business community were hoping for. The facts that (1) many of the requirements placed on China are not new and have yet to be implemented despite almost two decades of pressure, and (2) that the threat of tariffs is all that seems to bring the two parties together means any misstep or disagreement in the next few months could see a return to the status quo of the last two years, in which international business and supply chains were anything but stable.

Takeaways

- The phase one deal is one-sided in its obligations, forcing China to make numerous concessions in exchange for a reprieve in tariffs. The concessions are in many cases issues that have been sticking points between China and the international community for decades.
- The enforcement and implementation mechanisms for the phase one deal are weak, and companies should not assume that the trade war is over, or that disruption to business continuity and supply chains will suddenly end.

1 Office of the United States Trade Representative, *Economic and trade agreement between the government of the United States of America and the government of the People's Republic of China*, accessed January 29, 2020, http://bit.ly/36yvi7n.
2 Office of the United States Trade Representative, "Article 6.2: Trade Opportunities," *Economic and trade agreement.*
3 Orange Wang, "Trade war: China's US imports under phase one deal not 'one-sided obligation', Chinese scholars say," *South China Morning Post*, January 20, 2020, http://bit.ly/2U8Ipts.
4 Cary Huang, "In the Year of the Rat, the US-China trade deal will not usher in a season of goodwill," *South China Morning Post*, January 26, 2020 http://bit.ly/2RA1a7m.